Government Financial Reporting in the United States

A foundational paper for high school economics courses
prepared for the Foundation for Teaching Economics

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This paper introduces high school economics teachers and students to government financial reporting in the United States. It lays the basis for classroom exercises and resource guides, but the main goal is to inspire enthusiasm for learning about topics that matter for the rights and responsibilities of citizenship.

Government plays an important role in the US economy, for good or ill -- or both. Government matters directly, through its fiscal and monetary policies, and indirectly, as it frames and regulates behavior in the private sector. Confidence in government matters for overall economic growth, and this confidence depends on the integrity of government financial management. Government financial reporting, when done well, should help to secure that integrity.

In economics, we learn that the macroeconomic output is measured in the equation C+I+G+NX -- consumer spending plus investment spending plus government spending plus exports minus imports. Whether “G” belongs in that equation is a matter of debate, but in 2019, the “G” totalled nearly $3.8 trillion, almost 20% of nominal GDP. Within total government spending, as big as our federal government is, you might be surprised to learn that state and local government spending represents about two-thirds of all government spending, according to GDP data.

Government spending may add to the overall economy, under conventional GDP accounting, but the money spent didn’t come from out of thin air. Americans pay a lot of money for their governments, through income, sales, property, and payroll and other taxes (like those for Social Security and Medicare). Our governments borrow a lot of money, too, and they depend on future taxpayers and citizens whenever they borrow. They also depend on creditors, who are concerned in turn with government fiscal and monetary policies, and the financial condition of the governments they lend money to.

The main financial statements in government are framed, like they are in the private sector, to provide perspective for a “residual claim.” In the private sector, shareholders get what is “left over” -- on the income statement (revenue minus expenses) and the balance sheet (assets less liabilities). Like shareholders in corporations, American taxpayers and citizens have a stake in what is left over. If it is negative, they may have to make up for the difference later.

Citizens deserve reliable accounting for the management of government finances. The government owes it to us, as the consent of the governed lays the foundation for our republic.

This is the first of two papers. It will emphasize the federal government. The second paper will cover state and local governments.

INTRODUCTORY TOPICS

Here are ten fundamental topics laying the groundwork for students learning about government financial reporting in the United States. They are building blocks, and they are more important, not less important, for that reason.

- What's Better, a Dollar Today or a Dollar Tomorrow?
- Three Roles for Money
- What Is a Dollar?
- What is Cash?
- Double-Entry Accounting
- Cash-Based vs. Accrual-Based Accounting
- Basic Financial Statements
- Auditing
- Budgets vs. Financial Statements
- American Government: Constitution, Branches, and Federalism

Vince Lombardi, Hall of Fame coach for the Green Bay Packers, once said "Statistics are for losers." He coached his teams to excel at the basics, like the fundamentals of blocking and tackling. If they excelled at the fundamentals, the statistics would take care of themselves.

In a fun but motivating twist, in finance and accounting, the raw material leading to the statistics are themselves the fundamentals, like blocking and tackling. In finance and accounting, statistics are for winners.

What's Worth More -- a Dollar Today or a Dollar Tomorrow? At first blush, this may sound like a silly question, especially for students new to financial topics. A dollar is a dollar is a dollar, right? Putting aside questions about how well we really know what a "dollar" is (see below), there are important reasons why a dollar tomorrow is not the same thing as a dollar today.

A dollar today is worth more than a dollar tomorrow, with positive interest rates, anyway. The two main reasons why are contained in the ageless saying “A bird in the hand is worth two in the bush.” It takes time to get to the bush, when you could have had a bird in your hand. In turn, by the time you get to the bush, the birds may have flown away. And if a bird in the hand is worth two in the bush, a bird in the bush is worth less than a bird in the hand.

So it goes with dollars. Future dollars aren’t in the hand. If they were in hand today, they could be invested, earning money even at risk-free interest rates. And future dollars promised in contracts (like bonds, pensions, or other financial instruments) are risky – they might “fly away.” For bonds, the risk is that party making that promise can’t (or won’t) make good on their end of the agreement. For stocks, the cash flows upon which their value depends are not a sure thing, either.

So we discount future dollars to present values, in finance and accounting, using discount rates. The fundamentals are captured in the following two basic equations.

Here’s the first one.

$$FV = PV * (1 + r)^t$$

What does that say? Basically, that the future value (FV) of a dollar is equal to the present value (PV) times one plus the interest rate, with (1+r) raised to an exponent (t) based on how long (in years, say) in the future the future value is.

Simply, if I have a dollar that I expect to invest at 5% interest rate for a year, I expect the future value of that dollar to be worth 1 times (1.05) raised to the first power (1), or 1.05.

From the first equation above, we can “solve” for the present value of a dollar, given the future value, using some fundamentals we learn in algebra. How do we solve for the present value, from that equation? *Divide both sides of the equation by* $(1 + r)^t$. Then, $(1 + r)^t$ drops out of the right hand side of the equation, leaving what we want to know, the present value, all by itself. And the equation turns into:

$$PV = \frac{FV}{(1+r)^t}$$

With positive interest rates, and r in the denominator, the present value of a future dollar is, by definition, less than a dollar.

A dollar tomorrow may be worth less than a dollar today, but that doesn't mean it is worth zero today -- either for assets or liabilities. This reminder will become more important when we discuss accounting for Social Security and Medicare, at the federal government level, and pension and retiree health care benefits, for state and local governments.

What interest rate do you use, when discounting the future? That's when we enter some of the more fascinating and important hallways of accounting and finance. We will peek around in some of those hallways later. For now, however, students have been introduced into one of the most fundamental building blocks of all.

The Roles for Money. In economics, students learn about what money is, and what it does. When you start asking simple questions in this area, however, you turn over rocks and see all the scary creatures crawling around underneath, with important implications for finance and accounting.

What is money? A simple question, but a question loaded with implications, and leading to considerable debate. For introductory purposes, it makes sense to take "money" for granted, and in fact, that is what many early economics courses do. One way they do this to define money in terms of what it does, not in terms of what it is.

Students learn that money serves as a medium of exchange, as a store of value, and as a unit of account. As a medium of exchange, "money" is whatever people accept in settling transactions, or in extinguishing debts. In this role, money provides massive social welfare benefits, when it works well, anyway. If I have bricks, and you have flowers, and you don't want bricks, we can still do a deal, if we have money, anyway. Money lifts us up above the world of barter, and opens the possibility for a much wider range of opportunities for value-enhancing trade among individuals and organizations.

Money also serves as a store of value, when it works well, anyway. To be durably attractive as a medium of exchange, people have to trust it, and its value in terms of the goods and services in the economy for which it is used. This helps to illustrate the lesson that the three main roles of money are interdependent – they matter individually, and for each other.

Which brings us to the third main role for money – its role as a "unit of account."

When we walk into a grocery store, there are lots of different things on the shelves. But they all share one thing in common! They have a price, denominated in dollars. We can compare them to each other, and to our wallets, based on that price.

Similarly, when we open an organization's financial statements, there are lots of different line items on those sheets of paper -- different assets, different liabilities, different sources of revenue, different types of expenses. All the line items have different words, with different numbers attached.

But just like the supermarket, all the "shelves" on the financial statement contain items with one thing in common – they are all denominated in dollars, in money. Users of financial statements – investors, creditors, employees, customers, and, in the case of governments, taxpayers and citizens, depend on the ability to add, subtract, divide, different things on the basis of a common denominator, when assessing the performance of an organization.

Some people, this author included, think this "unit of account" role for money is the most significant economic role of all. In terms of its relationship with the other roles for money, what happens to the value of money as a unit of account if money loses value as a store of value, for example, amidst a period of higher inflation? Then you open doors to the worlds of inflation accounting, and (a separate topic) accounting for inflation, introducing fascinating higher-level topics to high school students.

What is a Dollar? Dollars are important. We carry pieces of paper around that say "One Dollar" or "Ten Dollars" and so on. Government financial statements include values that are all denominated in dollars. So we should probably know what a dollar is, right?

The first three elements of the definition of "dollar" in the Oxford English Dictionary include "1) The English name for the German thaler, a large silver coin, of varying value, current in the German states from the sixteenth century … 2) The English name for the peso or piece of eight (i.e. eight reales), formerly current in Spain and the Spanish American colonies, and largely used in the British North American Colonies at the time of their revolt. … 3a) The standard unit of the gold and silver coinage of the United States of America, containing 100 cents."

Here we see a progression of definitions, over time, with important lessons about the fundamental nature of a dollar. We learn, first, that it dates to a German silver coin, and second, to a Spanish coin circulating in the American colonies at the time of the American revolution. Then we learn what many people understand the dollar to be – the

standard unit of money in the United States. But there is a problem in that third definition. In the United States, the dollar is no longer defined as a unit of "gold or silver coinage."

This opens another door, into a hallway to a fascinating room full of mirrors. High school students can be introduced to the history of legal developments framing the definitions of a dollar and money, including topics like the Legal Tender Cases around the time of the Civil War, Franklin Delano Roosevelt's exercise of presidential authority in a banking crisis in 1933, the Gold Reserve Act of 1934, Richard Nixon's proclamation closing the "gold window" in 1971, and the role of the Federal Reserve and its relationship with Congress and the executive branch.

For a provocative and fascinating introduction to the history of the "What is a Dollar" question, see "What is a Dollar?" by Edwin Vieira.

What is Cash? Here is another simple question, like "What is a Dollar?" And another one with weighty and fascinating issues underneath – issues that matter for accounting for the financial condition of the federal government of the United States.

There are three main types of financial statements -- the income statement, the balance sheet, and the statement of cash flows (see "Basic Financial Statements" below). The income statement tracks financial performance over a *period* of time (say, a year), while the balance sheet provides a "snapshot" view of the financial condition of an organization, at a *point* in time (at least in theory).

The balance sheet includes three main sections -- assets, liabilities, and net position. Assets (loosely defined as stuff you own) minus liabilities (loosely defined as stuff you owe) leaves you with the net position (loosely defined as stuff that is left over, after you subtract liabilities from assets).

By convention, the assets are listed on the balance sheet from top to bottom by an ordering determined by their "liquidity." For this purpose, liquidity refers to the ease and/or how fast a given asset can be converted into cash. The items near the top of the balance sheet include accounts receivable and inventory, which aren't cash, but expected to be turned into cash inflows in the near future. Further down the list of assets are longer-term categories like property, plant and equipment, and intangible assets like goodwill.

Cash is at the top of the list for the assets, given that the assets are ordered by liquidity, and cash, by definition, is the measuring stick for liquidity. But what if cash is not

precisely defined? And for that matter, note that “cash” is only shorthand for the top line item -- the standard line item is termed “Cash and Cash Equivalents.”

In accounting, Cash includes two main things -- cash on hand, and cash in a bank. In banking history, including recent banking history, we have received regular lessons that cash on hand and cash in a bank are not the same thing, for example, during bank runs and periods of instability in financial markets.

If “cash” contains two things that aren’t the same thing, and occasionally valued quite differently by depositors, then cash contains two things that aren’t equal to one another. This raises not just philosophical questions whether “cash equivalents” can even exist, if cash isn’t equal to itself. And in the financial crisis of 2007-2009, money market mutual funds -- “liquid” assets normally included in “cash and cash equivalents” -- proved to be subject to runs like bank runs.

Why does this depth matter, for high schoolers learning about government finance? It provides a general lesson that it pays to dig deeper, below accepted conventions, while seeking the truth. But it matters here more directly. Our government has established a variety of insurance-like schemes advertised to stabilize our financial system, and the integrity of cash and cash equivalents. These schemes have exposed the public purse, and taxpayers, to the risk of loss, and accounting and reporting for that risk isn’t easy.

Here’s a brief video providing some wisdom on the matter.

Double-Entry Accounting. For every debit, there is a credit -- and vice versa. So it goes in the methodology of double-entry accounting, a financial management and recording system with sometimes disputed origins. It may have originated in the Roman Empire, or Africa, or both. But the roots really took hold in commercial activity in Italy from 1300 to 1500, with some of the most significant foundations laid in the system meticulously documented by the ‘father of accounting,’ Luca Pacioli, in the late 1400s (see Appendix II).

Raw financial information enters the accounting system through journal entries. Journal entries have at least two line items, and they always have a debit and a credit. The debit is on the left-hand side of the entry, and the credit is on the right-hand side.

Here’s a simple example. A retailer pays a wholesaler $500 in cash for goods the retailer will put on the shelves. The entry is:

Inventory	$500	
Cash		$500

What's going on here? We are about to learn how debits and credits move different types of accounts around. For now, focus on the balance sheet, where both of these accounts reside. The balance sheet includes assets, liabilities, and net position. For the balance sheet, debit entries increase assets and reduce liabilities, and credit entries do the opposite. In the example above, debiting inventory increases the inventory account in the assets, while crediting cash reduces the cash account in the assets. This represents what just happened in that last transaction, where the retailer paid out cash to get inventory in.

Now let's look at a simple entry affecting both the income statement and the balance sheet. This entry will open a door into the next introductory topic -- "Cash-Based vs. Accrual-Based Accounting."

On the income statement, debit entries increase expenses, and credit entries increase revenues. Assume the retailer in the example above actually sold the stuff the retailer bought as inventory, and for $1000. What happens, accounting-wise?

Well, one entry could be:

Cash	$1000	
Sales		$1000

As we learned above, debit entries increase assets on the balance sheet. When the retailer gets cash in the door on the sale, cash goes up, by $1000, as reflected in the debit entry. But on this transaction, we also become interested in the income statement, and credit Sales revenue for $1000.

In both of the journal entries above, the debits equal the credits, And throughout the accounting cycle, as journal entries accumulate, one check on the integrity of the information is that the total debits must always equal the total credits.

Have we fully reflected the impact of the sale of inventory on our retailer in that second entry, however? Not yet -- we accounted for the revenue, but that cash didn't just come

from nowhere -- it was “earned” only with the aid of an expense that must be recognized. That arrives in the second entry required for that sale transaction:

Cost of Goods Sold	$500	
Inventory		$500

What just happened? We recognized an expense - Cost of Goods Sold (COGS) - by debiting COGS for the $500 the retailer paid for the goods. Debit entries increase expenses, as noted above, on the income statement. And for this second entry, we credited (reduced) the inventory asset on the balance sheet at the amount we paid for it, the “cost of goods sold.”

This is a simple introduction to the world of debits and credits. Students who take accounting courses will go on to learn in depth about how debits and credits move all the financial statement accounts around, and in all their glory. For our purposes here, we can now introduce the next introductory topic -- a critical one for understanding accounting in general, and government financial reporting in particular.

Cash-Based vs. Accrual-Based Accounting. Understanding that cash itself is not so simple, it still makes sense to do a careful job tracking the flow and amount of cash in any organization. That helps explain why the statement of cash flows is the third basic financial statement (see below).

But cash flow and overall economic performance are two different things. Cash flow can go up when economic performance is going down, and vice versa. That’s why, centuries ago, accounting leaders develop “accrual-based” accounting, based on “double-entry” methods (see below) to provide a better picture of organizational performance and financial integrity.

Cash-based accounting tracks inflows as they arrive, but accrual-based measures recognize “revenue” not when cash arrives, but when it is *earned*. In turn, cash may flow out of an organization before (or after) and expense is *incurred*.

Assume the retailer above sold the inventory to a customer, and delivered it to their house. But the retailer made the sale on credit, not for cash, accepting the promise of payment in 30 days as consideration. Under accrual accounting, which the accounting world has long stressed does a better job of capturing the economic significance of

accounting events, the sale would be recognized as revenue when it was earned, before the cash came into the door.

At the time the retailer above made the sale and delivered the goods, the two entries would be:

Accounts Receivable	$1000	
Sales		$1000

Cost of Goods Sold	$500	
Inventory		$500

The only difference from the two entries above, in this case, is that when we sell on credit, we first debit Accounts Receivable, not Cash, for the sale. And to emphasize that we are practicing accrual-based, not cash-based, accounting, note that we have recognized revenue (Sales) when it is earned, and we have recognized expense (COGS) when it is incurred -- not when the cash changes hands.

When that day comes for this sale, the simple final entry is:

Cash	$1000	
Accounts Receivable		$1000

The distinction between cash-based and accrual-based accounting critically matters for understanding government accounting and financial reporting. Budgets tend to be more closely grounded in cash-based accounting methods, while financial reports tend to be more closely grounded in accrual-based methods. Cash-based methods have arguably enabled governments to issue “balanced” budget reports -- and surrounding rhetoric of fiscal responsibility -- at odds with what good accrual accounting would have indicated.

Basic Financial Statements. The income statement and the balance sheet have long been considered the main financial statements. There are private sector versions and

governmental versions of each of these statements. We will dive deeper into the similarities (and differences) between those versions later, along with how they relate to financial reports used in budgeting. For now, let's start at square one.

The income statement and the balance sheet are each prepared after the end of a fiscal interval, such as a fiscal year, and present the results and condition, respectively, as of the end of that period. The income statement illustrates performance over that period of time, and the balance illustrates the financial position at a point in time -- the end of that interval. The balance sheet is a snapshot, in theory, while the income statement is more of a video.

Both the income statement and the balance sheet have three main elements. They are both presented in an "A minus B equals C" framework, leading to a bottom-line residual that matters for the parties to whom the organization or government owes their most fundamental duties.

In the income statement, Revenue less Expenses equals Net Income. The revenues generated less the expenses incurred yield a residual, and what is left over (which may be positive or negative) belongs to the shareholders.

Similarly, for the balance sheet, Assets less Liabilities equals Equity (for corporations, anyway). The organization's assets are for the shareholders, but so are the liabilities. If the organization is liquidated, the assets are sold, the liabilities paid with those proceeds, and any remaining assets belong to the shareholders. Equity is a "residual claim."

Note that corporate shareholders are shielded if assets aren't sufficient to pay liabilities, by the legal concept of "limited liability." Shareholder exposure is limited to the amount of their investment, and creditors unsatisfied by liquidated assets may not legally pursue other assets of the shareholders. Government entities don't have shareholders, but that doesn't mean they don't have a residual claim.

For state and local governments, the income statement is known as the "Statement of Activities," and the balance sheet is known as the "Statement of Net Position." The federal government has its own versions of income statements and balance sheets. These statements are similar to those at the corporate level, and lead to a "what's left over" result that matters for citizens and taxpayers.

Auditing. Accounting and auditing are two peas in the pod of financial reporting. Accountants do auditing, and auditors do accounting, but they also do different things.

Here is a simple way to introduce the difference -- accountants are the players, and auditors are the referees.

Accountants track, analyze and report financial transactions, leading to the development of financial statements based on a system of accounting standards. Auditors independently analyze that work. Internal auditors reporting to management do so within an organization, while external auditors may be retained by management do so "independently," from "outside" the organization.

External auditors collect and evaluate supporting material in order to render an opinion on management's financial statements. An important opinion relates to whether those statements fairly present the financial results, in accordance with "GAAP" -- generally accepted accounting principles.

For private corporations, GAAP resides in standards issued by the Financial Accounting Standards Board (FASB). For state and local governments, GAAP resides in standards issued by the Governmental Accounting Standards Board (GASB). For the federal government, GAAP resides in standards issued by the Federal Accounting Standards Board (FASAB).

We are going to learn more about these different sources of accounting principles, and the differences between their views about what should or shouldn't be "generally accepted." For introductory purposes, note that important differences exist, and lead to sometimes dramatically different pictures of "reality."

Budgets vs. Financial Statements. Governments develop and report budgets, as well as financial statements. Budgets tend to get a lot more coverage in the media, but the financial statements in end-of-year financial reports deserve at least as much attention.

Budgets are important financial reports themselves. They provide an important planning and management control tool, at least in theory. And in governments, they are developed under legal directives implementing government appropriations, another key to securing government accountability.

But budgets are prospective, looking-forward exercises. Financial statements are developed after the period for which budgets relate. "There are words, and there are deeds" the saying goes. That's a good way to distinguish budgets from financial reports.

Another important difference has to do with the basis of accounting. In governments, budgets are more closely framed and communicated on cash-based accounting

principles, while end-of-period financial statements are more closely grounded in relatively truthful accrual-based principles.

The cash-basis principles in government budgeting fall short of depicting financial and economic reality in some important ways (see below), which helps explain how financial statements can put government leaders' claims of living up to "balanced-budget" requirements to the test.

American Government: The Constitution, Branches, and Federalism. The Constitution of the United States of America provides us with a republican form of government. We have three main branches of government -- legislative, executive, and judicial. We also have a federal system, with authority residing in federal as well as state governments. But the system is based on republican principles.

In a "republic," the supreme power (or "sovereignty") resides in the people -- not in a monarch. The government serves the people, not the other way around. In a list of ten fundamental principles for a high school course on government financial reporting, this may be the most fundamental principle of all.

The Constitution introduces itself with a statement of intent, in the Preamble. The Preamble reads:

> **We the People** of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

The bold text in the first three words is no accident. In the original Constitution document, those three words are bolded, and the letters that are about five times as large as the text in the rest of the preamble.

Consider in turn the earlier Declaration of Independence, inspiring a revolution motivated by a quest for government based on republican principles.

> "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.--That to secure these rights,

> Governments are instituted among Men, deriving their just powers from the consent of the governed, --That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such principles and organizing its powers in such form, as to them shall seem most likely to effect their Safety and Happiness."

Our government may work for us, but that doesn't mean it isn't powerful. Our constitutional framework, and laws passed underneath it, have granted government powers like the power to tax, to borrow money, and to "coin money, and regulate the value thereof."

Why should our federal, state and local governments prepare and present financial statements? Under the federal constitution, and the 50 state constitutions, governments pursue a wide range of policies. To do so, they spend a lot of money. They run a public purse, and owe the people an accounting for how that purse is managed.

For the federal government, the spending authority, or power of the purse, is vested in the Congress of the United States. The executive branch, under the President, executes the law. But Article I of the U.S. Constitution comes first, after the Preamble. Article I articulates the legislative powers, vesting them in Congress. And Article I, Section 9 includes the following fundamental principle -- the "Statement and Account Clause."

> "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time."

How well has the federal government lived up to this constitutional principle? How well have the state and the city governments discharged similar duties for their citizens and taxpayers? If the consent of the governed should be treated with respect, a basic awareness and understanding of government accounting is required to pursue these questions -- a quest arguably at the root of citizenship.

Financial Reporting by the US Federal Government

The federal government produces an annual budget, as well as an annual financial report that includes financial statements.

The Federal Budget. As introduced above, budgets annually "set the table," establishing goals, mandates and controls for a) how much money will be spent, b) what the money will be spent on, and c) how to get the money in the door.

The modern budget process was framed in the Congressional Budget Act of 1974. Congress retains the fundamental power of the purse, but this law -- passed by Congress and signed by President Gerald Ford -- deals the cards to the President, first, in the annual budget process.

Early in the calendar year, every year, the President develops a budget request, after canvassing all the departments in the executive branch, and submits that request to Congress. The budget is for the next fiscal year, which begins October 1, after the end of the fiscal year (which ends on September 30).

Federal spending covered by the budget has been placed in two main categories -- "mandatory" and "discretionary." Mandatory spending arises under federal programs driven by statutory commitments, not annual deliberations, including spending for Social Security, Medicare, Medicaid, federal employee retirement benefits, and interest on the national debt. The President's budget may make recommendations for policy changes for these programs, but spending for them is included as estimated to be required by existing law.

On the other side of the coin, the budget also includes "discretionary" spending. Money for these programs must be determined annually, and developed in formal appropriations bills. A wide variety of programs are included in this section of the budget, including defense spending.

In developing the budget report, the executive branch can play a leadership role in government fiscal policy, depending on the individual administration and the Congress then in place. But under the law, this step in the budget process is best called a request, not a directive, especially as it relates to discretionary programs. In the next step in the process, Congress will typically hold hearings relating to executive branch requests, and then develop the "Congressional Budget Resolution."

The formal legwork leading to the Congressional Budget Resolution is undertaken in the House and Senate Budget Committees, which develop their own versions and send them to the House and Senate floors, respectively, for a vote (after any amendments take place). From there, any differences in the House and Senate versions are

hammered out in a joint “conference committee,” which returns a common bill voted on in both the House and Senate.

This budget resolution is not a formal bill, however, and does not require a Presidential signature. As a result, it does directly establish spending or tax law. It is much simpler than the detailed President’s budget, and sets total spending goals in about 20 budget functions, together with expectations for revenue, leading to an estimated deficit (or surplus) projections for each of the next ten years. Spending is reported both for budget “authority” and for “outlays;” the former is what Congress plans to authorize, and the latter is for what Congress believes will actually be spent.

Once this “budget resolution” is adopted, the nitty-gritty follows, which involves enacting actual budget legislation. Appropriations bills are developed to fund discretionary programs annually, to change revenue laws, and to make any changes to “mandatory” programs underneath the goals set in the budget resolution. These appropriations bills are the formal laws determining government spending, and they must be signed by the President, like other bills, in order to become law.

Individual appropriations bills set authorities and limits on spending, but Congress has also passed overarching constraints on total spending contemplated in the budget, including deficit control and debt ceiling laws. Violation of those laws can lead to “sequestration” (across-the-board) cuts in spending, and even government shutdowns.

The debt ceiling dates to World War I, when Congress first issued overall limits on debt issued by the Treasury. Interestingly, the motivation was to afford more flexibility for borrowing in a time of war, as the new law replaced existing requirements to manage and alter specific borrowings individually. As time and experience have shown, the debt ceiling matters unless it doesn’t matter, as Congress and the President regularly raise it whenever it threatens to become binding. The ceiling has been raised 20 times since the mid-1990s. It is worth noting, in turn, that the debt ceiling does not apply to all government “debt.” Today, the debt ceiling doesn’t even exist, formally, as it has been suspended through mid-2021.

Those are the main elements of the federal budget process. Three important reports for that process are a) the President’s budget, b) the annual analysis of the President’s budget by the Congressional Budget Office (CBO), and c) the Financial Report of the U.S. Government.

Here’s a link to the most recent President’s budget.

Here's a link to the most recent CBO analysis of the President's budget.

Here's a link to the most recent annual Financial Report of the U.S. Government.

Note the time frames for which those three reports apply. The latest President's budget is for fiscal year 2021, which begins October 1, 2020 -- about six months from now. And it was developed before the coronavirus pandemic, with its massive fiscal consequences. The latest CBO analysis is an analysis for that budget. But the latest Financial Report of the U.S. Government is a report for fiscal year 2019, a year that *ended* about seven months ago.

The Financial Report of the U.S. Government. As noted above, there are words and there are deeds. Budgets are prospective planning and control documents, and tend to be based on cash-basis, not accrual-basis, accounting methods. The proof is in the pudding, and it pays to watch results indicated by the Financial Report of the US Government.

Those reported results are not perfect themselves, but deserve at least as much attention as the budget process receives. Unfortunately, the budget process gets the ink and attention, while the results tend to be widely ignored.

The federal government issued the latest audited financial report in early March, 2020. The following day, one major national newspaper had prominent stories about the coronavirus, an IPO for DoorDash, parallel parking, the NFL's likely #1 draft pick, the sale of an elevator business, research about the inflation rate, swarms of locusts in Africa and the Middle East, cellphone data handling, the resignation of the CEO of Harley Davidson, and leap year babies. And nothing -- zero -- about the annual financial report.

Sadly, this may be a symptom of unsustainable special-interest-driven demands on the public purse. Budgets get more attention, because the people who care the most care about government spending because they have a stake in it. Most people don't care about the results, and what is left over (or behind), as indicated in the audited financial statements.

One fundamental difference between budgets and financial statements is that the latter are audited. For the federal government, the financial statements are audited by the U.S. Government Accountability Office (GAO), the audit arm of Congress. As in the private sector, there are a few different type of audit opinions that can be delivered. They include an “unmodified” (clean) opinion, a “modified” opinion, an “adverse” (flunk) opinion, and a “disclaimer” (another flunk-like) opinion.

Which of these opinions is the worst kind of opinion? You can make an argument that an adverse opinion, where the auditor declaratively delivers an opinion that the statements do not fairly represent the financial condition of the entity, and/or are not prepared consistent with generally accepted accounting principles, is the worst type of opinion. But a case can also be made for a “disclaimer” opinion, where the auditor shrugs their shoulders, citing how unreliable source material and accounting systems undermine the ability to even deliver an opinion at all.

With that by way of background, what opinion do you think the GAO delivers on the financial statements of the U.S. Government? Every year since 1998, under the modern reporting framework, the GAO has delivered a *disclaimer of opinion* on the financial statements. In other words, the financial statements in the document we are about to learn about and explore has effectively been deemed unreliable by the auditor -- every year for more than 20 years. Here’s a link to the latest letter from the Comptroller General of the United States, summarizing the results of the latest audit, which we will review a little more thoroughly below.

For the financial results, we have to make do with what we have, however. So let’s get started.

Before reviewing the government’s own explanation of the results, it makes sense to introduce the main financial statements on which that discussion is based. The financial statements we will discuss are:

1) Statement of Net Cost
2) Statement of Operations and Changes in Net Position
3) Reconciliation of Net Operating Cost and Budget Deficit
4) Balance Sheet
5) Statements Social Insurance

Statement of Net Cost. In this statement, costs are accumulated, reported and totalled for more than 40 agencies and other line items. The total (gross) cost for each line item is adjusted (reduced) by revenues earned when that entity charges for its services, leading to a subtotal. Then, the subtotal is adjusted (up or down) resulting from changes in accounting assumptions, leading to a net cost. That net cost becomes central for the next financial statement, the Statement of Operations and Changes in Net Position -- the federal government's version of an income statement.

In 2019, the federal government reported roughly $5.1 trillion in total net cost. Back in 2000, the government reported $2 trillion in net cost, and the increase in net cost (155%) far exceeded nominal GDP growth (109%) in that time frame.

The four agencies costing the most in 2019 were, in order, the Department of Health and Human Services, the Social Security Administration, the Department of Defense, and the Department of Veterans Affairs. These four entities accounted for more than two-thirds of the net cost reported by the entire federal government. While the Department of Defense did not lead the list, it bears noting that the separately-identified Department of Veterans Affairs came in fourth. Combining those two entities, "defense spending" would be at the top of the list.

The fifth largest line item for those 40+ items for net cost is not an agency -- it is titled "Interest on Treasury Securities Held By The Public." At roughly $400 billion in 2019, interest on Treasuries has risen about 75% since 2000. This is a lot slower than overall net cost, but the increase deserves to be viewed -- perhaps with alarm -- in light a historic decline in interest rates over that time frame. Under current law and policy, implied future deficit and debt levels are projected to lead to mushrooming future interest expense. Those large increases are so large as to be called "unsustainable" in related discussion in the report, a topic to be discussed below.

Here's a look at the Statement of Net Cost in the latest annual report:

United States Government
Statement of Net Cost
for the Year Ended September 30, 2019

(In billions of dollars)	Gross Cost	Earned Revenue	Subtotal	(Gain)/Loss from Changes in Assumptions	Net Cost
Department of Health and Human Services	1,341.4	119.1	1,222.3	-	1,222.3
Social Security Administration	1,101.2	0.3	1,100.9	-	1,100.9
Department of Defense	813.6	44.2	769.4	139.0	908.4
Department of Veterans Affairs	364.7	5.1	359.6	58.0	417.6
Interest on Treasury Securities Held by the Public	403.6	-	403.6	-	403.6
Department of the Treasury	181.0	25.3	155.7	-	155.7
Department of Agriculture	149.1	8.3	140.8	-	140.8
Department of Education	153.9	31.9	122.0	-	122.0
Office of Personnel Management	118.5	24.1	94.4	0.3	94.7
Department of Transportation	82.2	1.1	81.1	-	81.1
Department of Homeland Security	77.0	14.0	63.0	0.9	63.9
Department of Energy	59.3	5.7	53.6	-	53.6
Department of Labor	40.5	-	40.5	-	40.5
Security Assistance Accounts	38.6	-	38.6	-	38.6
Department of Justice	40.8	3.5	37.3	-	37.3
Department of State	33.9	4.6	29.3	0.7	30.0
Department of Housing and Urban Development	29.6	1.8	27.8	-	27.8
National Aeronautics and Space Administration	21.0	0.2	20.8	-	20.8
Department of the Interior	21.1	2.6	18.5	-	18.5
U.S. Agency for International Development	12.2	0.1	12.1	-	12.1
Railroad Retirement Board	12.1	-	12.1	-	12.1
Federal Communication Commission	11.2	0.4	10.8	-	10.8
Department of Commerce	13.8	3.6	10.2	-	10.2
Environmental Protection Agency	8.8	0.3	8.5	-	8.5
Pension Benefit Guaranty Corporation	35.7	27.8	7.9	-	7.9
National Science Foundation	7.3	-	7.3	-	7.3
U.S. Postal Service	77.5	70.2	7.3	-	7.3
Smithsonian Institution	1.5	0.4	1.1	-	1.1
Millennium Challenge Corporation	0.5	-	0.5	-	0.5
National Credit Union Administration	0.4	0.2	0.2	-	0.2
U.S. Nuclear Regulatory Commission	0.8	0.7	0.1	-	0.1
Farm Credit System Insurance Corporation	0.1	0.2	(0.1)	-	(0.1)
Small Business Administration	0.3	0.4	(0.1)	-	(0.1)
Overseas Private Investment Corporation	(0.2)	0.1	(0.3)	-	(0.3)
Securities and Exchange Commission	1.8	2.1	(0.3)	-	(0.3)
National Railroad Retirement Investment Trust	0.1	0.7	(0.6)	-	(0.6)
Export-Import Bank of the U.S.	(0.1)	0.5	(0.6)	-	(0.6)
General Services Administration	0.1	0.8	(0.7)	-	(0.7)
Tennessee Valley Authority	9.9	11.3	(1.4)	-	(1.4)
Federal Deposit Insurance Corporation	0.4	5.0	(4.6)	-	(4.6)
All other entities	22.0	1.8	20.2	-	20.2
Total	5,287.2	418.4	4,868.8	198.9	5,067.7

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

Statement of Operations and Changes in Net Position. The Statement of Net Cost leads the federal government's basic overall income statement, the Statement of Operations and Changes in Net Position. This statement begins, like it does with private sector income statements, with various sources of revenue. Those sources include "Individual income tax and tax withholdings," "Corporate income taxes," "Excise taxes," "Unemployment taxes," "Customs duties," "Estate and gift taxes," and some other line items.

Individual income tax and tax withholdings are by far the largest source(s) of revenue, and they are split into two categories -- Funds from Other Than Dedicated Collections (regular individual income taxes), and Funds from Dedicated Collections (payroll taxes for Social Security and Medicare). In 2019, corporate income tax revenue amounted to $323, billion far below the $2.9 trillion reported for revenue from total individual income tax and tax withholdings.

Below this revenue section the Statement of Operations and Changes in Net Position reports the "Net Cost of Government Operations," based most importantly on the Statement of Net Cost introduced above. In 2019, the net cost of federal government operations totalled $5.1 trillion, which this statement then subtracts from total revenue ($3.6 trillion) to lead to a "bottom line" titled "Net operating (cost)/revenue" at ($1.445 trillion) -- and the parentheses mean that cost exceeded revenue, leading to a nearly $1.5 trillion shortfall in fiscal (September) 2019 -- before the coranavirus even hit the US economy, and federal government finances.

There is another bottom line below that "Net operating (cost)/revenue" bottom line in this statement, however. That is in a section that explains the change in net position (a balance sheet item) from the beginning of the year to the end. If positive, the "Net operating (cost)/revenue" amount leads to a higher (improved) net position. In 2019, we see that nearly $1.5 trillion net operating cost lead to a significant decline in the federal government's reported net position.

We will soon look at the Statements of Social Insurance, however, and introduce how the federal government's reported net position can significantly overstate its true net position.

Here's a look at the latest Statement of Operations and Changes in Net Position.

United States Government
Statement of Operations and Changes in Net Position
for the Year Ended September 30, 2019

(In billions of dollars)	Funds other than those from Dedicated Collections (Combined)	Funds from Dedicated Collections (Note 20) (Combined)	Eliminations	Consolidated
		2019		
Revenue (Note 17):				
Individual income tax and tax withholdings	1,687.6	1,218.6	-	2,906.2
Corporate income taxes	322.5	-	-	322.5
Excise taxes	42.1	60.7	-	102.8
Unemployment taxes	-	39.4	-	39.4
Customs duties	72.6	0.1	-	72.7
Estate and gift taxes	16.7	-	-	16.7
Other taxes and receipts	102.4	42.9	-	145.3
Miscellaneous earned revenues	12.0	3.4	-	15.4
Intragovernmental interest	-	95.5	(95.5)	-
Total Revenue	2,255.9	1,460.6	(95.5)	3,621.0
Net Cost of Government Operations:				
Net cost	3,237.5	1,830.2	-	5,067.7
Intragovernmental interest	95.5	-	(95.5)	-
Total net cost	3,333.0	1,830.2	(95.5)	5,067.7
Intragovernmental transfers	(406.0)	406.0	-	-
Unmatched transactions and balances (Note 1.R)	1.6	-	-	1.6
Net operating (cost)/revenue	(1,481.5)	36.4	-	(1,445.1)
Net position, beginning of period	(25,001.4)	3,480.7	-	(21,520.7)
Adjustments to beginning net position (Note 1.S)	13.0	-	-	13.0
Net operating (cost)/revenue	(1,481.5)	36.4	-	(1,445.1)
Net position, end of period	(26,469.9)	3,517.1	-	(22,952.8)

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

Reconciliation of Net Operating Cost and Budget Deficit. This next statement helps us understand the differences between budgets and financial statements, and the different accounting principles on which they are based.

Newly-elected President Donald Trump proposed his first budget, for FY 2018, in February 2017. The CBO analysis of the proposal indicated it would entail $4.1 trillion in outlays funded (in part) with $3.7 trillion in revenue, under budget accounting, leading to

a $440 billion deficit. The CBO analysis was reported in July 2017, before the FY 2018 started (on October 1, 2017).

The Congressional budget resolution (see budget discussion above) didn't arrive until *after* the fiscal year had actually started, however. Senate debate on the budget didn't begin until mid-October 2017. The government operated under a series of special resolutions, until it didn't, anyway, when the failure to pass one of them led to a government shutdown in early 2018, in the middle of the fiscal year for which the budget applied.

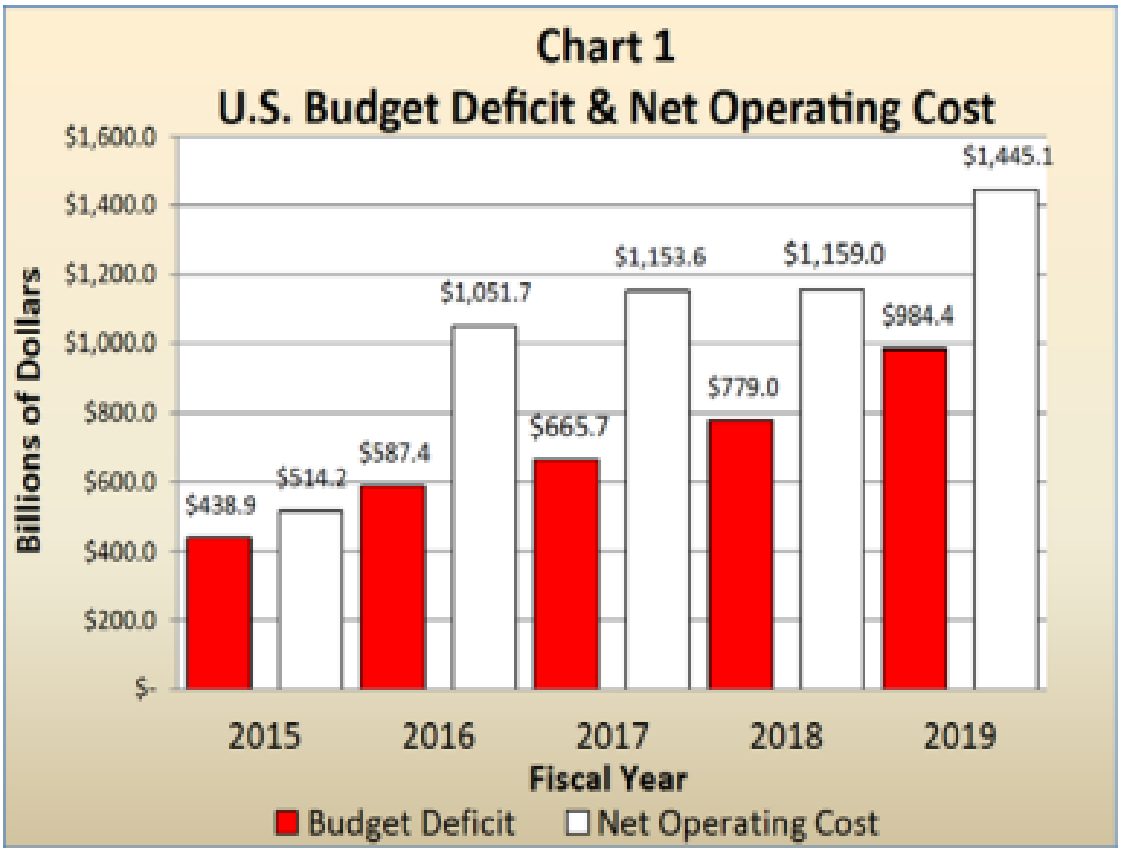
The final appropriations bill for that FY 2018 budget arrived in March 2018, well after the Congress passed (and the President signed) the Tax Cuts and Jobs Act in late 2017. This law coupled with other forces to lead to a significantly higher budget deficit than anticipated in the 2017 CBO budget analysis. When the final accounting arrived, the budget deficit for FY 2018 came in at $779 billion, compared to the $440 billion anticipated in the CBO analysis.

Herein lies a lesson to remember, both for the federal and state and local governments. Budgets are established before (and sometimes, during) the year to which they relate, and that year can unfold in ways at odds with budget expectations. External effects that governments are not directly responsible for can change outlays and revenues in unanticipated ways, and governments may not themselves behave in ways implied by the budgets they present before the people.

If the final tally for the FY 2018 budget deficit came to $779 billion, how could the government also have reported net operating cost (revenue less costs) of $1.159 trillion, nearly $400 billion higher than the "final" budget deficit? Similarly, how could the final tally for the FY 2019 budget deficit have come in at $984 billion, compared to reported net operating cost of $1.445 trillion for that year?

The answer lies in the statement called Reconciliation of Net Operating Cost and Budget Deficit. The net operating cost is based not simply on the cash outlays and inflows counted in budget accounting, but on theoretically more meaningful accrual-based accounting concepts. The Reconciliation statement accounts for those differences, and reconciles the two numbers. In recent years, the "more truthful" net operating cost has been significantly higher (worse) than the budget deficits.

This background helps a reader understand Chart 1 in the Executive Summary to the 2019 Financial Report of the U.S. Government, found on page 2 of that 270 page report.



Both the budget deficit and net operating cost “rose” significantly from 2015 to 2019, with significantly higher net operating cost than budget deficit every year, implying deterioration in the federal government’s overall financial position.

Here’s a look at the latest Reconciliation of Net Operating Cost and Budget Deficit.

United States Government
Reconciliations of Net Operating Cost and Budget Deficit
for the Years Ended September 30, 2019, and 2018

(In billions of dollars)	2019	Restated 2018
Net operating cost	(1,445.1)	(1,159.0)
Components of net operating cost not part of the budget deficit		
Excess of accrual-basis expenses over budget outlays		
* Federal employee and veteran benefits payable		
Pension and accrued benefits	183.1	88.4
Veterans compensation and burial benefits	173.5	146.3
Post-retirement health and accrued benefits	55.0	33.0
Other benefits	46.4	14.5
Subtotal - federal employee and veteran benefits payable	458.0	282.2
* Insurance and guarantee program liabilities	24.3	(32.3)
* Environmental and disposal liabilities	18.1	112.8
* Accounts payable	11.3	15.9
* Benefits due and payable	12.5	(7.7)
* Other liabilities	31.4	5.8
Subtotal - excess of accrual-basis expenses over budget outlays	555.6	376.7
Amortized expenses not included in budget outlays		
Property, plant, and equipment depreciation expense	88.4	72.7
Other expenses that are not reported as budget outlays		
Property, plant, and equipment disposals and revaluations	(38.8)	(4.0)
Excess of accrual-basis revenue over budget receipts		
Accounts receivable, net	(4.0)	6.2
Taxes receivable, net	(89.1)	(7.8)
Other losses/(gains) and cost/(revenue) that are not budget receipts		
* Investments in government-sponsored enterprises	1.1	(20.6)
Subtotal - components of net operating cost not part of budget deficit	513.2	423.2
Components of the budget deficit that are not part of net operating cost		
Budget receipts not included in net operating cost		
Credit reform and other loan activities	45.3	5.0
Budget outlays not included in net operating cost		
Acquisition of capital assets	(66.0)	(72.2)
* Debt and equity securities	(6.1)	4.0
* Inventories and related property	(18.2)	(10.8)
* Other assets	1.2	35.9
Subtotal - components of the budget deficit that are not part of net operating cost	(43.8)	(38.1)
Adjustments to beginning net position	13.0	0.1
Other		
All other reconciling items	(21.7)	(5.2)
Budget deficit	(984.4)	(779.0)

* The amounts represent the year over year net change in the Balance Sheet line items.

Balance Sheet. Now we move away from the “period of time” / income statement-like perspective for the first three statements we discussed, to a “point in time” / financial position perspective. The first of these statements is the balance sheet.

The federal government of the United States may be the largest and most complicated financial organization in world history, but it reports an amazingly short and simple balance sheet -- perhaps a little too short and simple. There are assets, liabilities, and net position categories. There are eight categories of assets, eight categories of

liabilities, and two components to the net position -- the “residual claim.” The whole statement, presented for the end of the latest and just-prior fiscal years, takes up a little more than half a page in the report.

It may be a short and simple statement, but it reports lots and lots of debt -- and a lot more debt than assets. In turn, it may report lots and lots of debt, but it may be too short and simple -- because it arguably fails to exclude some of the largest debts of all.

In FY 2019, the federal government reported $4.0 trillion in total assets. The largest of the eight components was $1.4 trillion in “Loans receivable, net” -- primarily student loans. The rapid growth and accounting for this asset over the past decade is a matter of debate, with more than a few observers questioning the optimistic assumptions for the value of this asset to the government. But even so, that $4.0 trillion in assets is swamped by the $26.9 trillion in liabilities reported by the federal government, leading to a net position of (negative) $23 trillion.

What do those $27 trillion in liabilities include? Treasury debt securities held by “the public” account for nearly two-thirds of them. During and after the financial crisis of 2007-2009, Treasury borrowing accelerated, and nearly $17 trillion in Treasury debt was reported in liabilities in 2019. The second largest category is also massive -- “Federal employee and veteran benefits payable,” with $8.4 trillion in debt owed for government employee and veteran retirement pension, medical care and other benefits.

Here’s a look at the latest balance sheet:

United States Government
Balance Sheets
as of September 30, 2019, and 2018

(In billions of dollars)	2019	Restated 2018
Assets:		
Cash and other monetary assets (Note 2)	524.6	507.5
Accounts and taxes receivable, net (Note 3)	238.0	144.9
Loans receivable, net (Note 4)	1,425.8	1,419.1
Inventories and related property, net (Note 5)	365.7	337.5
Property, plant and equipment, net (Note 6)	1,106.9	1,090.5
Debt and equity securities (Note 7)	118.3	112.2
Investments in government-sponsored enterprises (Note 8)	112.1	113.2
Other assets (Note 9)	110.6	111.8
Total assets	3,992.0	3,836.7
Stewardship land and heritage assets (Note 24)		
Liabilities:		
Accounts payable (Note 10)	98.0	86.7
Federal debt securities held by the public and accrued interest (Note 11)	16,861.0	15,812.7
Federal employee and veteran benefits payable (Note 12)	8,440.3	7,982.3
Environmental and disposal liabilities (Note 13)	595.4	577.3
Benefits due and payable (Note 14)	223.6	211.1
Insurance and guarantee program liabilities (Note 15)	194.5	170.2
Loan guarantee liabilities (Note 4)	21.7	38.2
Other liabilities (Note 16)	510.3	478.9
Total liabilities	26,944.8	25,357.4
Contingencies (Note 18) and Commitments (Note 19)		
Net Position:		
Funds from Dedicated Collections (Note 20)	3,517.1	3,480.7
Funds other than those from Dedicated Collections	(26,469.9)	(25,001.4)
Total net position	(22,952.8)	(21,520.7)
Total liabilities and net position	3,992.0	3,836.7

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

The “Federal Employee and Veteran Benefits Payable” amount is the present value of future benefits like pension and health care services promised to government employees. A little further down, you also see a line item titled “Benefits Due and Payable.” At “only” $224 billion, this line item amounts to less than 3% of the “Federal Employee and Veteran Benefits Payable.” The content of the much-smaller “Benefits Due and Payable” is disclosed in footnote 14 to the financial statements, reproduced below:

Note 14. Benefits Due and Payable

Benefits Due and Payable as of September 30, 2019, and 2018

(In billions of dollars)	2019	2018
Federal Old-Age and Survivors Insurance	79.8	75.1
Grants to States for Medicaid	37.1	35.6
Federal Supplementary Medical Insurance (Medicare Parts B and D)	37.1	30.7
Federal Hospital Insurance (Medicare Part A)	34.4	31.5
Federal Disability Insurance	22.4	24.6
All other benefits programs	12.8	13.6
Total benefits due and payable	223.6	211.1

Benefits due and payable are amounts owed to program recipients or medical service providers as of September 30 that have not been paid. Most of the benefits due and payable relate to programs administered by HHS and SSA. For a description of the programs, see Note 22—Social Insurance and the unaudited RSI—Social Insurance section.

The biggest line item within those “Benefits Due and Payable” relate to “Federal Old-Age and Survivors Insurance” -- Social Security, which also includes the “Federal Disability Insurance total of $22 billion above. With debt of only about $100 billion, you might be asking how such a huge program like Social Security is so tiny compared to the liabilities the government reports for retirement benefits for its own workers.

Some of the disturbing answers lie in the Statements of Social Insurance. The present value amounts in these statements are “owed” in Social Security and Medicare, and they massively exceed the $8.4 trillion in Federal Employee and Veteran Benefits Payable. But they are not included as debts on the federal government’s balance sheet, under the stated reasoning that the government controls the law, and can change the law at any time.

Yes, government makes law, and can change the law. But a strong argument can be made that as long as current law leads to massive shortfalls in the financial positions for Social Security and Medicare, the present value of those unfunded obligations should be on the balance sheet until the law is changed.

Statements of Social Insurance. This statement provides a balance sheet-like “point in time” perspective for understanding the financial position for Social Security and Medicare, two of the largest programs in the federal government. Two of the topics in the introductory section of this paper -- “What’s Worth More, a Dollar Today or a Dollar

Tomorrow?" and "Cash-Based vs. Accrual-Based Accounting" -- help in understanding these statements, and their implications for the government's overall financial position.

The top section of this statement is for Social Security (the formal name is "Federal Old-Age, Survivors and Disability Insurance. It reports amounts for each of the last five years for three groups of "participants" -- those that have reached eligibility age (retired people), those who haven't reached eligibility age (working people), and future participants (the young and the unborn). Within this top section, you see rows divided into two main parts -- revenue and expenditures. The revenue relates to payroll taxes deducted from paychecks, and the expenditures to payments.

How does the government come up with those numbers? After a lot of hard work projecting future cash flows based on assumptions about demographic trends and economic growth, the government discounts those cash flows (projected over 75 years) to their present value, which we have learned is important in financial valuations. Those cash flows are discounted for revenue as well as expenditures, and for all three different groups, leading to the total present value for total revenue and total expenditures. Revenue and expenditure present value totals are netted (revenue less expenditures), leading to a net present value for all three groups as well as Social Security as a whole.

In 2019, the present value of Social Security expenditures came to $87.2 trillion, much higher than the estimated present value of revenue ($70.4 trillion), leading to a gaping $16.8 trillion negative net present value position for the program. Looking across the table, you can see that the net position deteriorated steadily over those five years. A valuable (and alarming) exercise for students asks them to compare the net position for current vs. future participants, and consider what that means for their future.

Below the Social Security section, you see three sections for Medicare (Parts A, B, and D) presented in the same way as the Social Security section. And at the very bottom of the overall Statement of Social Security, you see a bottom-line line item for the net present value for Social Security and Medicare together. In 2019, that amounted to a massive $59.1 trillion hole, a hole that deepened about 40% (by $18 trillion) from 2015 to 2019.

Note that the net position for Social Security and Medicare far exceeds the reported national debt and the total liabilities listed on the federal government's overall balance sheet (see "Issues" below). The deterioration in the government's overall financial position, including those negative net present values for Social Security and Medicare, arguably provides a more accurate accrual-based picture than either the reported

budget deficits or the net operating costs. In 2019, Truth in Accounting estimated the change in overall financial position at a negative $8 trillion far above either the budget deficit or net operating cost that year.

Here's a look at the latest Statement of Social Insurance (Note that there are two pages, with Medicare Part D on the second page).

United States Government
Statements of Social Insurance (Note 22)
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In trillions of dollars)	2019	2018	2017	2016	2015
Federal Old-Age, Survivors and Disability Insurance (Social Security):[11]					
Revenue (Contributions and Dedicated Taxes) from:					
Participants who have attained eligibility age (age 62 and over)	1.5	1.5	1.4	1.3	1.2
Participants who have not attained eligibility age	33.6	31.6	30.2	29.3	27.8
Future participants	35.3	31.8	30.5	29.7	26.6
All current and future participants	70.4	64.9	62.1	60.3	55.6
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (age 62 and over)	(16.9)	(15.9)	(14.7)	(13.6)	(12.8)
Participants who have not attained eligibility age	(55.8)	(52.2)	(50.2)	(48.4)	(45.3)
Future participants	(14.5)	(13.0)	(12.6)	(12.4)	(10.9)
All current and future participants	(87.2)	(81.1)	(77.5)	(74.4)	(69.0)
Present value of future expenditures in excess of future revenue	(16.8)[1]	(16.2)[2]	(15.4)[3]	(14.1)[4]	(13.4)[5]
Federal Hospital Insurance (Medicare Part A):[11]					
Revenue (Contributions and Dedicated Taxes) from:					
Participants who have attained eligibility age (age 65 and over)	0.6	0.5	0.5	0.5	0.4
Participants who have not attained eligibility age	12.0	11.3	10.6	10.2	9.1
Future participants	11.8	11.0	10.6	10.0	8.4
All current and future participants	24.4	22.8	21.7	20.7	17.9
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (age 65 and over)	(5.3)	(5.0)	(4.5)	(4.3)	(3.8)
Participants who have not attained eligibility age	(20.0)	(18.6)	(17.2)	(16.8)	(14.5)
Future participants	(4.5)	(3.9)	(3.5)	(3.4)	(2.8)
All current and future participants	(29.8)	(27.5)	(25.2)	(24.5)	(21.1)
Present value of future expenditures in excess of future revenue	(5.4)[1]	(4.7)[2]	(3.5)[3]	(3.8)[4]	(3.2)[5]
Federal Supplementary Medical Insurance (Medicare Part B):[11]					
Revenue (Premiums) from:					
Participants who have attained eligibility age (age 65 and over)	1.5	1.3	1.1	1.0	0.9
Participants who have not attained eligibility age	7.5	6.6	5.9	5.3	4.6
Future participants	1.9	1.5	1.4	1.2	1.0
General Fund Transfers	28.8	25.1	22.4	20.0	17.5
All current and future participants	39.7	34.5	30.8	27.5	24.0
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (age 65 and over)	(5.8)	(5.2)	(4.5)	(4.0)	(3.6)
Participants who have not attained eligibility age	(27.3)	(23.9)	(21.4)	(19.2)	(16.9)
Future participants	(6.6)	(5.4)	(4.9)	(4.3)	(3.5)
All current and future participants	(39.7)	(34.5)	(30.8)	(27.5)	(24.0)
Eliminations	(28.8)	(25.1)	(22.4)	(20.0)	(17.5)
Present value of future expenditures in excess of future revenue (after eliminations)[6]	(28.8)[1]	(25.1)[2]	(22.4)[3]	(20.0)[4]	(17.5)[5]

United States Government
Statements of Social Insurance (Note 22), continued
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In trillions of dollars)	2019	2018	2017	2016	2015
Federal Supplementary Medical Insurance (Medicare Part D):[11]					
Revenue (Premiums and State Transfers) from:					
Participants who have attained eligibility age (age 65 and over)	0.2	0.3	0.3	0.3	0.3
Participants who have not attained eligibility age	2.1	2.1	2.1	2.2	1.8
Future participants	0.9	0.8	0.8	1.0	0.8
General Fund Transfers	8.0	7.9	7.6	8.7	7.3
All current and future participants	11.2	11.1	10.8	12.2	10.2
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age (age 65 and over)	(1.0)	(1.0)	(1.0)	(1.0)	(0.9)
Participants who have not attained eligibility age	(7.2)	(7.2)	(6.9)	(7.6)	(6.5)
Future participants	(3.0)	(2.9)	(2.9)	(3.6)	(2.8)
All current and future participants	(11.2)	(11.1)	(10.8)	(12.2)	(10.2)
Eliminations	(8.0)	(7.9)	(7.6)	(8.7)	(7.3)
Present value of future expenditures in excess of future revenue (after eliminations)[6]	(8.0)[1]	(7.9)[2]	(7.6)[3]	(8.7)[4]	(7.3)[5]
Other:					
Present value of future expenditures in excess of future revenue[7]	(0.1)[1]	(0.1)[2]	(0.1)[3]	(0.1)[4]	(0.1)[5]
Total present value of future expenditures in excess of future revenue[8, 9, 10]	(59.1)	(54.0)	(49.0)	(46.7)	(41.5)

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

Previously reported amounts have been adjusted for rounding differences.

The GAO Audit Opinion. As noted above, end-of-period financial reports contain financial statements that differ from year-ahead budget reports on another dimension -- they are audited, by more-or-less independent outside accounting experts. Those audits contain a final opinion whether or not the statements fairly present the financial condition of the reporting entity, in accordance with generally accepted accounting principles.

For the annual report of the US government, the Government Accountability Office (GAO), the audit arm of Congress, delivers the audit opinion on the financial statements in the report. And as also noted above, the GAO has delivered a “disclaimer” (flunk) opinion every year since the annual report has been issued in its modern format (since the late 1990s).

Information about that opinion arrives in two main places in the annual financial report. Early in the report, there is a relatively brief (nine page) summary statement by the Comptroller General of the United States, and the very end of the report includes the full "Independent Auditor's Report" (30 pages) from the GAO.

In 2019, the summary statement by the Comptroller General emphasized two main points, as it has in recent years. First, that three main issues lead to the GAO's inability to provide an opinion on the report, including long-standing and deeply rooted problems in Defense Department accounting practices, unreliable information relating to balances due and owing between different entities within the government, and weaknesses in the processes used to aggregate information from individual agencies to lead to consolidated results for the government as whole.

Some of those weaknesses relate directly to the reliability of budget reporting. The GAO has been citing how material accounting weaknesses render historical budget amounts to be unreliable but necessary inputs for developing the overall financial statements.

While the GAO audits the overall consolidated financial statements for the United States government, that audit depends in turn on extensive audits at the individual agency level. The modern government auditing architecture was developed in the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994, which instituted a new "CFO" position for 24 agencies together with new "Inspectors General" responsible for auditing those individual agency financial statements.

In 2019, as in previous years the Defense Department (DoD) Office of Inspector General (OIG) delivered a disclaimer of opinion on the financial statements in the DoD Agency Financial Report. The GAO regularly reviews DoD OIG opinions in its own report on the consolidated financial report of the US government. In 2019, that review included

> "We also considered the disclaimers of opinion issued by the Department of Defense (DOD) Office of Inspector General (OIG) on DOD's department-wide financial statements as of and for the fiscal years ended September 30, 2019, and 2018.38 The disclaimers of opinion were partially based on the disclaimers of opinion for multiple DOD components, including the Army, Navy, Air Force, U.S. Marine Corps, Defense Health Program, Defense Logistics Agency, U.S. Transportation Command, and U.S. Special Operations Command. The DOD

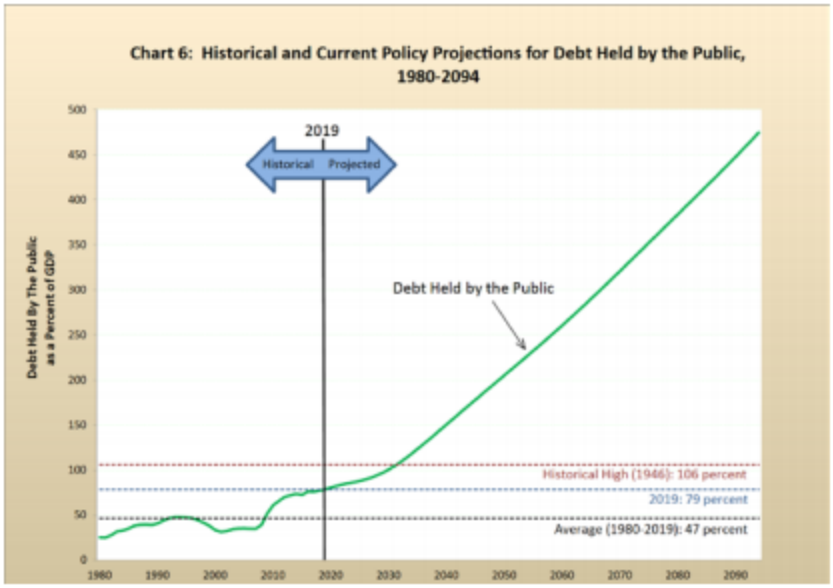
> OIG also reported 25 material weaknesses in internal control over financial reporting …"

In other words, the DoD has a lot of financial reporting issues, and remains central to the federal government's inability to secure a clean audit opinion for its overall financial statements.

Conclusion

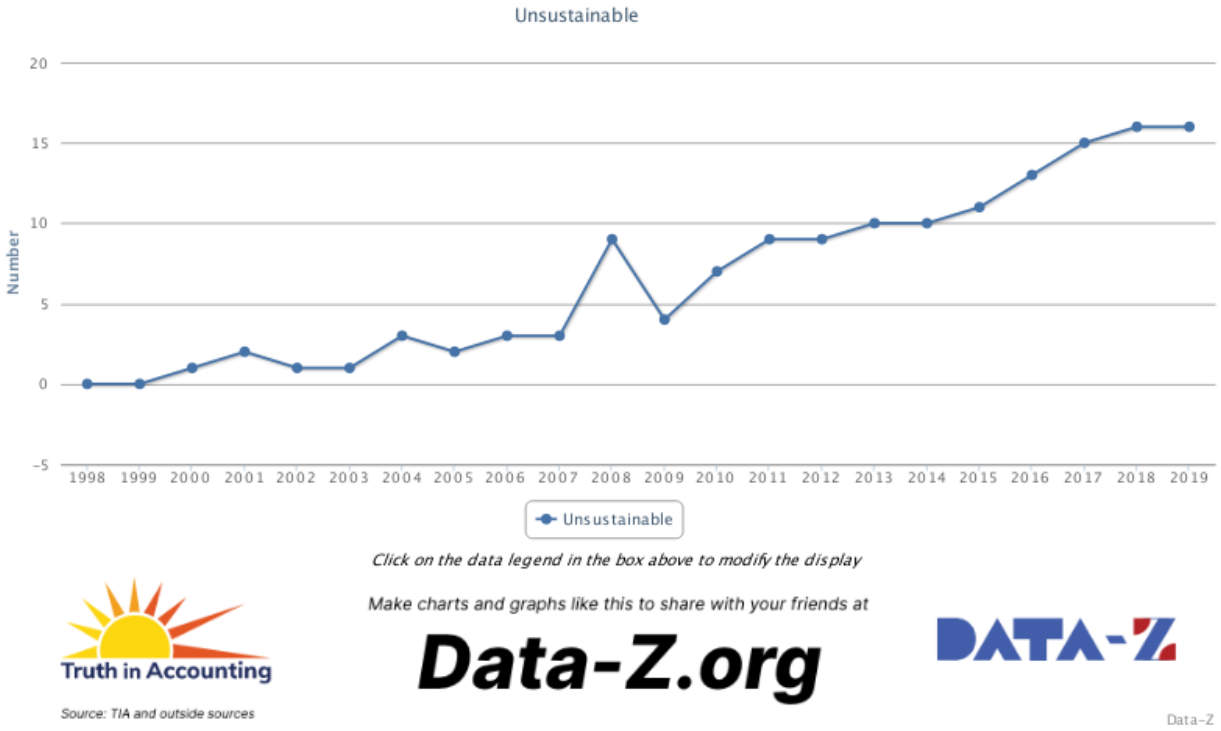
The annual GAO opinion letter and the Statement of the Comptroller General have gone beyond assessing the reliability of federal government accounting in recent years. They have also been expressing concern about the fundamental sustainability of the US government's fiscal future. These concerns are driven importantly by issues raised in the "Statements of Social Insurance" introduced above. Under current law and policy, and a projected surge in baby boomer retirements, funding the massive negative hole dug by Social Security and Medicare will require sharply accelerated borrowing (and interest expense). The GAO (and others) deem this implied future to be so draconian that they call it "unsustainable."

Here's a look at a picture in the executive summary to the annual financial report that reflects this concern. It shows the implied future "debt held by the public" under current law and policy and projected demographic trends.



Running the math on projections like this can get pretty complicated for the people putting the projections. The issues involved can get overwhelming for the average citizens. But there are times when you can do some simple but valuable things, when faced with difficult accounting and financial challenges.

Here's a look at the number of times the word "unsustainable" appeared in the annual Financial Report of the US Government, every year since 1998.



The number of times the word "unsustainable" appeared rose from 1 (in 2000) to 16 times in 2019, much faster than the number of pages (or words) in the overall financial report itself. This reflects greater attention, analysis, and concern by the report's authors for the future fiscal condition of the government of the United States.

This simple picture helps to motivate the need for education about government finance and financial reporting -- for citizens generally, and especially for young people.

In the introduction to the federal government's balance sheet above, I noted that the federal government reported roughly $4 trillion in assets and $27 trillion in liabilities in fiscal 2019. We've also learned how balance sheets are framed in an "A minus B leaves C, which is left over" construction. Assets of $4 trillion minus liabilities of $27 trillion leaves a huge negative net position left over for future citizens and taxpayers. And

we've also learned there is an argument that, but refusing to recognize unfunded Social Security and Medicare obligations as debts on the balance sheet, the federal government's reported negative net position can massively understate the real negative net position.

Introducing the balance sheet, however, the federal government gives us the following two "comforting" sentences.

> "There are, however, other significant resources available to the government beyond the assets presented in these Balance Sheets. Those resources include the Stewardship Land and Heritage Assets in addition to the government's sovereign powers to tax and to set monetary policy."

Here we have a disturbing, overly-ambitious claim, one that isn't so comforting for citizens and taxpayers -- especially young ones. Should we rest easy, knowing that our government can take our money away, and inflate the value of the dollar away?

Our government certainly has the power to tax, and to set monetary policy. But as a reporting entity, does it possess the "sovereign powers" to do so?

This claim probably shouldn't appear in a document that is supposed to help secure the accountability of the government to the real sovereign authority in the United States of America -- *We The People*.