# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Introduction

The Fiscal Year (FY) *2015 Financial Report of the United States Government (Financial Report)* provides the President, Congress, and the American people with a comprehensive view of the federal government's finances, i.e., its financial position and condition, its revenues and costs, assets and liabilities, and other obligations and commitments. The *Financial Report* also discusses important financial issues and significant conditions that may affect future operations, including the need to achieve fiscal sustainability over the medium and long term.

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

The *Financial Report* is prepared from the audited financial statements of specifically designated federal agencies, including the Cabinet departments and many smaller, independent agencies (see organizational chart on the next page). As it has for the past eighteen years, GAO issued a "disclaimer" of opinion on the accrual-based, consolidated financial statements for the fiscal years ended September 30, 2015 and 2014. GAO also issued disclaimers of opinion on the 2015 Statement of Long-Term Fiscal Projections (SLTFP); the 2015, 2014, 2013, 2012 and 2011 Statements of Social Insurance (SOSI); and the 2015 and 2014 Statement of Changes in Social Insurance Amounts (SCSIA). A disclaimer of opinion indicates that sufficient information was not available for the auditors to determine whether the reported financial statements were fairly presented in accordance with Generally Accepted Accounting Principles (GAAP). In FY 2015, 33[2] of the 39 most significant agencies earned unmodified opinions on their financial statement audits.[3]

The FY 2015 *Financial Report* consists of:

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

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

## Mission & Organization

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

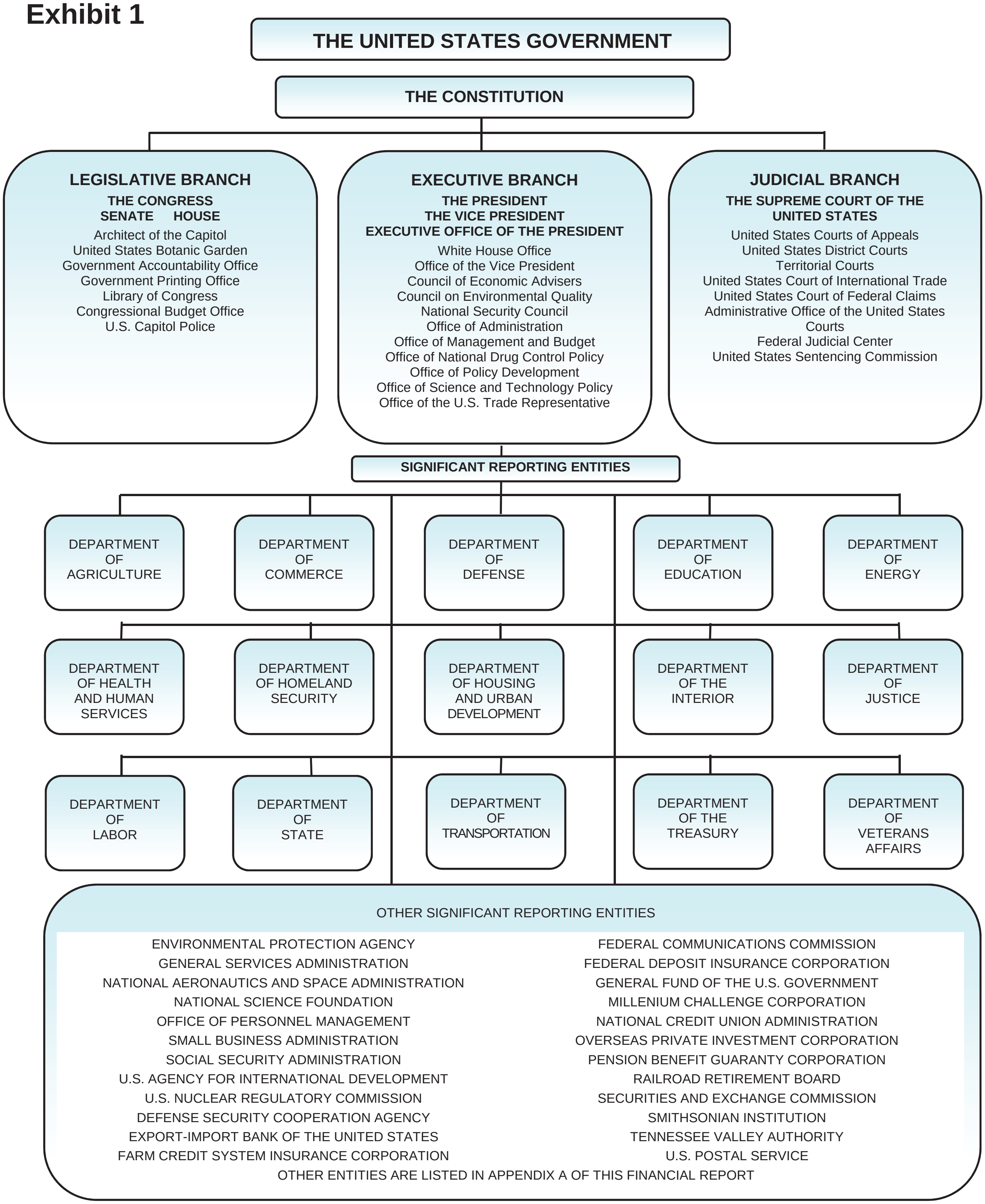
[1] The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of the Government, beginning with financial statements prepared for FY 1997. Treasury and OMB have elected to include certain financial information on the legislative and judicial branches in consolidated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

[2] The 32 agencies include the Department of Health and Human Services, which received disclaimers of opinion on its 2015, 2014, 2013, 2012, and 2011 SOSI and on its 2015 and 2014 SCSIA.

[3] The Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC) are among the 39 significant entities. However, because these entities operate on a calendar year basis (December 31 year-end), their 2015 audits are not yet complete. Statistic reflects 2014 audit results for these organizations. In addition, neither the Defense Security Cooperation Agency (DSCA) nor the General Fund of the U.S. Government were subject to audit for FY 2015.

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

## Exhibit 1



# The Government's Financial Position and Condition

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

**Table 1**
**The Federal Government's Financial Position and Condition**

| Dollars in Billions | 2015 | 2014 | Increase / (Decrease) $ | % |
|---|---|---|---|---|
| **FINANCIAL MEASURES** | | | | |
| **Gross Cost** | **$ (4,253.7)** | **$ (4,251.4)** | **$ 2.3** | **0.1%** |
| Less: Earned Revenue | $ 375.6 | $ 417.9 | $ (42.3) | (10.1%) |
| Gain/(Loss) from Changes in Assumptions | $ 19.3 | $ (3.5) | $ 22.8 | 651.4% |
| **Net Cost[1]** | **$ (3,858.8)** | **$ (3,837.0)** | **$ 21.8** | **0.6%** |
| Less: Tax and Other Revenues | $ 3,334.0 | $ 3,066.1 | $ 267.9 | 8.7% |
| Unmatched Transactions & Balances | $ 5.1 | $ (20.4) | $ (25.5) | (125%) |
| **Net Operating Cost[2]** | **$ (519.7)** | **$ (791.3)** | **$ (271.6)** | **(34.3%)** |
| **Assets[3]:** | | | | |
| Cash & Other Monetary Assets | $ 305.1 | $ 264.9 | $ 40.2 | 15.2% |
| Loans Receivable, Net | $ 1,216.0 | $ 1,125.7 | $ 90.3 | 8.0% |
| Inventories & Related Property, Net | $ 320.6 | $ 318.4 | $ 2.2 | 0.7% |
| Property, Plant & Equipment, Net | $ 893.9 | $ 878.3 | $ 15.6 | 1.8% |
| Other | $ 494.2 | $ 478.0 | $ 16.2 | 3.4% |
| **Total Assets** | **$ 3,229.8** | **$ 3,065.3** | **$ 164.5** | **5.4%** |
| **Liabilities[3]:** | | | | |
| Federal Debt Held by the Public & Accrued Interest | $ (13,172.5) | $ (12,833.6) | $ 338.9 | 2.6% |
| Federal Employee & Veterans Benefits | $ (6,719.3) | $ (6,672.6) | $ 46.7 | 0.7% |
| Other | $ (1,559.9) | $ (1,259.8) | $ 300.1 | 23.8% |
| **Total Liabilities** | **$ (21,451.7)** | **$ (20,766.0)** | **$ 685.7** | **3.3%** |
| **Net Position (Assets minus Liabilities)** | **$ (18,221.9)** | **$ (17,700.7)** | **$ 521.2** | **2.9%** |
| **SUSTAINABILITY MEASURES** | | | | |
| **Social Insurance Net Expenditures[4]:** | | | | |
| Social Security (OASDI) | $ (13,440) | $ (13,330) | $ 110 | 0.8% |
| Medicare (Parts A, B, & D) | $ (27,940) | $ (28,483) | $ (543) | (1.9%) |
| Other | $ (108) | $ (103) | $ 5 | 4.6% |
| **Total Social Insurance Net Expenditures** | **$ (41,487)** | **$ (41,916)** | **$ (429)** | **(1.0%)** |
| **Total Noninterest Spending Less Receipts[5]** | **$ (4,100)** | **$ (4,700)** | **$ (600)** | **(12.8%)** |
| **BUDGET DEFICIT** | | | | |
| **Unified Budget Deficit[6]** | **$ (438.9)** | **$ (483.4)** | **$ (44.5)** | **(9.2%)** |

1 Source: Statements of Net Cost.

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

3 Source: Balance Sheet.

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

5 Represents the 75-year projection of the federal government's receipts less non-interest spending as reported in the Statement of Long-Term Fiscal Projections.

6 Source: Final Monthly Treasury Statement (as of 9/30/2015 and 9/30/2014).

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

Table 1 on the previous page and the following summarize the federal government's financial position:

- The Government's gross costs stayed essentially flat, increasing by only $2.3 billion or 0.1 percent to $4.3 trillion. Deducting $375.6 billion in revenues earned for goods and services provided to the public (e.g., Medicare premiums, national park entry fees, and postal service fees) and deducting $19.3 billion in net gains from changes in assumptions (e.g., interest rates, inflation, disability claims rates) results in the Government's net cost of $3.9 trillion in FY 2015 a slight increase of $21.8 billion or 0.6 percent from FY 2014.
- Tax and other revenues increased $267.9 billion or 8.7 percent to $3.3 trillion, which, when offset against the Government's net cost, with some adjustment for unmatched transactions and balances, results in a "bottom line" net operating cost of $519.7 billion for FY 2015, a decrease of more than a third ($271.6 billion or 34.3 percent) from FY 2014.
- Comparing total 2015 Government assets of $3.2 trillion to total liabilities of $21.5 trillion (comprised mostly of $13.2 trillion in federal debt held by the public and accrued interest payable[4], and $6.7 trillion of federal employee and veterans benefits payable) yields a negative net position of $18.2 trillion.
- The sum of debt held by the public excluding accrued interest ($13.1 trillion), and intragovernmental debt ($5.1 trillion) equals gross federal debt, which, with some adjustments, is subject to the statutory debt limit. As of September 30, 2015, the Government's total debt subject to the debt limit was $18.1 trillion. Congress suspended the debt limit from February 15, 2014 through March 15, 2015 (P.L. 113-83), after which Treasury began implementing "extraordinary measures" on a temporary basis, which were still in effect as of September 30, 2015, to enable the Government to protect the full faith and credit of the United States Government by continuing to pay the Nation's bills. On November 2, 2015, Congress again suspended the debt limit, this time through March 15, 2017 (P.L. 114-74).

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

- Total projected spending, including other major programs (e.g., defense, Medicaid, and education) and tax revenues provide another perspective of the Government's projected fiscal condition. Over the next 75 years, under current policy, the present value (PV) of the Government's total non-interest spending (including its social insurance programs) is projected to exceed the PV of total receipts by $4.1 trillion.
- The SOSI compares the actuarial present value[5] of the Government's projected expenditures for scheduled benefits for Social Security, Medicare Parts A, B and D, and other social insurance programs over 75 years[6] to a subset of the revenues[7] supporting these programs. For 2015, these projected expenditures exceeded projected revenues by about $41.5 trillion, a $429 billion decrease from 2014 social insurance projections.

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

- The unified budget deficit (i.e., including the consolidated receipts and outlays from federal funds and the Social Security Trust Fund) decreased from $483.4 billion or 2.8 percent of GDP in FY 2014 to $438.9 billion (the lowest since 2007) or 2.5 percent of GDP in FY 2015, the lowest deficit-to-GDP level since

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

[5] Present values recognize that a dollar paid or collected in the future is worth less than a dollar today because a dollar today could be invested and earn interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed.

[6] The Black Lung Program is projected through September 30, 2040.

[7] Social Security is funded by the payroll taxes and revenue from taxation of benefits. Medicare Part A is funded by the payroll taxes, revenue from taxation of benefits, and premiums that support those programs. Medicare Parts B and D are primarily financed by general revenues and premiums. By accounting convention, general revenues transferred to Medicare Parts B and D are eliminated in consolidation at the governmentwide level and, as such, are not included in the SOSI.

2007 and less than the average of the last 40 years. The deficit-to-GDP ratio has declined by about three-quarters since 2009 – the fastest sustained deficit reduction since just after World War II.[8]

- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2015, debt held by the public, excluding accrued interest, was $13.1 trillion (about 74 percent of GDP).
- The projected $41.5 trillion net present value excess of expenditures over receipts over 75 years for the programs reported in the 2015 SOSI represents about 3.7 percent of the present value of GDP over 75 years. The excess of total projected non-interest spending over receipts of $4.1 trillion discussed in the 'Statement of Long Term Fiscal Projections' represents 0.3 percent of GDP over 75 years. As discussed in this *Financial Report*, these projections can, in turn, have a significant impact on projected debt as a percent of GDP.

# Fiscal Year 2015 Financial Statement Audit Results

For FY 2015, GAO issued a nineteenth consecutive disclaimer of audit opinion on the accrual-based, governmentwide financial statements. In addition, GAO issued disclaimers of opinion on the 2015 Statement of Long-Term Fiscal Projections (SLTFP); the 2015, 2014, 2013, 2012 and 2011 SOSI; and the 2015 and 2014 SCSIA. The SOSI, SCSIA, and SLTFP disclaimers stem from significant uncertainties (discussed in Note 23, Social Insurance), primarily related to the achievement of projected reductions in Medicare cost growth and certain other limitations.

Twenty-one of the 24 agencies required to issue audited financial statements under the Chief Financial Officers (CFO) Act received unmodified audit opinions, as did 12 of 15 additional significant reporting agencies (see Appendix A).[9]

**Table 2: FY 2015 CFO Act Financial Statement Audit Results**

| Chief Financial Officers (CFO) Act Agency | Audit Opinion |
|---|---|
| Department of Agriculture (USDA) | Disclaimer |
| Department of Commerce (DOC) | Unmodified |
| Department of Defense (DOD) | Disclaimer |
| Department of Education (Education) | Unmodified |
| Department of Energy (DOE) | Unmodified |
| Department of Health and Human Services (HHS)[1] | Unmodified |
| Department of Homeland Security (DHS) | Unmodified |
| Department of Housing and Urban Development (HUD) | Disclaimer |
| Department of the Interior (DOI) | Unmodified |
| Department of Justice (DOJ) | Unmodified |
| Department of Labor (DOL) | Unmodified |
| Department of State (State) | Unmodified |
| Department of Transportation (DOT) | Unmodified |
| Department of the Treasury (Treasury) | Unmodified |
| Department of Veterans Affairs (VA) | Unmodified |
| Agency for International Development (USAID) | Unmodified |
| Environmental Protection Agency (EPA) | Unmodified |
| General Services Administration (GSA) | Unmodified |
| National Aeronautics and Space Administration (NASA) | Unmodified |
| National Science Foundation (NSF) | Unmodified |
| Nuclear Regulatory Commission (NRC) | Unmodified |
| Office of Personnel Management (OPM) | Unmodified |
| Small Business Administration (SBA) | Unmodified |
| Social Security Administration (SSA) | Unmodified |

[1] Received disclaimer of opinion on Statement of Social Insurance and Statement of Changes in Social Insurance Amounts.

## The Governmentwide Reporting Entity

This *Financial Report* includes the financial status and activities of the executive, legislative, and judicial branches of the federal government. The legislative and judicial branches are not required by law to submit financial statement information to Treasury; however, these branches provided cash and a significant amount of accrual basis financial information to include in the *Financial Report*. Appendix A lists the organizations and agencies (entities) included in the U.S. Government's consolidated reporting entity for the *Financial Report*, as well as some entities not included in the reporting entity.

A number of entities and organizations are excluded due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and Government-Sponsored Enterprises (GSEs), including the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). Following U.S. GAAP for federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial majority equity investment. Under Statement of Federal Financial

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[8] Final Monthly Treasury Statement (as of September 30, 2015 and 2014), 10/15/15 press release – Joint Statement of Treasury Secretary Jacob J. Lew and OMB Director Shaun Donovan on Budget Results for Fiscal Year 2015

[9] The 21 agencies include the Department of Health and Human Services, which received disclaimers of opinions on its 2015, 2014, 2013, 2012, and 2011 SOSI and its 2015 and 2014 SCSIA.

Accounting Concepts (SFFAC) No. 2, these entities meet the criteria of paragraph 50 and do not appear in the Federal Budget section "Federal Programs by Agency and Account." As such, these entities are not consolidated into the financial reports of the Government. However, the values of the investments in and any related liabilities to such entities are presented on the balance sheet. Appendix A includes a list of the agencies and entities contributing to this *Financial Report*.[10]

The following pages contain a more detailed discussion of the Government's financial results for FY 2015, the budget, the economy, the debt, and a long-term perspective about fiscal sustainability, including the Government's ability to meet its social insurance benefits obligations. The information in this *Financial Report*, when combined with the Budget of the U.S. Government, collectively presents information on the Government's financial position and condition.

## Accounting Differences Between The Budget and the Financial Report

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

Treasury generally prepares the financial statements in this *Financial Report* on an accrual basis of accounting as prescribed by U.S. GAAP for federal entities.[11] These principles are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured "Statement of Net Cost," which is intended to present net Government resources used in its operations. Also, unique to Government is the preparation of separate statements to reconcile differences and articulate the relationship between the budget and financial accounting results.

| Budget of the U.S. Government | Financial Report of the U.S. Government |
|---|---|
| Prepared primarily on a "*cash basis*"<br>• Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them.<br>• Receipts ("cash in"), taxes and other collections recorded when received.<br>• Outlays ("cash out"), largely recorded when payment is made. | Prepared on an "*accrual and modified cash basis*"<br>• Agency-based and retrospective – prior and present resources used to implement initiatives.<br>• Revenue: Tax revenue (more than 90 percent of total revenue) recognized on modified cash basis (see Financial Statement Note 1.B). Remainder recognized when earned, but not necessarily received.<br>• Costs: recognized when incurred, but not necessarily paid. |

[10] Since programs are not administered at the governmentwide level, performance goals and measures for the federal government, as a whole, are not reported here. The outcomes and results of those programs are addressed at the individual agency level and can be found in each agency's financial report. Go to www.performance.gov for more information about Government performance.

[11] Under U.S. GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. The Statement of Social Insurance presents the present value of the estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs; and through September 30, 2040 for the Black Lung program. The Statement of Long-Term Fiscal Projections presents the present value of the projected future receipts and non-interest spending for the federal government.

## Budget Deficit vs. Net Operating Cost

The Government's primarily cash-based[12] budget deficit decreased nearly $44.5 billion (about 9 percent) from approximately $483.4 billion in FY 2014 to about $438.9 billion in FY 2015 (the lowest since 2007) due to higher receipts that more than offset an increase in outlays in FY 2015. The $227.9 billion (7.5 percent) increase in receipts can be attributed to a stronger economy. Growth in wages and salaries made collections of individual and payroll taxes strong throughout the year. Corporation income tax collections also increased in FY 2015 due to growth in taxable profits. Outlays increased $184 billion (5 percent) due to the net effect of: (1) spending increases for Social Security, Medicare, and Medicaid, along with lower dividend receipts from the GSEs, Fannie Mae and Freddie Mac (recorded as offsets to spending), partially offset by (2) spending decreases in the Departments of Agriculture, Defense, Housing and Urban Development, and Labor, among other agencies.[13] The Government's largely accrual-based net operating cost also decreased by $271.6 billion, or 34.3 percent, from $791.3 billion to $519.7 billion during FY 2015. As explained below, net operating costs are affected by both changes in revenues and costs.

**Table 3: Net Operating Cost vs. Budget Deficit**

| Dollars in Billions | | 2015 | | 2014 |
|---|---|---|---|---|
| **Net Operating Cost** | **$** | **(519.7)** | **$** | **(791.3)** |
| Change in: | | | | |
| Federal Employee and Veterans Benefits Payable | $ | 46.7 | $ | 134.3 |
| Environmental and Disposal Liabilities | $ | 42.5 | $ | 20.0 |
| Property, Plant, and Equipment, Net[1] | $ | (15.6) | $ | 18.4 |
| Yearend Upward/(Downward) Credit Reform Subsidy Reestimates, Net[2] | $ | (26.8) | $ | 22.9 |
| Other Liabilities | $ | 38.6 | $ | 7.3 |
| Other, Net | $ | (4.6) | $ | 105.0 |
| Subtotal - Net Difference: | $ | 80.8 | $ | 307.9 |
| **Budget Deficit** | **$** | **(438.9)** | **$** | **(483.4)** |

1 Net effect of: capitalized fixed assets, depreciation expense, and asset disposals and revaluations

2 Net effect of: yearend upward/(downward) credit reform subsidy reestimates and effect of prior year (upward)/downward credit reform subsidy reestimates.

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

The ***Reconciliation of Net Operating Cost and Unified Budget Deficit Statement***, Table 3 summarizes how the Government's net operating cost as reported in the primarily accrual-based financial statements relates to the more widely-known and primarily cash-based budget deficit. Table 3 shows how many of the elements described above contribute to the $80.8 billion net difference between the Government's budget deficit and net operating cost for FY 2015, the majority of which is attributable to: (1) a $46.7 billion net increase in liabilities for Federal employee and veteran benefits payable, and (2) a $42.5 billion increase in environmental and disposal liabilities. These and most of the other "Change in" amounts summarized in Table 3 affect net operating cost, but not the budget deficit.

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

[13] 10/15/15 press release -- Joint Statement of Treasury Secretary Jacob J. Lew and OMB Director Shaun Donovan on Budget Results for Fiscal Year 2015.

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

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

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

The Government's ***Statement of Operations and Changes in Net Position***, much like a corporation's income statement, shows the Government's "bottom line" and its impact on net position (i.e., assets net of liabilities). To derive the Government's "bottom line" net operating cost, the ***Statement of Net Cost*** first shows how much it costs to operate the federal government, recognizing expenses when incurred, regardless of when payment is made (accrual basis). It shows the derivation of the Government's *net cost* or the net of: (1) gross costs, or the costs of goods produced and services rendered by the Government, (2) the earned revenues generated by those goods and services during the fiscal year, and (3) gains or losses from changes in actuarial assumptions used to estimate certain liabilities. This amount, in turn, is offset against the Government's taxes and other revenue reported in the ***Statement of Operations and Changes in Net Position*** to calculate the "bottom line" or *net operating cost*.[14]

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

| Dollars in Billions | | 2015 | | 2014 | Increase / (Decrease) $ | % |
|---|---|---|---|---|---|---|
| **Gross Cost** | **$** | **(4,253.7)** | **$** | **(4,251.4)** | **$ 2.3** | **0.1%** |
| Less: Earned Revenue | $ | 375.6 | $ | 417.9 | $ (42.3) | (10.1%) |
| Gain/(Loss) from Changes in Assumptions | $ | 19.3 | $ | (3.5) | $ 22.8 | 651.4% |
| **Net Cost** | **$** | **(3,858.8)** | **$** | **(3,837.0)** | **$ 21.8** | **0.6%** |
| Less: Tax and Other Revenues | $ | 3,334.0 | $ | 3,066.1 | $ 267.9 | 8.7% |
| Unmatched Transactions and Balances | $ | 5.1 | $ | (20.4) | $ (25.5) | (125%) |
| **Net Operating Cost** | **$** | **(519.7)** | **$** | **(791.3)** | **$ (271.6)** | **(34.3%)** |

Table 4 shows that the Government's "bottom line" net operating cost decreased by more than a third, from $791.3 billion in FY 2014 to $519.7 billion in FY 2015. This $271.6 billion or 34.3 percent decrease is largely attributable to a $267.9 increase in tax and other revenues that more than offset a slight net increase in net cost amounts across agencies over the past fiscal year as summarized in the following.

### Gross Cost and Net Cost

The ***Statement of Net Cost***, starts with the Government's total gross costs of $4.3 trillion, subtracts revenues earned for goods and services provided (e.g., Medicare premiums, national park entry fees, and postal service fees), and adjusts the balance for gains or losses from changes in actuarial assumptions used to estimate certain liabilities, including federal employee and veterans benefits to derive its net cost of $3.9 trillion, a slight $21.8 billion or 0.6 percent increase over FY 2014.

Typically, the annual change in the Government's net cost is impacted by a variety of offsetting increases and decreases across agencies. For example offsetting change in net cost during FY 2015 included:

- an $88.7 billion decrease at DOD due largely to decreases in costs for future military retirement and health care benefits, largely driven by plan amendments, changes in actuarial assumptions, and other actuarial gains and losses. Specifically, these changes from actuarial assumptions resulted in a $27.5 billion gain (cost decrease) at DOD. Across the government, the net gain from changes in actuarial assumptions associated with the Government's civilian and military benefits programs amounted to $19.3 billion in FY 2015 as compared to a $3.5 billion loss in FY 2014, resulting in a $22.8 billion combined decrease in net cost. Agencies administering these types of programs employ a complex series of assumptions, including but not limited to interest rates, beneficiary eligibility, life expectancy, medical cost levels, compensation levels, disability claims rates, and cost of living to make annual actuarial projections of their long-term benefits liabilities. In addition to DOD, the Department of Veterans Affairs (VA) ($13.0 billion gain) and

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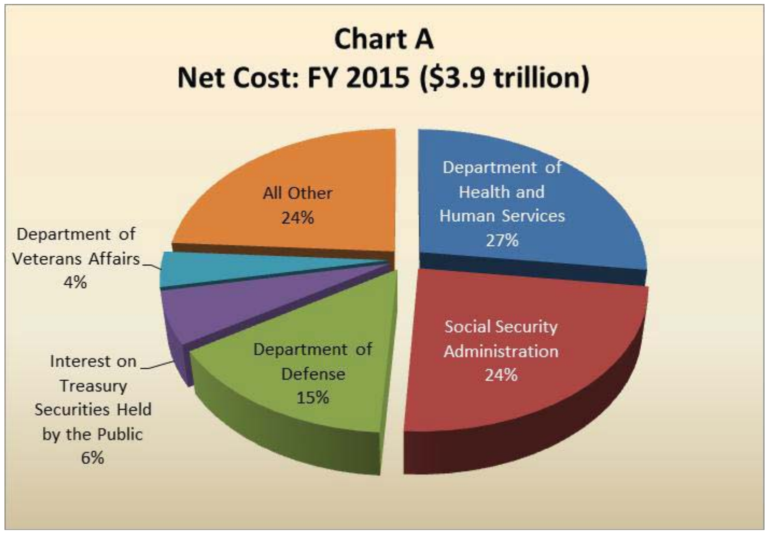
[14] As shown in Table 4, net operating cost includes an adjustment for unmatched transactions and balances, which represent unreconciled differences in intragovernmental activity and balances between Federal agencies. These amounts are described in greater detail in the Other Information section of this *Financial Report*.

the Office of Personnel Management (OPM) ($17.1 billion loss) reported significant gains and losses, respectively from changes in these assumptions for FY 2015;

- $78.0 billion and $38.3 billion net cost increases at the Department of Health and Human Services (HHS) and the Social Security Administration (SSA), respectively, primarily due to cost increases of the benefits programs that these agencies administer (HHS – Medicare and Medicaid programs, SSA – Old Age Survivors and Disability Insurance (OASDI) programs);




- a $19.9 billion cost increase at the Department of Energy, largely associated with changes in environmental and other liability estimates[15];
- an $11.6 billion cost decrease at the Department of Housing and Urban Development (HUD) due largely to subsidy cost reestimates by the Federal Housing Administration (FHA) and a decline in interest expenses for insurance and mortgage programs and funds[16]; and
- an $11.4 billion cost decrease at the Department of Education (Education), primarily due to a combination of decreases in gross costs related to subsidy cost reestimates (e.g., for updates for actual loan activity, changes and updates to loan program interest and discount rates) for Education's largest loan programs, and increases in earned or exchange revenues (interest earned on loans).[17]

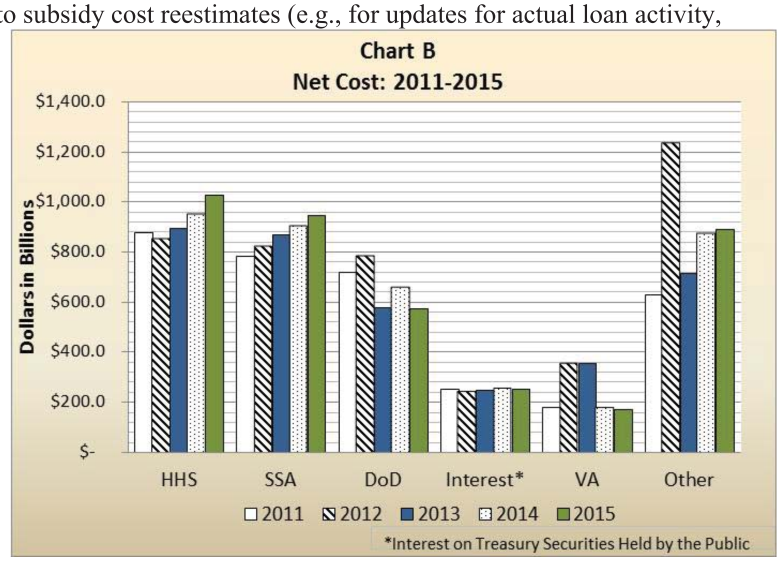
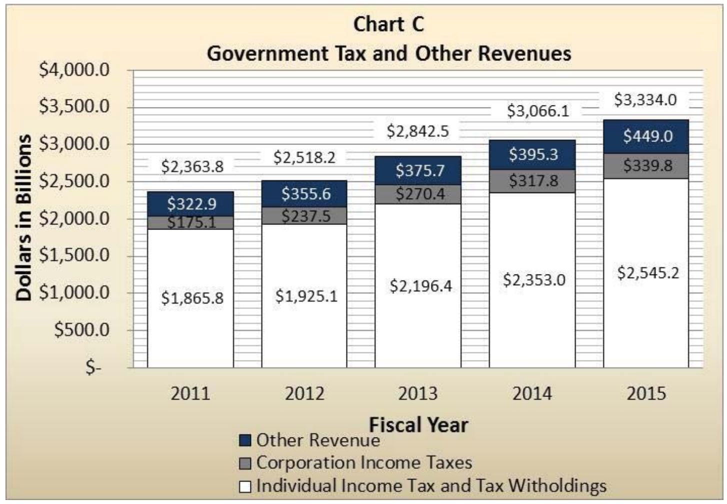



Chart A shows the composition of the Government's net cost. In FY 2015, nearly two-thirds of total net cost came from DOD, the Social Security Administration (SSA), and the Department of Health and Human Services (HHS). These three agencies have consistently incurred the largest agency shares of the Government's total net cost in recent years (Chart B). As indicated above, HHS and SSA net costs for FY 2015 ($1,029.5 billion and $944.7 billion, respectively) are attributable to major social insurance programs administered by these agencies. The *Statement of Long-Term Fiscal Projections (SLTFP),* the *Statement of Social Insurance* (SOSI), and the related analysis and discussion included in this *Financial Report*, discuss the projected future revenues, expenditures, and sustainability of federal government programs in general and of social insurance programs in particular in greater detail. DOD net costs of $573.6 billion relate primarily to operations, readiness, and support; personnel; research; procurement; and retirement and health benefits. Chart A shows that the Department of Veterans Affairs (VA) as well as interest on debt held by the public contributed an additional combined 10 percent, and the other agencies included in the Government's FY 2015 Statement of Net Cost accounted for a combined 24 percent of the Government's total net cost for FY 2015.

[15] Department of Energy FY 2015 Agency Financial Report, p. 23
[16] Department of Housing and Urban Development FY 2015 Agency Financial Report, p. 35
[17] Department of Education FY 2015 Agency Financial Report, pp. 32-36

### Tax and Other Revenues - Getting to the "Bottom Line"

As noted earlier, tax and other revenues from the ***Statement of Operations and Changes in Net Position*** are deducted from total net cost to derive the Government's "bottom line" net operating cost. Chart C shows that increases in each of the three taxes and other revenue categories shown - individual income tax and withholdings, corporation income taxes, and other revenue - combined to increase total Government tax and other revenues by $267.9 billion or 8.7 percent to nearly $3.3 trillion for FY 2015. This change is primarily attributed to an overall improvement in individual and corporation income tax collections.[18] As noted in the earlier discussion of budget receipts, these increases largely stem from a stronger economy and growth in wages and salaries. Earned revenues from Table 4 are not considered "taxes and other revenue" and, thus, are not shown in Chart C. Individual income tax and tax withholdings and corporation income taxes accounted for about 76 percent and 10 percent of total revenue, respectively in FY 2015; other revenues from Chart C include excise taxes, unemployment taxes, and customs duties.




As previously shown in Table 4, the increase in tax and other revenues more than offset the slight increase in net cost, resulting in a net operating cost decrease of more than one-third ($271.6 billion or 34.3 percent) from $791.3 billion for FY 2014 to $519.7 billion for FY 2015.

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

The Government's net position at the end of the year is derived by netting the Government's assets against its liabilities, as presented in the ***Balance Sheet*** (summarized in Table 5). It is important to note that the balance sheet does not include the financial value of the Government's sovereign powers to tax, regulate commerce, and set monetary policy. It also excludes its control over nonoperational resources, including national and natural resources, for which the Government is a steward. In addition, as is the case with the ***Statement of Operations and Changes in Net Position***, the ***Balance Sheet*** includes a separate presentation of the portion of net position related to funds from dedicated collections. Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet, when such items as the Government's future social insurance exposures (namely, Medicare and Social Security), as well as other fiscal projections, commitments and contingencies, are taken into account. These exposures are discussed later in this Management Discussion and Analysis (MD&A) section as well as in the financial statements and RSI sections of this *Financial Report*.

**Table 5: Assets and Liabilities**

| Dollars in Billions | 2015 | 2014 | Increase / (Decrease) $ | % |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash & Other Monetary Assets | $ 305.1 | $ 264.9 | $ 40.2 | 15.2% |
| Loans Receivable, Net | $ 1,216.0 | $ 1,125.7 | $ 90.3 | 8.0% |
| Inventories & Related Property, Net | $ 320.6 | $ 318.4 | $ 2.2 | 0.7% |
| Property, Plant & Equipment, Net | $ 893.9 | $ 878.3 | $ 15.6 | 1.8% |
| Other | $ 494.2 | $ 478.0 | $ 16.2 | 3.4% |
| **Total Assets** | **$ 3,229.8** | **$ 3,065.3** | **$ 164.5** | **5.4%** |
| **Less: Liabilities, comprised of:** | | | | |
| Federal Debt Held by the Public & Accrued Interest | $ (13,172.5) | $ (12,833.6) | $ 338.9 | 2.6% |
| Federal Employee & Veteran Benefits | $ (6,719.3) | $ (6,672.6) | $ 46.7 | 0.7% |
| Other | $ (1,559.9) | $ (1,259.8) | $ 300.1 | 23.8% |
| **Total Liabilities** | **$ (21,451.7)** | **$ (20,766.0)** | **$ 685.7** | **3.3%** |
| **Net Position (Assets Minus Liabilities)** | **$ (18,221.9)** | **$ (17,700.7)** | **$ 521.2** | **2.9%** |

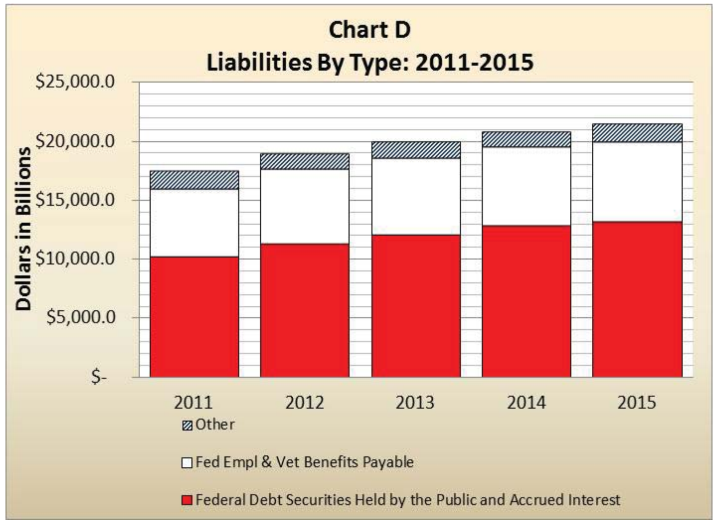
[18] Department of the Treasury FY 2015 Agency Financial Report, p. 27

### Assets – "What We Own"

As of September 30, 2015, the Government held about $3.2 trillion in assets, an increase of $164.5 billion (5.4 percent). The Government's assets are comprised mostly of net loans receivable ($1.2 trillion) and net property, plant, and equipment ($893.9 billion).[19] From Note 4, the Department of Education's (Education's) Federal Direct Student Loan Program accounted for $880.6 billion (72.4 percent) of total net loans receivable. Education's direct student loan program receivables balances have more than doubled since FY 2011 largely due to increased direct loan disbursements, attributable to the continued effect of 2010 legislation requiring a transition for new loans from guaranteed student loans to full direct lending by Education.[20]

### Liabilities – "What We Owe"

As indicated in Table 5 and Chart D, of the Government's $21.5 trillion in total liabilities, the largest liability is federal debt securities held by the public and accrued interest, the balance of which increased $338.9 billion (2.6 percent) to $13.2 trillion as of September 30, 2015.




The other major component of the Government's liabilities is federal employee and veteran benefits payable (i.e., the Government's pension and other benefit plans for its military and civilian employees), which increased $46.7 billion (0.7 percent) during FY 2015, to $6.7 trillion. OPM administers the largest civilian pension plan, covering nearly 2.7 million current employees and 2.6 million annuitants and survivors. The military pension plan covers about 2.1 million current military personnel (including active service, reserve, and National Guard) and approximately 2.8 million retirees and annuitants.

### Federal Debt

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

The Government's publicly-held debt, or federal debt held by the public, and accrued interest, which is reported on the Government's balance sheet as a liability, is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the federal government. Federal debt held by the public and accrued interest totaled $13.2 trillion as of September 30, 2015. As indicated above, budget surpluses have typically resulted in borrowing reductions, and budget deficits have conversely yielded borrowing increases. However, the Government's debt operations are generally much more complex. Each year, trillions of dollars of debt mature and new debt is issued to take its place. In FY 2015, new borrowings were $7.0 trillion (decrease from FY 2014) and repayments of maturing debt held by the public were $6.7 trillion (slight increase from FY 2014).

In addition to debt held by the public, the Government has about $5.1 trillion in intragovernmental debt outstanding, which arises when one part of the Government borrows from another. It represents debt issued by the

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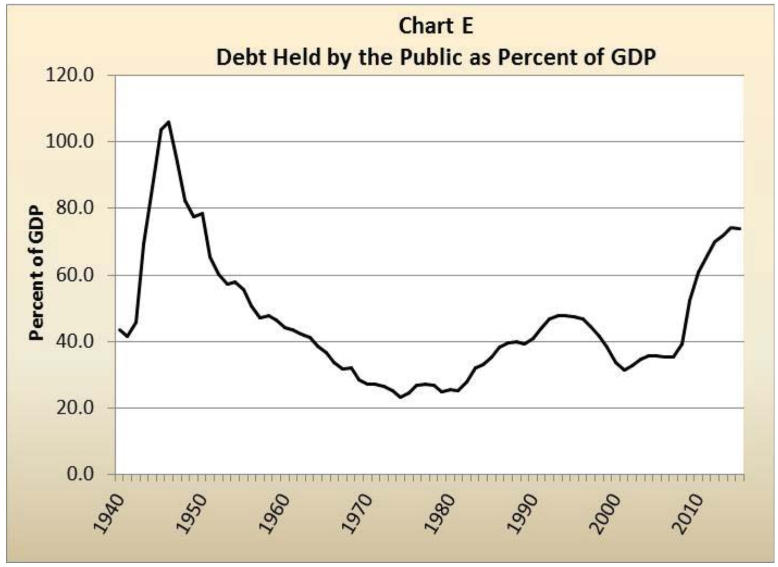
[19] For financial reporting purposes, other than multi-use heritage assets, stewardship assets are not recorded as part of Property, Plant, and Equipment. Stewardship assets are comprised of stewardship land and heritage assets. Stewardship land consists of public domain land (e.g., national parks,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

[20] With the enactment of the SAFRA Act, which was included as part of the Health Care and Education Reconciliation Act of 2010 (HCERA) (Pub. L. 111-152), beginning in July 2010, no new loans were originated under the Federal Family Education Loan (FFEL) Program (FY 2015 Federal Student Aid Financial Report ). See also: U.S. Department of Education FY 2015 Agency Financial Report p. 30.

Treasury and held by Government accounts, including the Social Security ($2.8 trillion) and Medicare ($261.6 billion) trust funds. Intragovernmental debt is primarily held in Government trust funds in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts (including interest earnings) over disbursements to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated as part of the consolidation process for the governmentwide financial statements (see Note 11). When those securities are redeemed, e.g., to pay Social Security benefits, the Government will need to obtain the resources necessary to reimburse the trust funds. The sum of debt held by the public and intragovernmental debt equals gross federal debt, which (with some adjustments), is subject to a statutory ceiling (i.e., the debt limit). At the end of FY 2015, debt subject to the statutory limit (DSL) was $18.1 trillion.




Prior to 1917, Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress established a dollar ceiling for federal borrowing. With the Public Debt Act of 1941 (Public Law 77-7), Congress and the President set an overall limit of $65 billion on Treasury debt obligations that could be outstanding at any one time. Since then, Congress and the President have enacted a number of measures affecting the debt limit, including several in recent years. In February 2013, enactment of the No Budget, No Pay Act of 2013 (Public Law 113-3) suspended the debt limit, enabling the debt to increase as needed through May 18, 2013. In accordance with provisions of the Act, the debt limit was reinstated on May 19, 2013 at a level of $16.7 trillion. Because the new debt limit was set at the level of then outstanding debt, Treasury began implementing "extraordinary measures", on a temporary basis, which were still in effect on September 30, 2013, to keep the DSL under the statutory limit. On October 17, 2013, P.L. 113-46 again suspended the debt limit, this time through February 7, 2014, after which the limit was re-instated at a level of $17.212 trillion. P.L. 113-83 again suspended the debt limit, this time from February 15, 2014 through March 15, 2015. On March 16, 2015, Treasury again implemented extraordinary measures, on a temporary basis, which were still in effect on September 30, 2015, to keep the DSL under the statutory limit of $18.1 trillion.[21] Most recently, in November 2015, the Bipartisan Budget Act of 2015 (P.L. 114-74) again suspended the debt limit through March 15, 2017. It is important to note that increasing or suspending the debt limit does not increase spending or authorize new spending; rather, it permits the United States to continue to honor pre-existing commitments to its citizens, businesses, and investors domestically and around the world.

The federal debt held by the public measured as a percent of GDP (debt-to-GDP ratio) (Chart E) compares the country's debt to the size of its economy, making this measure sensitive to changes in both. Over time, the debt-to-GDP ratio has varied widely. For most of the nation's history, the debt-to-GDP ratio has tended to increase during wartime and decline during peacetime. That pattern continued to hold following World War II until the 1970s. As shown in Chart E, wartime spending and borrowing had pushed the debt-to-GDP ratio to an all-time high of 106 percent in 1946, but it decreased rapidly in the post-war years, falling to 79 percent by 1950, 44 percent in 1960, and the postwar low point of 23 percent in 1974. Since then, the ratio has increased, growing rapidly from the mid-1970s until the early 1990s. In the 1990s, strong economic growth and fundamental fiscal decisions, including measures to reduce the federal deficit and implementation of binding "Pay As You Go" (PAYGO) rules, generated a significant decline in the debt-to-GDP ratio over the course of the 1990s, from a peak of 48 percent in 1993-1995, to

[21] A delay in raising the statutory debt limit existed as of September 30, 2015. When delays in raising the statutory debt limit occur, Treasury often must deviate from its normal debt management operations and take a number of extraordinary measures to meet the Government's obligations as they come due without exceeding the debt limit. Extraordinary measures taken by Treasury during the period of March 16, 2015, through September 30, 2015 resulted in federal debt securities not being issued to certain federal government accounts. As a result of Treasury securities not being issued to: the Government Securities Fund (G Fund) of the Thrift Savings Plan (TSP) , Treasury reported miscellaneous liabilities in the amount of $204.6 billion that represent uninvested principal of and related interest for the G Fund that would have been reported as Federal Debt Securities Held by the Public and Accrued Interest had there not been a delay in raising the statutory debt limit as of September 30, 2015, and had the securities been issued. In addition, uninvested principal of and related interest for the Civil Service Retirement and Disability Fund and the Postal Service Retiree Health Benefits Fund that would have been reported as intragovernmental debt totaled $146.1 billion. See Note 11, Federal Debt Securities Held by the Public and Accrued Interest and Note 16, Other Liabilities.

31 percent in 2001. During the last decade, much of this progress was undone as PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 39 percent of GDP. The extraordinary demands of the last economic and fiscal crisis and the consequent actions taken by the federal government, combined with slower economic growth in the wake of the crisis, pushed the debt-to-GDP ratio up to 74.4 percent as of September 30, 2014, but the ratio declined slightly during FY 2015 to 73.8 percent despite a slight increase in borrowing to finance the deficit.[22]

# The Economy in Fiscal Year 2015

A review of the nation's key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. As summarized in Table 6, the economy continued to expand at a moderate pace during FY 2015. Employment rose steadily and the unemployment rate declined during the fiscal year to its lowest level in more than seven years.

**Table 6: National Economic Indicators***

| | FY 2015 | FY 2014 |
|---|---|---|
| Real GDP Growth | 2.2% | 2.9% |
| Residential Investment Growth | 9.4% | 0.5% |
| Average monthly payroll job change (thousands) | 227 | 226 |
| Unemployment rate (percent, end of period) | 5.1% | 6.0% |
| Consumer Price Index (CPI) | 0.0% | 1.7% |
| CPI, excluding food and energy | 1.9% | 1.7% |
| Treasury constant maturity 10-year rate (end of period) | 2.06% | 2.52% |
| Moody's Baa bond rate (end of period) | 5.35% | 4.81% |

* Some FY2014 data may differ from the FY2014 *Financial Report* due to updates and revisions.

Real (i.e., inflation-adjusted) GDP expanded 2.2 percent during FY 2015, slowing from the 2.9 percent increase recorded over the four quarters of FY 2014. The moderation in the pace of expansion was due in part to a deterioration in the net export deficit. Growth of consumer spending accelerated during FY 2015 to 3.2 percent, and the recovery in the housing sector picked up sharply, with residential fixed investment increasing by 9.4 percent, compared with a rise of 0.5 percent during FY 2014. Growth of nonresidential fixed investment slowed to a 2.2 percent advance during FY 2015 from 7.6 percent during the previous fiscal year.

Labor market conditions improved further during FY 2015. The economy added 2.7 million nonfarm payroll jobs during the course of the fiscal year, matching the number of jobs added during FY 2014. On a monthly basis, nonfarm payroll employment rose at an average rate of 227,000 jobs per month, close to the average monthly increase of 226,000 during FY 2014. The number of unemployed persons fell from 9.3 million in September 2014 to 7.9 million in September 2015. The unemployment rate declined 0.9 percentage points, from 6.0 percent in September 2014 to 5.1 percent in September 2015. At the end of FY 2015, the unemployment rate was 4.9 percentage points lower than the peak of 10.0 percent, reached in October 2009.

Inflation remained low during FY 2015. The consumer price index (CPI) was flat during FY 2015, reflecting sharply lower energy prices and slower growth of food prices. Consumer price inflation was 1.7 percent during FY 2014. Underlying core inflation (the CPI excluding food and energy) was 1.9 percent during FY 2015, compared with 1.7 percent during the previous fiscal year.

Growth of real disposable (i.e., after-tax) personal income accelerated during FY 2015, reflecting lower inflation. The level of corporate profits fell 5.1 percent during FY 2015, compared with a gain of 5.8 percent during the previous fiscal year.

[22] Joint Statement of OMB Director, Shaun Donovan and Treasury Secretary, Jacob Lew.

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

While the Government's immediate priority is to ensure that the economic expansion is sustained, there are longer-term fiscal challenges that must ultimately be addressed. The Government took potentially significant steps towards a sustainable fiscal policy by enacting the Affordable Care Act (ACA) [23] in 2010, the Budget Control Act (BCA) in 2011, and the American Taxpayer Relief Act (ATRA) in 2013. The ACA holds the prospect of lowering long-term per-beneficiary spending growth for Medicare and Medicaid, the BCA significantly curtails discretionary spending, and ATRA increases revenues. Together, these three laws substantially reduce the estimated long-term fiscal gap. However, persistent growth of health care costs the retirement of the "baby boom" generation[24], increasing longevity, and lower birth rates will make it increasingly difficult to fund critical social programs, including Medicare, Medicaid, and Social Security.

Pursuant to federal accounting standards, this FY 2015 *Financial Report* introduces a ***Statement of Long-Term Fiscal Projections*** as a basic financial statement and a related Note Disclosure (Note 24). This statement, note disclosure, and additional related information had previously appeared collectively in the *Financial Report* as Required Supplementary Information (RSI). The Statement displays the present value of 75-year projections of the federal government's receipts and non-interest spending[25] for FY 2015 and FY 2014 (see Table 1). Additional information about these projections may be found in Note 24 and the RSI section of this *Financial Report*.

## Fiscal Sustainability

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

To determine if current fiscal policies are sustainable, the projections of the deficit and debt discussed here assume current policy (i.e., current law, with certain adjustments, such as extension of expiring policies that are expected to continue)[26] will continue indefinitely and draw out the implications for the growth of debt held by the public as a share of GDP. The projections are therefore neither forecasts nor predictions. As policy changes are enacted, actual financial outcomes will be different than those projected.

The projections in this *Financial Report* indicate that current policy is not sustainable. As discussed below, if current policy is left unchanged, the debt-to-GDP ratio is projected to fall about 6 percentage points over the next decade before commencing a steady rise to 223 percent in 2090 and is expected to rise continuously thereafter. Preventing the debt-to-GDP ratio from rising over the next 75 years is estimated to require some combination of spending reductions and revenue increases that amount to 1.2 percent of GDP over the period. While this estimate of the "75-year fiscal gap" is highly uncertain, it is nevertheless nearly certain that current fiscal policies cannot be sustained indefinitely.

It is important to address the Government's fiscal imbalances soon. Delaying action increases the magnitude of spending reductions and/or revenue increases necessary to stabilize the debt-to-GDP ratio. For example, it is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap is about 25 percent larger if reforms are delayed by just ten years, and nearly 60 percent larger if reform is delayed 20 years.

The estimates of the cost of policy delay in this *Financial Report* assume policy does not affect GDP or other economic variables. Delaying fiscal adjustments for too long raises the risk that growing federal debt would increase interest rates, which would, in turn, reduce investment and ultimately economic growth. However, abrupt and poorly designed deficit reduction could also be counterproductive for the economy, particularly if it takes the form of reducing investments in infrastructure, education, or innovation that are essential for robust longer-term economic growth.

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

[24] Refers to the segment of the population born during the post-World War II era during which time birth rates in the U.S. were higher than normal.

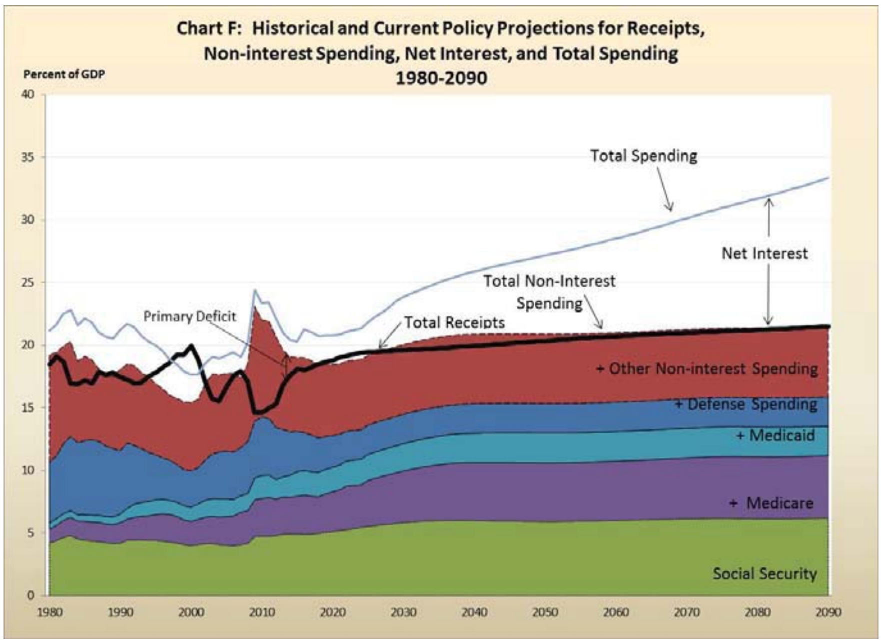
[25] For the purposes of the Statement of Long-Term Fiscal Projections and this analysis, spending is defined in terms of outlays. In the context of federal budgeting, spending can either refer to: (1) budget authority – the authority to commit the government to make a payment; (2) obligations – binding agreements that will result in either immediate or future payment; or (3) outlays, or actual payments made.

[26] Current policy in the projections is based on current law, but includes certain adjustments, such as extension of certain policies that expire under current law but are routinely extended or otherwise expected to continue (e.g., reauthorization of the Supplemental Nutrition Assistance Program).

## The Primary Deficit, Interest, and Debt

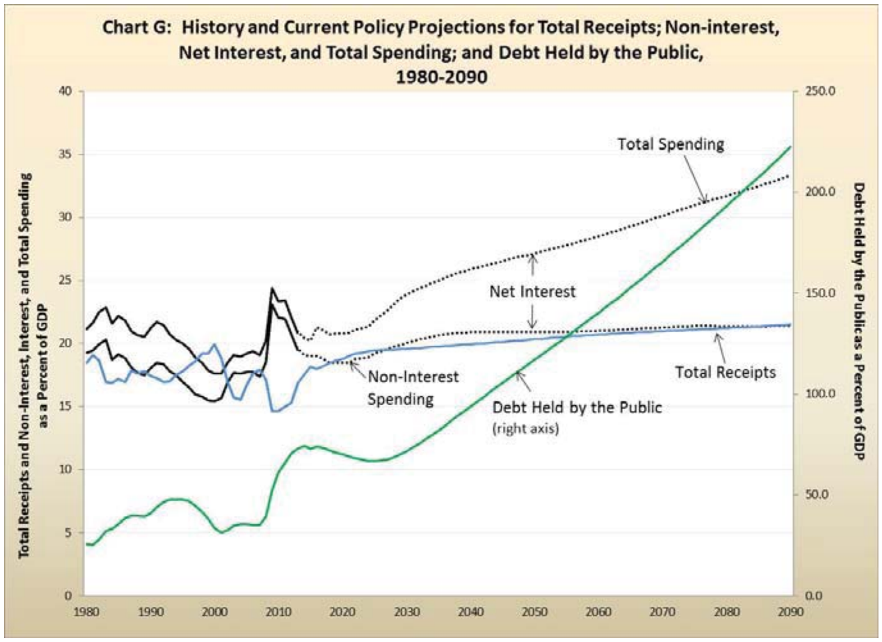
The primary deficit – the difference between non-interest spending and receipts – is the only determinant of the debt-to-GDP ratio that the Government controls directly. (The other determinants are interest rates and growth in GDP). Chart F shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP (primary deficit-to-GDP ratio). The primary deficit-to-GDP ratio grew rapidly in 2009 due to the financial crisis and the recession and the policies pursued to combat both. The ratio remained high from 2010 to 2012 despite shrinking in each successive year, and fell significantly in 2013 and 2014. The primary deficit is projected to shrink in the next few years as discretionary spending limits called for in the BCA continue and the economy continues to recover, becoming a primary surplus in 2019 that peaks at 0.5 percent of GDP in 2024. After 2025, however, increased spending for Social Security and health programs due to the ongoing retirement of the baby boom generation and increases in the price of health care services is expected to cause the primary surplus to steadily deteriorate and become a primary deficit starting in 2028 that reaches 1.0 percent of GDP by 2038. After 2039, the age composition of the population is stable and the pace of health care price increases slows, causing the primary deficit to gradually decrease and become a primary surplus in 2085 that reaches 0.1 percent of GDP in 2090.

Receipts as a share of GDP fell substantially in 2009 and 2010 and remained low in 2011 and 2012 because of the recession and tax reductions enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA) and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The share rose to 18.1 percent in 2015, exceeding its 30-year average due to continued economic growth and the higher tax rates enacted under the ATRA. After 2020, receipts are projected to grow slightly more rapidly than GDP as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets.




Non-interest spending as a share of GDP is projected to stay at or below its current level of about 19 percent until 2027, and to then rise gradually to 20.9 percent of GDP by 2040 and 21.4 percent of GDP in 2090. The reductions in the non-interest spending share of GDP over the next few years are mostly due to the expected reductions in spending for overseas contingency operations, caps on discretionary spending, and the automatic spending cuts mandated by the BCA; the subsequent increases are principally due to faster growth in Medicare, Medicaid, and Social Security spending (see Chart F). The aging of the baby boom generation over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.1 percentage points, 1.6 percentage points, and 0.4 percentage points, respectively. After 2040, the Social Security spending share of GDP gradually declines, returns to 2040 levels in 2060, and then increases slightly, while the combined Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs. The ACA provision of health insurance subsidies and expanded Medicaid coverage boost federal spending, and other ACA provisions significantly reduce per-beneficiary Medicare cost growth. On net, the ACA is projected to substantially reduce the growth rate of Medicare expenditures over the next 75 years. However, as discussed in Note 23, these projections are subject to much uncertainty about the ultimate effects the ACA will have on health care cost growth.

The primary deficit-to-GDP projections in Charts F and G (left axis), along with projections for interest rates, determine the debt-to-GDP ratio projections shown in Chart G (right axis). That ratio was 74 percent at the end of FY 2015 and under the long-term fiscal projections of current policy is projected to be 67 percent in 2025, 106 percent in 2045, and 223 percent in 2090. The debt-to-GDP ratio rises at an accelerating rate despite primary deficits that flatten out because higher levels of debt lead to higher net interest expenditures, and higher net interest expenditures lead to higher debt.[27] The continuous rise of the debt-to-GDP ratio after 2025 indicates that current policy is unsustainable.




These debt projections are generally lower than the corresponding projections in both the FY 2014 and FY 2013 *Financial Reports*. For example, the debt-to-GDP projection for 2088 (the final projection year for the 2013 report) is 217 percent in this year's *Financial Report*, 315 percent in the FY 2014 *Financial Report*, and 277 percent in the FY 2013 *Financial Report*.[28]

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

The 75-year fiscal gap is one measure of the degree to which current fiscal policy is unsustainable. It is the amount by which primary surpluses over the next 75 years must rise above current-policy levels in order for the debt-to-GDP ratio in 2090 to equal its level in 2015 (74 percent). This fiscal gap is estimated to equal 1.2 percent of GDP. It is the difference between the average level of primary surpluses over the next 75 years that would result in the 2090 debt-to-GDP ratio equaling its 2015 level (0.9 percent), and the average level of primary surpluses over the next 75 years under current policies (-0.3 percent, i.e., primary deficits averaging 0.3 percent). The 75-year fiscal gap is 6.1 percent as large as the 75-year present value of projected receipts and 6.0 percent as large as the 75-year present value of non-interest spending, and is 0.9 percentage points smaller than the 2.1 percent estimate in 2014.

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

Table 7 illustrates the cost of delaying policy to close the fiscal gap by comparing three policies that begin on different dates. The first policy begins immediately and calls for increasing primary surpluses by 1.2 percent of GDP in every year between 2016 and 2090. This is accomplished by invoking some combination of spending reductions and revenue

| Table 7 | |
|---|---|
| **Costs of Delaying Fiscal Reform** | |
| **Period of Delay** | **Change in Average Primary Surplus** |
| No Delay: Reform in 2016................ | 1.2 percent of GDP between 2016 and 2090 |
| Ten Years: Reform in 2026.............. | 1.5 percent of GDP between 2026 and 2090 |
| Twenty Years: Reform in 2036......... | 1.9 percent of GDP between 2036 and 2090 |

Note: Amounts represent the change in the average primary surplus over the specified period necessary to yield the current year debt-to-GDP ratio. Reforms occurring in 2015, 2025, and 2035 from the 2014 Financial Report were 2.1, 2.5, and 3.1 percent.

[27] The change in debt each year is also affected by certain transactions not included in the unified budget deficit, such as changes in Treasury's cash balances and the nonbudgetary activity of Federal credit financing accounts. These transactions are assumed to hold constant at about 0.4 percent of GDP each year, with the same effect on debt as if the primary deficit was higher by that amount.

[28] See the Required Supplementary Information section of the FY 2014 Financial Report of the U.S. Government for more information about changes from the long term fiscal projections for FY 2013.

increases that amount to 1.2 percent of GDP in every year over the 75-year projection period. The second policy in Table 7 begins in 2026. Because the same fiscal consolidation must be compressed into ten fewer years, this policy change is more abrupt, calling for primary surplus increases amounting to 1.5 percent of GDP in every year between 2026 and 2090. Similarly, if debt is allowed to accumulate unabated for 20 years, then closing the 75-year fiscal gap would require even more abrupt primary surplus increases amounting to 1.9 percent of GDP in every year between 2036 and 2090. The differences between the primary surplus boost starting in 2026 and 2036 (1.5 and 1.9 percent of GDP, respectively) and the primary surplus boost starting in 2016 (1.2 percent of GDP) is a measure of the additional burden policy delay would impose on future generations. Future generations are harmed by a policy delay of this sort because the higher the primary surplus is during their lifetimes the greater the difference is between the taxes they pay and the programmatic spending from which they benefit.

## Conclusion

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

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

These and other issues concerning fiscal sustainability are discussed in further detail in Note 24 and the RSI section of this *Financial Report*.

# Social Insurance

The preceding analysis of the Government's long-term fiscal projections considered Government receipts and spending as a whole. The Statement of Social Insurance (SOSI) provides a more focused perspective of the Government's "social insurance" programs: Social Security, Medicare, Railroad Retirement, and Black Lung.[29] For these programs, the SOSI reports: (1) the actuarial present value of all future program revenue (mainly taxes and premiums) - excluding interest - to be received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures to be paid to or on behalf of current and future participants; and (3) the difference between (1) and (2). Amounts reported in the SOSI and in the RSI section in this *Financial Report* are based on each program's official actuarial calculations. By accounting convention, the transfers of general revenues are eliminated in the consolidation of the SOSI at the governmentwide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations even though the expenditures on these programs are included. For the FY 2015 and 2014 SOSI, the amounts eliminated totaled $24.8 trillion and $24.7 trillion, respectively. SOSI programs and amounts are included in the broader fiscal sustainability analysis in the previous section, although on a slightly different basis (as described in Note 24).

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

[29] The Black Lung Benefits Act (BLBA) provides for monthly payments and medical benefits to coal miners totally disabled from pneumoconiosis (black lung disease) arising from their employment in or around the nation's coal mines. See http://www.dol.gov/owcp/regs/compliance/ca_main.htm

**Table 8: Social Insurance Future Expenditures in Excess of Future Revenues**

| Dollars in Billions | 2015 | 2014 | Increase / (Decrease) $ | % |
|---|---|---|---|---|
| Open Group (Net): | | | | |
| Social Security (OASDI) | $ (13,440) | $ (13,330) | $ 110 | 0.8% |
| Medicare (Parts A, B, & D) | $ (27,940) | $ (28,483) | $ (543) | (1.9%) |
| Other | $ (108) | $ (103) | $ 5 | 4.6% |
| **Total Social Insurance Expenditures, Net (Open Group)** | **$ (41,487)** | **$ (41,916)** | $ (429) | (1.0%) |
| **Total Social Insurance Expenditures, Net (Closed Group)** | **$ (58,257)** | **$ (56,680)** | $ 1,578 | 2.8% |
| **Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*** | | | | |
| **Open Group** | | | | |
| Social Security (OASDI) | (1.1%) | (1.3%) | | |
| Medicare (Parts A, B, & D) | (2.7%) | (2.9%) | | |
| Other | 0.0% | 0.0% | | |
| **Total (Open Group)** | **(3.7%)** | **(4.0%)** | | |
| **Total (Closed Group)** | **(5.2%)** | **(5.4%)** | | |

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

* GDP values used are from the 2015 & 2014 Social Security and Medicare Trustees Reports and represent the present value of GDP over the 75-year projection period. As the GDP used for Social Security and Medicare differ slightly in the Trust Fund Reports, the two values are averaged to estimate the 'Other' and Total Net Social Insurance Expenditures as % of GDP.

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

Table 8 summarizes amounts reported in the SOSI, showing that net social insurance expenditures are projected to be $41.5 trillion over 75 years as of January 1, 2015 for the "Open Group," a decrease of $429 billion over net expenditures of $41.9 trillion projected in the 2014 *Financial Report*.[30] The 2015 amounts reported for Medicare reflect current law[31] and the 2014 amounts reflect the "projected baseline scenario" for Part B.[32]

Table 9 on the following page summarizes the principal reasons for the changes in projected social insurance amounts during 2015 and 2014. The following briefly summarizes the significant changes for the current valuation (as of January 1, 2015) as disclosed in Note 23, Social Insurance. See Note 23 for additional information.

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

[31] The Medicare Access and CHIP Reauthorization Act (MACRA) of 2015 permanently replaces the sustainable growth rate (SGR) formula, which was used to determine payment updates under the Medicare physician fee schedule with specified payment updates through 2025. The changes specified in MACRA also establish differential payment updates starting in 2026 based on practitioners' participation in eligible alternative payment models; payments are also subject to adjustments based on the quality of care provided, resource use, use of certified electronic health records, and clinical practice improvement.

[32] The projected baseline scenario includes the assumption that the current-law physician updates will be legislatively overridden and that physician updates that were required at the time of publication of the 2014 Medicare Trustees Report will be 0.6 percent each year starting with 2016. (2014 Medicare Trustees Report, p. 8/footnote 5)

| Table 9: Changes in Social Insurance Projections | | |
|---|---|---|
| Dollars in Billions | 2015 | 2014 |
| **Net Present Value (NPV) - Open Group** | | |
| **(Beginning of the Year)** | **$ (41,916)** | **$ (39,698)** |
| **Changes In:** | | |
| Valuation Period | $ (1,858) | $ (1,769) |
| Demographic data and assumptions | $ (249) | $ (54) |
| Economic data and assumptions[1] | $ (146) | $ (605) |
| Law or policy | $ (23) | $ 29 |
| Methodology and programmatic data[1] | $ 671 | $ (90) |
| Economic and other healthcare assumptions[2] | $ 3,221 | $ (318) |
| Change in projection base[2] | $ (1,187) | $ 589 |
| Net Change in Open Group measure | $ 429 | $ (2,218) |
| **NPV - Open Group (End of the Year)** | **$ (41,487)** | **$ (41,916)** |

1 Relates to SSA.
2 Relates to HHS.
Note - totals may not equal sum of components due to rounding.

- Change in valuation period: This change replaces a small negative net cash flow for 2014 and replaces it with a much larger negative net cash flow for 2089. As a result, the present value of the estimated future net cash flows decreased (became more negative) by $1.9 trillion.
- Changes in economic and other healthcare assumptions: The assumption changes, specific to the Medicare projections, included, but were not limited to: for the current valuation (beginning on January 1, 2015), the only change to the ultimate economic assumption was that the ultimate real wage differential is assumed to be 1.17 percent in the current valuation period, compared to 1.13 percent in the prior valuation period. The higher wage differential assumption is more consistent with recent experience and expectations of slower growth in employer sponsored group health insurance premiums from the Centers for Medicare and Medicaid Services (CMS) Office of the Actuary. Because these premiums are not subject to the payroll tax, slower growth in these premiums means that a greater share of employee compensation will be in the form of wages that are subject to the payroll tax.
  - Otherwise, the ultimate economic assumptions for the current valuation are the same as those for the prior valuation. However, the starting economic values, and the way these values transition to the ultimate assumptions, were changed: (1) the ratio of average taxable earnings to the average wage averages about 0.6 percentage points higher during the long-range period compared to the previous valuation; and (2) the projected suspense file contains fewer wage items, which is consistent with having fewer workers (many of whom are undocumented immigrants) with wages on the suspense file and more of these workers with earnings in the underground economy, compared to the previous valuation.
  - The following health care assumptions, specific to the Medicare projections, were changed in the current valuation: (1) lower long-range growth rate assumptions; (2) utilization rate assumptions for inpatient hospital services were decreased; (3) lower assumed hospice spending; (4) higher assumed enrollment in Medicare Advantage plans where benefits are more costly; and (5) introduction of high-cost specialty drugs used to treat hepatitis C.

  The net impact of these changes increased (made less negative) the present value of the estimated future cash flows by $3.2 trillion. For Part A, these changes resulted in an increase to the present value of future expenditures and income, with an overall increase in the estimated future net cash flow. For Parts B and D, these changes decreased the present value of estimated future expenditures (and also income).
- Change in projection base: Actual income and expenditures in 2014 were different than what was anticipated when the 2014 Trustees Report projections were prepared. Medicare Part A income was slightly lower and expenditures were slightly higher than anticipated, based on actual experience. Part B total income and expenditures were also higher than estimated based on actual experience. For Part D, actual income and expenditures were both higher than prior estimates. The net impact of the Part A, B, and D projection base changes is a decrease in the estimated future net cash flow. Actual experience of the Medicare Trust Funds between January 1, 2014 and January 1, 2015 is incorporated in the current valuation and is slightly more than projected in the prior valuation. These changes had an overall net effect of decreasing (making more negative) the estimated future net cash flows by $1.2 trillion.

Projected net expenditures for Medicare Parts A and B declined significantly between FY 2009 and FY 2010 reflecting provisions of the ACA. As reported in Note 23, there continues to be uncertainty about whether the projected cost savings and productivity improvements will be sustained in a manner consistent with the projected cost growth over time. Note 23 includes an alternative projection to illustrate the uncertainty of projected Medicare costs. As indicated earlier, GAO disclaimed opinions on the 2015, 2014, 2013, 2012 and 2011 SOSI because of these significant uncertainties.

Costs as a percent of GDP of both Medicare and Social Security, which are analyzed annually in the Medicare and Social Security Trustees' Reports, are projected to increase substantially through 2035 because: (1) the number of beneficiaries rises rapidly as the baby-boom generation retires and (2) the lower birth rates that have persisted since the baby boom cause slower growth in the labor force and GDP.[33] According to the Medicare Trustees' Report, spending on Medicare is projected to rise from its current level of approximately 3.5 percent of GDP to 5.6 percent in 2040 and to 6.0 percent in 2089.[34] The Hospital Insurance (HI) Trust Fund is now expected to remain solvent until 2030, (unchanged from last year's report). Under current law, scheduled HI tax revenue would be sufficient to pay 86 percent of HI costs after depletion in 2030 and then gradually increasing to 84 percent by 2089.

As for Social Security, combined spending is projected to increase gradually from its current level of 4.9 percent of GDP to about 6.0 percent by 2035, declining to 5.9 percent by 2050 and rises to 6.2 percent by 2089. The Social Security Trustees' Report indicates that annual OASDI income, considered on a theoretical basis, including interest on trust fund assets, will exceed annual cost and trust fund assets will increase every year until 2020, at which time it will be necessary to begin drawing down on trust fund assets to cover part of expenditures until asset reserves become depleted in 2034 (one year later than indicated in last year's Report). Continuing tax income would be sufficient to pay 79 percent of scheduled benefits in 2034 and 73 percent of scheduled benefits in 2089. The Disability Insurance (DI) Trust Fund alone was expected to deplete much sooner, by the end of 2016. However, the impending depletion of the DI Trust Fund was circumvented by the passage of the Bipartisan Budget Act of 2015, which reallocated a portion of the payroll tax rate from the Old Age Survivors Insurance (OASI) Trust Fund to the DI Trust Fund. This reallocation is expected to ensure full payment of disability benefits into 2022.[35] The projections assume that full Social Security and Medicare benefits are paid after the corresponding trust fund assets are depleted.

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

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[33] 2015 Annual Trustees Reports on Social Security and Medicare (Summary), pp. 3, 9-10.

[34] Percent of GDP amounts are expressed in gross terms (including amounts financed by premiums and state transfers).

[35] 2015 Annual Trustees Reports on Social Security and Medicare (Summary), pp. 3, 9-10.

# Systems, Controls, and Legal Compliance

## Systems

As federal agencies demonstrate success in obtaining opinions on their audited financial statements, the federal government continues to face challenges in implementing financial systems that meet federal requirements. The number of CFO Act agencies reporting lack of substantial compliance with one or more of the three Section 803(a) requirements of the Federal Financial Management Improvement Act (FFMIA) was 10 in both FY 2015 and FY 2014, and the number of auditors reporting lack of substantial compliance with one or more of the three Section 803(a) FFMIA requirements was 12 in FY 2015 and 11 in FY 2014. These results underscore the importance of current initiatives to standardize the financial management practices across the federal government.

## Controls

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

In response to major management challenges to agency mission and goals, agencies are increasingly recognizing the importance and utility of Enterprise Risk Management (ERM) as a tool for identifying, assessing, mitigating, managing and preparing for risk. Effectively implemented, ERM contributes to improved decision-making, adopting a proactive rather than a reactive approach towards risk. ERM has the potential to change the perception that internal controls are limited to just compliance and financial reporting. Instead, internal controls can play a key tool to address management challenges that cut across multiple agency functions. ERM is currently practiced in both the private and public sectors as well as internationally, with examples in governments of the United Kingdom, Canada, and Japan, among others. In an effort to improve taxpayers' trust in government and prepare for future challenges, OMB has promoted ERM best practices across agencies. The upcoming update to OMB Circular No. A-123 will further explain and highlight ERM.

The Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* is the policy document that implements the requirements of 31 U.S.C. 3512 (c), (d) (commonly known as the Federal Managers' Financial Integrity Act or FMFIA). Circular No. A-123 primarily focuses on providing agencies with a framework for assessing and managing risks more strategically and effectively. The Circular is currently being revised to reflect changes incorporated in GAO's recently updated Standards for Internal Control in the federal government. The revised Circular will be available to the Agencies in the near future. The Circular contains multiple appendices that address, at a more detailed level, one or more of the objectives of effective internal control. Appendix A provides a methodology for agency management to assess, document, test, and report on internal controls over financial reporting. Appendix B requires agencies to maintain internal controls that reduce the risk of fraud, waste, and error in Government charge card programs. Appendix C implements the Requirements for Effective Estimation and Remediation of Improper Payments. Appendix D defines new requirements for determining compliance with the FFMIA and will contribute to efforts to reduce the cost, risk, and complexity of financial system modernizations.

The total number of reported material weaknesses for the CFO Act agencies was 40 and 35 for FYs 2015 and 2014, respectively. Effective internal controls are a challenge not only at the agency level, but also at the governmentwide level. GAO reported that at the governmentwide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the Government in identifying and resolving internal control deficiencies, continued diligence and commitment are needed.

The Department of Health and Human Services (HHS) and the Department of the Treasury (Treasury) each have responsibilities for ensuring payment accuracy in programs created under the Affordable Care Act. Performing comprehensive risk assessments is critical to establishing an effective program for achieving payment accuracy in future years. In FY 2015, both Departments finalized plans for and began to perform comprehensive improper payment risk assessments to determine areas that might affect Advance Premium Tax Credit (APTC), Premium Tax Credit (PTC), Cost-sharing Reduction and Basic Health Plan payment accuracy. Both Departments are leveraging non-profit contractors known as Federally Funded Research and Development Centers (FFRDC) for the risk assessments, which will facilitate interagency coordination and provide a complete assessment of risk that takes into account activities by the Marketplaces created under the ACA, HHS and the Internal Revenue Service. An update on the status and preliminary results of the FFRDC supported risk assessments will be reported in the FY 2016 Agency Financial Reports (AFR). In addition, both Departments have established internal controls to provide for effective program operations, reliable financial reporting, and compliance with laws and regulations.

## Legal Compliance

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

# Financial Management Progress and Priorities

Since the passage of the CFO Act of 1990, the federal financial community has made important strides in instilling strong accounting and financial reporting practices. For FY 2015, 21 of the 24 CFO Act agencies obtained an opinion from the independent auditors on their financial statements, three agencies received disclaimers[36]. In addition, 40 auditor-identified material weaknesses were reported in FY 2015, an approximately 30 percent decline from the material weaknesses that were identified in the early 2000s (see Table 10 on the following page). An increasing number of federal agencies have initiated and sustained disciplined and consistent financial reporting operations, implemented effective internal controls around financial reporting, and have successfully integrated transaction processing and accounting records. These efforts have resulted in improved results on financial statement audits. However, weaknesses in basic financial management practices and other limitations continue to prevent three of the CFO Act agencies, and the Government as a whole, from achieving an audit opinion.

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

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

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

[36] The 21 agencies include HHS, which received a clean opinion on all statements except the Statement of Social Insurance and the Statement of Changes in Social Insurance, both of which received a disclaimer of opinion.

| Table 10: Auditor-Reported Material Weaknesses: FY 2015 | | | | | |
|---|---|---|---|---|---|
| Agency | Beginning | New | Resolved | Consolidated | Ending |
| Department of Agriculture (USDA) | 2 | 0 | 0 | 0 | 2 |
| Department of Commerce (DOC) | 0 | 0 | 0 | 0 | 0 |
| Department of Defense (DOD) | 13 | 0 | 0 | 0 | 13 |
| Department of Education (Education) | 0 | 0 | 0 | 0 | 0 |
| Department of Energy (DOE) | 0 | 0 | 0 | 0 | 0 |
| Department of Health and Human Services (HHS) | 1 | 0 | 0 | 0 | 1 |
| Department of Homeland Security (DHS) | 4 | 0 | 1 | 0 | 3 |
| Department of Housing and Urban Development (HUD) | 8 | 3 | 2 | 0 | 9 |
| Department of the Interior (DOI) | 1 | 2 | 1 | 0 | 2 |
| Department of Justice (DOJ) | 0 | 0 | 0 | 0 | 0 |
| Department of Labor (DOL) | 0 | 1 | 0 | 0 | 1 |
| Department of State (State) | 0 | 0 | 0 | 0 | 0 |
| Department of Transportation (DOT) | 1 | 0 | 0 | 0 | 1 |
| Department of the Treasury (Treasury) | 1 | 0 | 0 | 0 | 1 |
| Department of Veterans Affairs (VA) | 1 | 3 | 0 | 0 | 4 |
| Agency for International Development (USAID) | 1 | 0 | 0 | 0 | 1 |
| Environmental Protection Agency (EPA) | 1 | 0 | 0 | 0 | 1 |
| General Services Administration (GSA) | 1 | 0 | 1 | 0 | 0 |
| National Aeronautics and Space Administration (NASA) | 0 | 0 | 0 | 0 | 0 |
| National Science Foundation (NSF) | 0 | 0 | 0 | 0 | 0 |
| Nuclear Regulatory Commission (NRC) | 0 | 0 | 0 | 0 | 0 |
| Office of Personnel Management (OPM) | 0 | 1 | 0 | 0 | 1 |
| Small Business Administration (SBA) | 0 | 0 | 0 | 0 | 0 |
| Social Security Administration (SSA) | 0 | 0 | 0 | 0 | 0 |
| **Totals** | **35** | **10** | **5** | **0** | **40** |

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

### DATA Act

The Digital Accountability and Transparency Act of 2014 (DATA Act), signed on May 9, 2014, sets forth a clear vision for the future of Federal spending transparency. The Act amended the Federal Funding Accountability and Transparency Act of 2006 (FFATA) by requiring that all federal spending be displayed on a website in searchable, downloadable, and machine-readable format. This data includes obligations, outlays, budgetary authority, unobligated balances, and other budgetary resources for each appropriations account. It also expands federal award reporting previously required under FFATA. In May 2015, OMB and Treasury issued financial data definition standards and policy guidance outlining the first set of DATA Act implementation requirements. By 2017, all agencies must report this data to a centralized website and adhere to the data standards and guidance issued by OMB and Treasury. Posting this financial information will allow spending comparisons across and within agencies that have never been possible before as well as unlock spending data for use by the public.

Since the DATA Act was signed into law, OMB and Treasury have been partnering to lead governmentwide implementation. They have established a robust governance structure with representatives from agencies and functional communities fostering collaboration on data standards, policy changes, USAspending.gov improvements, and agency implementation. The implementation plan was developed to be collaborative, iterative, incremental, and agile, with a data centric focus. This approach sets the foundation for future success with shorter term and intermediate deliverables.

### USAspending.gov

USAspending.gov was established to provide clear information on federal award spending. Continuing to improve the quality, utility and transparency of this federal spending information is a foundational Administration commitment to open government, as identified in the U.S. Government's National Action Plan for Open Government. To continue its efforts to improve the quality of spending data, OMB and Treasury will issue additional policy guidance to adjust USAspending.gov reporting requirements and procedures pursuant to the DATA Act.

To align our federal spending and financial management transparency efforts, the Administration has transferred responsibility for USAspending.gov from the General Services Administration (GSA) to Treasury. In March 2015, Treasury released a new version of USAspending.gov with improved search capabilities and visualizations of data. Treasury's leadership in executing a governmentwide vision for spending transparency enables the federal government to move forward in achieving the objective of making spending data more useful, accurate, and timely – consistent with the agency's other work through financial reporting, work on improper payments, among other priority areas.

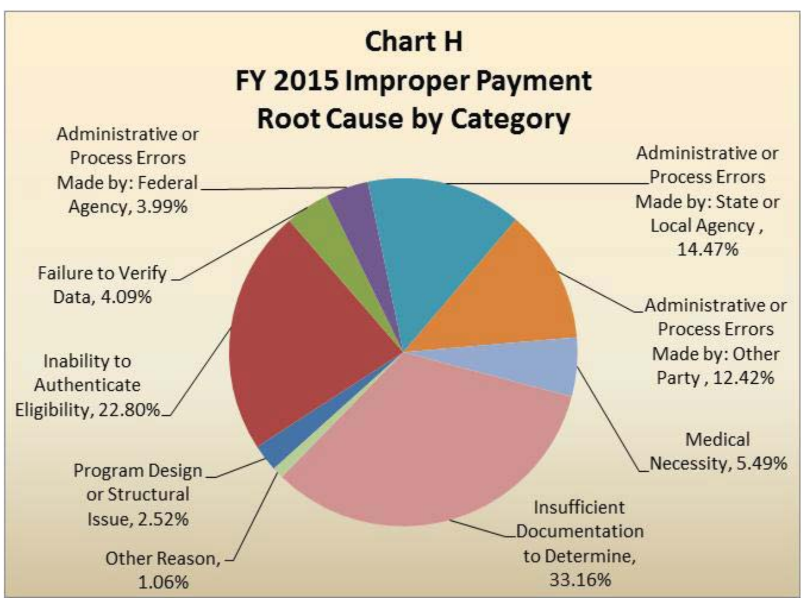
Moving forward, in concert with Treasury, OMB will continue to collaborate with federal and non-federal stakeholders to evolve the Administration's governmentwide spending transparency framework to effectively provide the public with transparent information about how taxpayer dollars are being spent.

## Protect Against Waste, Fraud, and Abuse

### Improper Payments

Addressing improper payments is a central component of the Administration's overall efforts to eliminate waste, fraud, and abuse. When the President took office in 2009, the improper payment error rate was 5.42 percent, an all-time high. Since then, the Administration, working together with Congress, has made progress by strengthening accountability and transparency through annual reviews by agency Inspectors General, and expanded requirements for high-priority programs. As a result of this concerted effort, in FY 2013 the Administration reported an improper payment rate of 3.53 percent. In FY 2014 and FY 2015, the governmentwide improper payment rate was 4.02 percent and 4.39 percent, which corresponds to an improper payment dollar amount of \$124.6 billion[37] and \$136.9 billion, respectively.[38] The Medicare Fee for Service (FFS) program continues to account for the largest portion of the government-wide total in FY 2015, whereas Earned Income Tax Credit (EITC) and Medicaid combined, account for approximately a third of the government-wide total. In addition, agencies recovered roughly \$20 billion in overpayments through the payment recapture audits and other methods in FY 2015.

Prior to FY 2015 reporting, agencies were required to categorize their improper payment estimates based on three categories of improper payments: (1) documentation and administrative errors; (2) authentication and medical necessity errors; and (3) verification errors. However, those categories proved to be limited and not necessarily applicable to most programs. Therefore, OMB—in consultation with agencies—developed new improper payment categories. FY 2015 marked the first year of the new OMB reporting requirement for root causes reporting as shown in Chart H. Approximately \$45 billion of the government-wide improper payments in FY 2015 are caused by insufficient documentation. A lack of supporting documentation could be a situation where there is a lack of supporting documentation necessary to verify the accuracy of a payment identified in the improper payment testing sample such as a program not having the documentation to support a beneficiary's eligibility for a benefit. Approximately \$31 billion of the government-wide improper payments in FY 2015 were caused by the inability to authenticate eligibility. The inability to authenticate eligibility is a situation in which an improper payment is made because the agency is unable to authenticate eligibility criteria such as no database or other




[37] Due to updates made in some agencies FY 2015 AFRs to reflect their prior year estimates the new revised estimate for FY 2014 is \$124.6 billion compared to the \$124.7 billion FY 2014 estimate previously reported.

[38] DOD's Commercial Payments were first included in the government-wide rate in FY 2013. When the DOD commercial payments are excluded from the government-wide figures the FY 2015 rate is 4.82 percent.

resource exist to help the agency make a determination of eligibility or statutory constraints exist preventing a program from being able to access the information that would help prevent the improper payment. This additional detail behind the root causes of improper payments provides more granularity on improper payment estimates and will be used to inform more effective corrective actions and more focused strategies for reducing improper payments.

The Administration continues to use the Budget to build on congressional and Administration action to reduce improper payments. For example, the President's FY 2016 and 2017 Budget included a number of program integrity proposals aimed at reducing improper payments and improving government efficiency. The FY 2016 proposals included a robust package of Medicare and Medicaid program integrity proposals, strategic reinvestment in the Internal Revenue Service (IRS), and an equally robust package of Social Security program integrity proposals, in addition to many other proposals for other programs also aimed at reducing improper payments. The President's FY 2017 Budget also includes a number of new program integrity proposals.

The Government is also advancing data analytics and improved technologies to prevent improper payments before they happen. In doing so, as part of the President's Do Not Pay Initiative, the Administration established a Do Not Pay System of Records at Treasury and launched data informed insights reports for agencies to improve their payment accuracy and program integrity. OMB's and Treasury's combined work with agencies to implement the Do Not Pay Initiative, outlined in Section 5 of IPERIA, and OMB Memorandum 13-20, Protecting Privacy while Reducing Improper Payments with the Do Not Pay List, has catalyzed agencies to improve their payment business operations, reduce improper payments, and incorporate multiple databases and analytics resources as they verify entity eligibility for awards or payments. Agencies have reported over $2 billion of improper payments stopped through the Do Not Pay initiative and other efforts in FY 2014, as identified in OMB's report to Congress transmitted on December 4, 2015. The Administration looks forward to continued work with Congress on Administration priorities including the sharing of death data from states to prevent improper payments to the deceased while maintaining privacy to ensure program integrity and payment accuracy.

Combating improper payments within the federal government is a top priority for the Administration and it will continue to explore new and innovative ways to address the problem. Each dollar paid in error represents a loss of public resources, and this Administration is committed to reducing waste, fraud, and abuse and continuing to improve payment accuracy with every tool at its disposal.

### Improving Grants Management

On December 19, 2014, 28 federal awarding agencies adopted final guidance to better target risk and reduce waste, fraud, and abuse (2 CFR Part 200—Uniform Administrative Requirements, Cost Principles, And Audit Requirements for Federal Awards). The culmination of a three-year collaborative effort across federal agencies and its non-federal partners, the rule effectively implements OMB guidance on grant-making across the 28 federal agencies. This effort streamlined eight existing OMB Circulars on financial management into one consolidated set of guidance in the CFR, reduced the total volume of financial management regulations for federal grants and other assistance by 75 percent, and reduced administrative burdens and risk of waste, fraud, and abuse for the approximately $600 billion awarded annually in federal financial assistance.

Specifically, the revised policies emphasize risk-based decision making to reduce administrative burden and waste, fraud, and abuse by:

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

The Council on Financial Assistance Reform (COFAR) has established metrics, as outlined in the OMB issued Memorandum M-14-17, Metrics for Uniform Guidance, that will measure the effectiveness of the new policies and is working with federal and non-federal stakeholders to develop additional training and outreach resources. The administrative metrics for the base year are published on the COFAR website at https://cfo.gov/cofar/.

To help with the implementation of the Uniform Guidance during the initial year of applicability, OMB has issued a set of technical corrections to the Uniform Guidance and developed a set of Frequently Asked Questions that provide additional instructions and clarifications to the provisions in the Uniform Guidance (https://cfo.gov/wp-content/uploads/2015/09/9.9.15-Frequently-Asked-Questions.pdf)

In July 2015, OMB published final guidance for reporting and use of information concerning recipient integrity and performance for inclusion in the Uniform Guidance (http://www.gpo.gov/fdsys/pkg/FR-2015-07-22/pdf/2015-17753.pdf). This guidance requires federal awarding agencies to use the Federal Awardee Performance and Integrity Information System (FAPIIS) to implement the requirements of Section 872 of the Duncan Hunter National Defense Authorization Act as applicable to grants. The requirements are effective for federal assistance awarded on or after January 1, 2016.

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

### FedStat/Benchmarking

Over the course of this Administration, OMB has used regular data-driven management reviews to advance many of its most important shared priorities. Through implementation of the GPRA Modernization Act of 2010 and the President's Management Agenda, these reviews have led to a number of tangible improvements in the effectiveness and efficiency of individual agencies and the Government as a whole, and OMB will continue that work through ongoing PortfolioStat, Benchmarking, and Strategic Review engagements.

The federal government's efforts to improve government efficiency aim to increase the quality and value of core administrative operations and enhance productivity to achieve cost savings or cost avoidance. Establishing cost and quality benchmarks for these operations have helped to develop tools for the federal government to measure performance in key mission-support areas, including human resources, financial management, acquisition, information technology, and real property.

During FY 2015, OMB designed and launched the "FedStat" review to bring these efforts and other emerging priorities into focus in a cohesive discussion of opportunities with the CFO Act agencies for improved performance and risk mitigation that will more closely align with the Budget process and inform program management and administration. OMB met with agencies to discuss data-driven evidence on shared challenges across the government, to identify potential areas for agency sub-component improvement, and to explore opportunities to pursue cross-agency solutions, including policies, processes, and leading practices of excellence for broader application.

In support of the President's Management Agenda, agency implementation of these action items will improve agency management of mission-support functions and mission delivery, identify potential Budget, legislative, or other proposals early to inform the development of the FY 2017 Budget, as appropriate, and inform the FY 2016 FedStat process with a meaningful data-driven decision making process that supports each agency's mission.

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

The Administration continues to make significant progress in the effort to minimize the costs and risks associated with agency financial systems modernization. While in the past the use of shared services was limited to smaller agencies, in FY 2015, cabinet-level agencies took steps to realize the benefit of shared service agreements. For example, in the Government's largest shared service arrangement to date, the Department of Housing and Urban Development (HUD) successfully transitioned many of its core financial management functions—as well as select administrative and human-resource functions— to Treasury, with other cabinet-level agencies expected to follow.

In February 2015, OMB commissioned a study to identify possibilities to improve the management of mission support shared services. The study confirmed that to improve performance and efficiency throughout government, reform is required in the way the government delivers and oversees its shared service initiatives. As a result of this study, a new cross-governmental Shared Services Governance Board (SSGB), led by OMB, was established to serve as the decision-making body for the shared services ecosystem. A Unified Shared Services Management (USSM) office was also established within the GSA to serve as an integration body for the ecosystem, working across functions, providers and consumers to enable the delivery of high-quality, high-value shared services. Led by the SSGB and USSM, stakeholders from across the government will work together to manage and oversee mission-support shared services with an initial scope of acquisitions, financial management, human resources, travel and information technology.

In addition, OMB published OMB Memorandum M-15-19, Improving Government Efficiency and Saving Taxpayer Dollars Through Electronic Invoicing, which directs agencies to transition to electronic invoicing for appropriate federal procurements by the end of FY 2018. The Government is the largest single purchaser of goods and services in the United States, processing over 19 million invoices each year. Approximately 40 percent of these invoices are processed using electronic invoicing with the remaining using a mix of electronic and manual processes that provide little visibility to businesses and can result in tax dollars being used for late payment fees rather than to support critical agency missions. The move to electronic invoicing can addresses cash flow issues for businesses, particularly small businesses, while also reducing administrative burden and costs to taxpayers.

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

The federal domestic building inventory is diverse and contains 300,000 buildings requiring approximately $21 billion of annual operation and maintenance expenditures, including approximately $6.8 billion of annual lease costs. Within the inventory, there are opportunities to realize cost savings by utilizing space more efficiently and reducing the portfolio. In 2013, the "Freeze the Footprint" Policy (OMB Management Procedures Memorandum 2013-02) was issued, requiring agencies to freeze their real property footprint. Agencies reduced their federal domestic office and warehouse space by 22 million square feet in FY 2013 and FY 2014. To improve the quality of federal real property data in annual PARs or AFRs, agencies were required to validate and report "Freeze the Footprint" square footage and associated operations and maintenance costs in their 2014 and 2015 financial statements. The final compliance year for the "Freeze the Footprint" policy was FY 2015, and that year's portfolio reduction will be released in April, 2016.

In FY 2015, the Government issued the National Strategy for the Efficient Use of Real Property (Strategy) and implementing policy− the Reduce the Footprint (RTF) policy. The Strategy provides a framework for agencies to measure the efficiency of their real property portfolios to identify and prioritize efficiency actions to reduce portfolio size. The RTF policy requires agencies to set annual portfolio reduction targets to help implement identified efficiency improvements and to implement an office space design standard to ensure office space is designed for efficiency. Over time, the Strategy and RTF policy will improve utilization of government-owned buildings to reduce reliance on leasing, lower the number of excess and underutilized properties, and improve the cost effectiveness and efficiency of the federal real property portfolio.

For the first time, the RTF policy requires that agencies reduce the size of the federal real property portfolios to improve program efficiency, and agencies have developed and finalized their first ever five year RTF reduction Plans to implement the policy. The agencies' RTF Plans target an aggregate reduction of 60 million square feet (SF) over the Plans' five year (FY 2016 – FY 2020) implementation time period. The magnitude of the targeted 60 million square feet reduction indicates the Strategy and RTF policy will be effective tools to improve the efficiency of the government's real property portfolio. Agencies will update their RTF Plans and annual reduction targets in March of each year with the goal of increasing the magnitude of targeted reductions year-over-year as agencies' ability to fully utilize the policies matures. The agencies' FY 2017 – FY 2021 RTF Plans are due in March, 2016.

To support increased reduction targets, the GSA and OMB have developed a new management tool within the Federal Real Property Profile (FRPP) database that enables agencies to fully analyze their portfolios. The new management tool uses the real property performance metrics developed through the President's Management Agenda to measure the performance of agencies' portfolios and thereby enable the identification and prioritization efficiency opportunities. The management tool, combined with the improved FRPP data quality that will result from the implementation of GSA's forthcoming technical guidance that establishes mandatory FRPP data validation and verification requirements, will enhance agencies' ability to implement data driven decision making to develop their annual RTF reduction targets. Focusing policy on reducing the portfolio, improving the quality of FRPP data through mandatory data validation and verification procedures, and the broad use of the new FRPP management tool will support higher RTF square foot reduction targets and efficiency gains in future years.

## Conclusion

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

# Additional Information

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

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

### Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the federal government, and the financial condition and changes in financial condition of its social insurance programs, and the federal government's projected long-term trends in receipts, spending, and debt, pursuant to the requirements of 31 U.S.C. § 331(e)(1). These statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.