Tax Expenditures Task Force Meeting Minutes
July 10, 2015
9 AM to 11 AM
441 G Street NW, Washington, D.C.
Room 5N30

- **Attendance**

The following task force members and officials were present at the meeting: Messrs. Bell, Carlson, and Edwards; Ms. Kearney; Messrs. McTigue and Murrin; Mses. Sergent, Taber, Thornton, and Valentine; and Mr. Weiner. The executive director, Ms. Payne, and support staff, Mr. Perry, were present throughout the meeting.

- **Approval of June Meeting Minutes**

Minutes for the June task force meeting were approved during the meeting. Members provided a few additional minor comments which were noted and incorporated into the final version for the record.

- **Member Comments and Updates to "Tax Expenditures Explained" Document (see Attachment 1 of meeting agenda)**

Staff note: The purpose of the "Tax Expenditures Explained" document is to provide background and context for respondents to any future Board proposal. Respondents who are less familiar with tax expenditures may find it challenging to respond to a proposal absent such background and context. Revision of this document is an ongoing project of the task force. See the June minutes and subsequent meeting minutes (as they become available) for additional information with respect to revisions made to this document.

In addition to editorial comments, members provided suggested edits and revisions in two sections of the document, including: 1) Types of Tax Expenditures - Table 1 and 2) Limitations of Estimates.

- Types of Tax Expenditures – Table 1 section

Members noted that the table focuses on examples of tax expenditures for individuals without providing examples for corporations.

Members agreed that the primary purpose of the table was to illustrate the *types* of tax expenditures rather than provide a comprehensive list of examples.

The task force sought changes to provide balance and help illustrate to readers that the six types of tax expenditures can apply to both individuals and corporations. They recommended a) providing and referring to a list of the top five individual and corporate tax expenditures in an appendix and/or b) pointing readers to an outside resource that lists examples of both.

- Limitations of Estimates section

Members recommended revising the section title by striking "Limitations" and replacing it with "Understanding" to more accurately reflect the nature of the information contained within the section taken as a whole.

Members recommended revising the sub-headings to be more descriptive. Several members noted that—although unintentional—the current subheadings may be interpreted as pejorative as they currently read. For example, members agreed that language stating that meaningful totals do not exist should be removed or softened.

Members noted that re-organizing the sequence of the sub-sections and providing some additional context regarding the uncertainties and assumptions inherent in both individual and aggregated tax expenditure estimates would help to improve the logical flow and enhance reader understanding. Although members did agree that some additional information should be provided to more comprehensively inform readers about the nature of tax expenditure estimates, they cautioned against making the section overly technical.

Ms. Payne and Mr. Perry said that they would make revisions, continue to reach out to and consult with members to ensure that the document is balanced and informative, and distribute an updated draft to the task force for the next meeting.

- **Member Discussion Regarding the Placement of Tax Expenditure Information within Treasury's Financial Report of the US Government**

Ms. Payne noted that FASAB is seeking the task force's feedback regarding where tax expenditure information should be placed within Treasury's Financial Report of the US Government, including the Management Discussion and Analysis (MD&A) and other Required Supplementary Information (RSI) sections. Excerpts from Treasury's 2014 Financial Report where such information might be included were provided to members.

Ms. Payne noted that the general public is most likely to read the MD&A section and that the purpose of this section is to provide a clear, concise description of the government's mission and organizational structure; performance goals, objectives, and results; and financial condition (see SFFAS 15 paragraphs 1-2; excerpts of FASAB standards related to MD&A from SFFAS 15 and 37 were provided).

Task force members reached agreement in the following areas:

1) Introducing the topic of tax expenditures, defining what they are, and pointing readers to where they can find more detailed information—including another section of the financial report or other external resources—would be appropriate information to include in MD&A.

    a. One task force member noted that it may be logical to include this information immediately following the "Taxes and Other Revenues – Getting to the Bottom Line" subsection of the "Government's Net Position: Where We Are" section of the MD&A. Although agreement was not reached on placement within this section, members agreed that this would be a good option for consideration.

2) Given the additional required audit procedures surrounding basic information (financial statements and notes) as compared to MD&A (see AU-C 730) — which is considered required supplementary information—presenting

estimates within basic information would likely present challenges for auditors.

Moreover, given the high visibility of the MD&A section, auditors would likely want appropriate caveats and assumptions to be disclosed with any estimates presented therein. As a result, it would be unrealistic to include the necessary level of detail in the MD&A section, a section that normally includes concise, high level information, as greater detail would potentially precipitate the need to include extensive caveats to provide sufficient context and explanation.

Members agreed that presenting tax expenditure information and estimates within MD&A charts and tables—such as Table 1 within the FY2014 MD&A (and the Snapshot of the Government's Financial Position and Condition within the Citizen's Guide)—would 1) be somewhat out of context, and 2) provide false assurance surrounding that information. A few members noted that, beginning in FY2015, all information in Table 1 would be audited.

3) Presentation of tax expenditure estimates and other detailed information, including limitations and caveats surrounding any disclosed estimates, should be included in RSI. Some members suggested this information should be included as other information rather than RSI.

Given the aforementioned areas of consensus amongst the task force, members agreed to narrow their focus during future meetings on the narrative information to be included in the MD&A.

One task force member noted that the sections on the long-term fiscal outlook and the economy sections within the MD&A might serve as a good frame of reference for brainstorming how to develop narrative language, as these sections also include narrative information surrounding numbers of significant magnitude and estimation uncertainty.

Ms. Payne noted that the "Tax Expenditures Explained" document could also be used as a starting point for the task force determining what information might be included in the larger section outside of MD&A during subsequent meetings.

- **Member Discussion Regarding Presenting a Total Estimate within RSI**

One member noted that CBO and other think tanks estimate a grand total for tax expenditures.

A few members acknowledged that, despite the limitations and uncertainties surrounding estimating a grand total amount of tax expenditures, tax analysts and outside parties will continue to analyze and publish such grand totals. While grand totals of individually estimated tax expenditures do not account for interaction among tax provisions, a recent CBO analysis of such interaction found that interactions offset so that current grand totals would be neither overstated nor understated.[1] CBO found that a grand total estimate of tax expenditures approximates the sum of the separate

[1] Congressional Budget Office. *The Budget and Economic Outlook: 2015 to 2025*. January 26, 2015.

estimates. It was noted that the CBO analysis reflected individual income tax expenditures based on current law at the time of its analysis.

One member noted that estimating a grand total may provide a sense of magnitude to readers.

A few members noted that presenting a grand total as a percentage of GDP may be a useful alternative to consider. This may help to provide readers with relevant context while deemphasizing the dollar estimate. Although members did not reach a consensus in this area during the meeting, they did not dismiss this idea as a viable alternative. One member also noted that the estimate could be presented as both a dollar estimate and a percentage of GDP estimate.

The task force agreed that any grand total estimates should be accompanied by a discussion of the significant limitations and uncertainty surrounding the estimate, including the underlying factors, data, and assumptions. These would include, for example, disclosures about the completeness of the estimate, the baseline used, and the quality and timeliness of data used for material components that make up the grand total. Moreover, the task force acknowledged the need to inform readers that individual tax expenditure estimates and totals of a combination of tax expenditure estimates do not incorporate behavioral responses and thus do not reflect the exact amount of revenue that would be gained if a specific tax expenditure or combination of tax expenditures were repealed.

- **Next Steps**

Ms. Payne noted that she and Mr. Perry would work to 1) revise the “Tax Expenditures Explained” document; 2) write up and distribute meeting minutes for task force review; and 3) develop illustrations of what information would be included in MD&A and RSI for task force discussion at the next meeting.

Tax Expenditures Task Force Meeting
July 10, 2015
9 AM to 11 AM
441 G Street NW, Washington, DC
Room 5950B

Agenda

9:00 – 9:30	Approve Minutes and Background Paper
9:30 – 10:45	Discussion Guide
10:45 – 11:00	Discuss Next Steps

There are several sections within each financial report. Accounting standards directly guide three sections: 1) management's discussion and analysis (MD&A), 2) financial statements including the notes, and 3) required supplementary information (RSI).[1] (These sections generally appear in the sequence listed within the overall report.) We have ruled out recognition of tax expenditure amounts in the financial statements due to difficulties in estimating, aggregating and understanding amounts considered "tax expenditures."

At the upcoming meeting, the task force will discuss the information that should be provided within the MD&A and RSI sections and how this information relates to existing MD&A components.

While management is required to include a discussion and analysis section with each annual financial report and to provide RSI, the auditor's relationship to this information is not as strong as the relationship with financial statements and notes (sometimes referred to as basic information). These sections are reviewed by the auditor and if any required items are missing (or not consistent with requirements or the financial statements) the auditor will note that in his/her report but would not modify the opinion regarding the financial statements. The required components of MD&A are identified on page 15-16. Presently, there are no RSI items related to tax expenditures.

Existing MD&A requirements include general items – for example, the entity must discuss its activities and performance – and specific items – for example, a singular presentation of key measures drawn from the financial statements. The overall goal is a concise presentation of the most important information about the entity's operations and finances with needed insight provided through management commentary. The latest government-wide MD&A is available at https://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/14frusg/ManagementDiscussionAnalysis_2014.pdf. The most relevant sections are presented beginning at page 4.

The discussion guide assumes the MD&A section would be abbreviated and the RSI section might contain more detail.

1. What **key narrative** should be included in the MD&A section of the financial report of the US Government regarding tax expenditures?
    a. What are tax expenditures?
    b. How are they used by elected officials (substitute for direct spending, designed to accomplish public policy goals)?
    c. What explanatory information is needed to help users understand the estimates and their limitations?
        i. Not revenue foregone because they do not consider behavioral effects of changes in policy and interaction among key tax provisions
        ii. Nature of these estimates – key data sources and methods (major components of a normal/baseline tax system)
        iii. Barriers to summation/categorization
        iv. Not complete because estimates exclude excise taxes and other revenues
        v. Not equivalent to amounts needed if the program were funded as a direct spending program
    d. Should specific tax expenditures be identified?

[1] Note that MD&A is classified as RSI. This has technical significance for auditors and preparers but we will refer to them separately as MD&A and RSI during our discussions.

   e. Should the reader be informed about how to locate more comprehensive information about tax expenditures (for example, Analytical Perspectives)?
   f. Given the consensus view on MD&A, what information should be in RSI even if not in MD&A?

2. What, if any, **tax expenditure estimates** should be presented in the MD&A of the Financial Report of the U.S. Government?
   a. Top five or ten or twenty based on:
      i. Cash flow estimated for the reporting period
      ii. Present value for the projection period
      iii. Other?
   b. Newly enacted tax expenditures
   c. Expiring or rescinded tax expenditures
   d. Tax expenditures relating to a priority cross-agency goal
   e. How any tax expenditure amounts should be related to other amounts in the MD&A. Currently a table of key measures is required and graphic presentations of results for the period are provided. Should tax expenditure amounts be included with:
      i. Tabular or graphic depictions of Outlays and Net Cost
      ii. Revenue
   f. Given the consensus view on MD&A, what information should be in RSI even if not in MD&A?

Excerpt from FY2014 MD&A

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	2014	2013	Increase / (Decrease) $	Increase / (Decrease) %
FINANCIAL MEASURES				
Gross Cost	$ (4,251.4)	$ (3,940.9)	**$ 310.5**	**7.9%**
Less: Earned Revenue	$ 417.9	$ 415.5	$ 2.4	0.6%
Gain/(Loss) from Changes in Assumptions	$ (3.5)	$ (131.2)	$ 127.7	97.3%
Net Cost[1]	**$ (3,837.0)**	**$ (3,656.6)**	**$ 180.4**	**4.9%**
Less: Taxes and Other Revenue:	$ 3,066.1	$ 2,842.5	$ 223.6	7.9%
Unmatched Transactions & Balances	$ (20.4)	$ 9.0	$ 29.4	326.7%
Net Operating Cost[2]	**$ (791.3)**	**$ (805.1)**	**$ (13.8)**	**(1.7%)**
Assets[3]:				
Cash & Other Monetary Assets	$ 264.9	$ 206.3	$ 58.6	28.4%
Loans Receivable, Net	$ 1,123.5	$ 1,022.3	$ 101.2	9.9%
Inventories & Related Property, Net	$ 318.4	$ 311.1	$ 7.3	2.3%
Property, Plant & Equipment, Net	$ 878.3	$ 896.7	$ (18.4)	(2.1%)
Other	$ 480.2	$ 531.9	$ (51.7)	(9.7%)
Total Assets	**$ 3,065.3**	**$ 2,968.3**	**$ 97.0**	**3.3%**
Liabilities[3]:				
Federal Debt Held by the Public & Accrued Interest	$ (12,833.6)	$ (12,028.4)	$ 805.2	6.7%
Federal Employee & Veterans Benefits	$ (6,672.6)	$ (6,538.3)	$ 134.3	2.1%
Other	$ (1,259.8)	$ (1,310.9)	$ (51.1)	(3.9%)
Total Liabilities	**$ (20,766.0)**	**$ (19,877.6)**	**$ 888.4**	**4.5%**
Net Position (Assets minus Liabilities)	**$ (17,700.7)**	**$ (16,909.3)**	**$ (791.4)**	**(4.7%)**
SUSTAINABILITY MEASURES				
Social Insurance Net Expenditures[4]:				
Social Security (OASDI)	$ (13,330)	$ (12,294)	$ 1,036	8.4%
Medicare (Parts A, B, & D)	$ (28,483)	$ (27,302)	$ 1,181	4.3%
Other	$ (103)	$ (102)	$ 1	0.6%
Total Social Insurance Net Expenditures	**$ (41,916)**	**$ (39,698)**	**$ 2,218**	**5.6%**
Total Federal Government Noninterest Net Expenditures[5]	**$ (4,700)**	**$ (4,000)**	**$ 700**	**17.5%**
BUDGET DEFICIT				
Unified Budget Deficit[6]	**$ (483.4)**	**$ (680.3)**	**$ (196.9)**	**(28.9%)**

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 in the Required Supplementary Information section of the *Financial Report*.

6 Source: Final Monthly Treasury Statement (as of 9/30/2014 and 9/30/2013).

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 increased by $310.5 billion (7.9 percent) to $4.3 trillion. Deducting $417.9 billion in revenues earned for goods and services provided to the public (e.g., Medicare premiums, national park entry fees, and postal service fees) and adding $3.5 billion in net losses from changes in assumptions (e.g., interest rates, inflation, disability claims rates) results in the Government's net cost of $3.8 trillion in FY 2014, an increase of $180.4 billion (4.9 percent) as compared to FY 2013.
- Taxes and other revenues increased $223.6 billion (7.9 percent) to $3.1 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 $791.3 billion for FY 2014, as compared to $805.1 billion for FY 2013.
- Comparing total 2014 Government assets of $3.1 trillion to total liabilities of $20.8 trillion (comprised mostly of $12.8 trillion in federal debt held by the public and accrued interest payable[2], and $6.7 trillion of federal employee and veterans benefits payable) yields a negative net position of $17.7 trillion.
- The sum of debt held by the public ($12.8 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, 2014, the Government's total debt subject to the debt limit was $17.8 trillion. Congress suspended the debt limit twice during FY 2014: first, from October 17, 2013 through February 7, 2014; and again from February 15, 2014 through March 15, 2015.

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

- The SOSI compares the actuarial present value[3] 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[4] to a subset of the revenues[5] supporting these programs. For 2014, these projected expenditures exceeded projected revenues by about $41.9 trillion, a $2.2 trillion increase over 2013 social insurance projections.
- Total projected expenditures, 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 expenditures (including its social insurance programs) is projected to exceed the PV of total receipts by $4.7 trillion.

The Government's current financial position and long-term financial condition can be evaluated both in dollar terms and in relation to the economy as a whole. Gross Domestic Product (GDP) measures the size of the nation's economy in terms of the total value of all final goods and services that are produced in a year. Considering financial results relative to GDP is a useful indicator of the economy's capacity to sustain the Government's many programs. 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 $680.3 billion or 4.1 percent of GDP in FY 2013 to $483.4 billion or 2.8 percent of GDP in FY 2014, the lowest deficit-to-GDP level since 2007 and less than the average of the last 40 years.[6]
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2014, debt held by the public, excluding interest payable, was $12.8 trillion (74 percent of GDP).

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[2] 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.

[3] 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.

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

[5] 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.

[6] Final Monthly Treasury Statement (as of September 30, 2014 and 2013), 10/15/14 press release – Joint Statement of Treasury Secretary Jacob J. Lew and OMB Director Shaun Donovan on Budget Results for Fiscal Year 2014.

- The projected $41.9 trillion net present value excess of expenditures over receipts over 75 years for the programs reported in the 2014 SOSI represents about 4.0 percent of the present value of GDP over 75 years. The excess of total projected non-interest spending over receipts of $4.7 trillion discussed in the 'Statement of Long Term Fiscal Projections' in the RSI section of the *Financial Report* represents 0.4 percent of GDP. As discussed in this *Financial Report*, these projections can, in turn, have a significant impact on projected debt as a percent of GDP.

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.[7]

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

Dollars in Billions		2014		2013	Increase / (Decrease) $		Increase / (Decrease) %
Gross Cost	**$**	**(4,251.4)**	**$**	**(3,940.9)**	**$**	**310.5**	**7.9%**
Less: Earned Revenue	$	417.9	$	415.5	$	2.4	0.6%
Gain/(Loss) from Changes in Assumptions	$	(3.5)	$	(131.2)	$	127.7	97.3%
Net Cost	**$**	**(3,837.0)**	**$**	**(3,656.6)**	**$**	**180.4**	**4.9%**
Less: Taxes and Other Revenue	$	3,066.1	$	2,842.5	$	223.6	7.9%
Unmatched Transactions and Balances	$	(20.4)	$	9.0	$	29.4	326.7%
Net Operating Cost	**$**	**(791.3)**	**$**	**(805.1)**	**$**	**(13.8)**	**(1.7%)**

Table 4 shows that the Government's "bottom line" net operating cost decreased slightly from $805.1 billion in FY 2013 to $791.3 billion in FY 2014. This $13.8 billion (1.7 percent) decrease is attributable to a number of offsetting revenue and cost changes over the past fiscal year as summarized in the following.

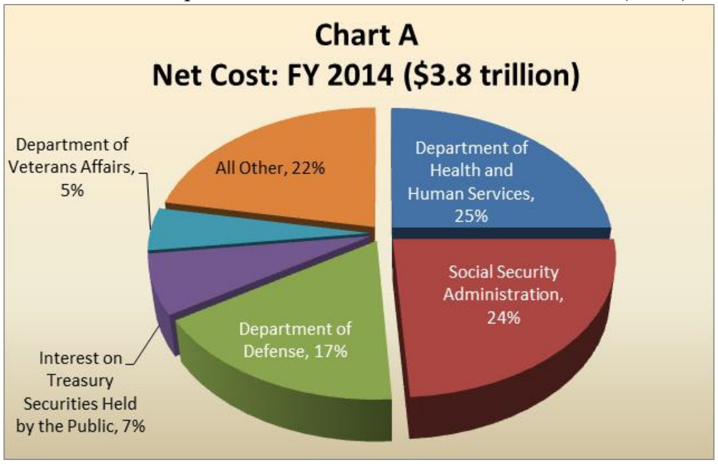
Gross Cost and Net Cost

The ***Statement of Net Cost***, starts with the Government's total gross costs of $4.3 trillion dollars, 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 $3.8 trillion, a $180.4 billion increase (4.9 percent) over FY 2013.

Typically, the Government's net cost is impacted by a variety of offsetting increases and decreases. The more significant drivers affecting the change in net cost during FY 2014 were:

[7] 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 loss on changes in assumptions associated with the Government's civilian and military benefits programs amounted to $3.5 billion in FY 2014 as compared to $131.2 billion in FY 2013, representing a $127.7 billion 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. The Department of Veterans Affairs (VA) and the Office of Personnel Management (OPM) reported significant decreases in losses from changes in these assumptions for FY 2014;
- Most of the Department of the Treasury's (Treasury's) $131.2 billion net cost increase is attributable to the effect of changes in the fair value of Treasury's investments in two GSEs – Fannie Mae and Freddie Mac – and to the decrease in dividend receipts from the GSEs[8];
- $55.8 billion and $39.4 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 $46.4 billion cost increase at the Department of Education, largely associated with increases in the projected long-term costs of its direct student loan programs due to changes in the types and availability of repayment plans and increases in default rates[9]; and
- a $26.5 billion decrease at the Department of Labor, primarily due to decreases in unemployment benefits provided under existing legislation and lower levels of unemployment as compared to FY 2013.[10]



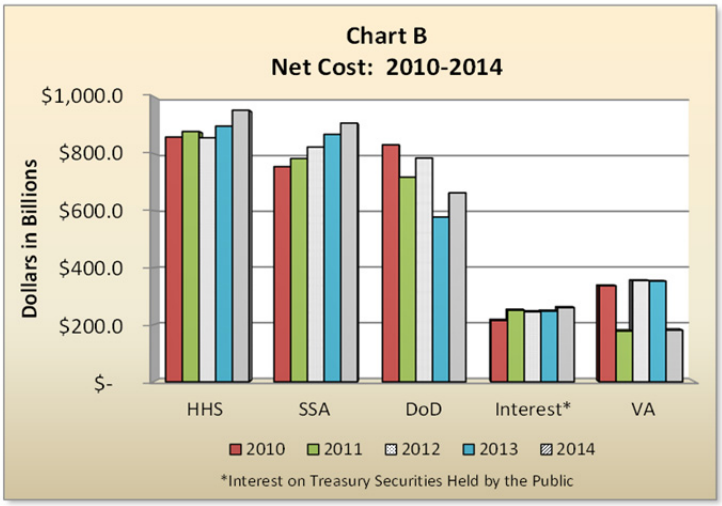


Chart A shows the composition of the Government's net cost. In FY 2014, two-thirds of total net cost came from DOD, the Social Security Administration (SSA), and the Department of Health and Human Services (HHS). These three agencies have consistently incurred the largest agency shares of the Government's total net cost in recent years (Chart B). As indicated above, HHS and SSA net costs for FY 2014 ($951.5 billion and $906.4 billion, respectively) are attributable to major social insurance programs administered by these agencies. The *Statement of Social Insurance* (SOSI) and the related information in this *Financial Report*, including the broader discussion of the Government's long-term fiscal projections, discuss the projected future revenues, expenditures, and sustainability of these programs in greater detail. DOD's net costs of $662.3 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 12 percent, and the other agencies included in the

[8] Department of the Treasury FY 2014 Agency Financial Report, p. 22-23. See also Note 9 – Investments in GSEs – of this *Financial Report*.
[9] Department of Education FY 2014 Agency Financial Report, p. 30
[10] Department of Labor FY 2014 Agency Financial Report, p. 27

Government's FY 2014 Statement of Net Cost accounted for a combined 22 percent of the Government's total net cost for FY 2014.

Fiscal Year 2014 Financial Statement Audit Results

For FY 2014, GAO issued an eighteenth consecutive disclaimer of audit opinion on the accrual-based, governmentwide financial statements. In addition, GAO issued disclaimers of opinion on the 2014, 2013, 2012, 2011 and 2010 SOSI, and disclaimers of opinion on the 2014 and 2013 Statement of Changes in Social Insurance Amounts (SCSIA). The SOSI and SCSIA disclaimers stem from significant uncertainties (discussed in Note 24, Social Insurance), primarily related to the achievement of projected reductions in Medicare cost growth as reflected in the SOSI.

Twenty-one of the 24 agencies required to issue audited financial statements under the Chief Financial Officers (CFO) Act received unmodified audit opinions (the audit opinion for the Department of Housing and Urban Development (HUD) was not available as of the release of this *Financial Report*), as did 12 of 13 additional significant reporting agencies (see Table 2 and Appendix A).[11]

Table 2: FY 2014 Agency Financial Statement Audit Results

Chief Financial Officers (CFO) Act Agency	Audit Opinion
Department of Agriculture (USDA)	Unmodified
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)	Unmodified[1]
Department of Homeland Security (DHS)	Unmodified
Department of Housing and Urban Development (HUD)	Pending
Department of the Interior (DOI)	Unmodified
Department of Labor (DOL)	Unmodified
Department of Justice (DOJ)	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)	Disclaimer
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
Other Significant Reporting Entities	
Export-Import Bank of the United States	Unmodified
Farm Credit System Insurance Corportation (FCSIC)	Unmodified[2]
Federal Communications Commission (FCC)	Unmodified
Federal Deposit Insurance Corporation (FDIC)	Unmodified[2]
Millenium Challenge Corporaton (MCC)	Unmodified
National Credit Union Administration (NCUA)	Unmodified[2]
Overseas Private Investment Corporation (OPIC)	Unmodified
Pension Benefit Guaranty Corporation (PBGC)	Unmodified
Railroad Retirement Board (RRB)	Disclaimer
Securities and Exchange Commission (SEC)	Unmodified
Smithsonian Institution	Unmodified[3]
Tennessee Valley Authority (TVA)	Unmodified
U.S. Postal Service (USPS)	Unmodified

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

[2] Entities operate under calendar year (CY)-end. Opinions reflect CY 2013 audit results.

[3] Opinion on the most recent annual report, covering FY 2013.

The Governmentwide Reporting Entity

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

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

[11] The 21 agencies include the Department of Health and Human Services, which received disclaimers of opinions on its 2014, 2013, 2012 2011, and 2010 SOSI and its 2014 and 2013 SCSIA.

financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial majority equity investment. Under Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, these entities meet the criteria of paragraph 50 and do not appear in the Federal Budget section "Federal Programs by Agency and Account." As such, these entities are not consolidated into the financial reports of the Government. However, the values of the investments in and any related liabilities to such entities are presented on the balance sheet. Appendix A includes a list of the agencies and entities contributing to this *Financial Report*.[12]

The following pages contain a more detailed discussion of the Government's financial results for FY 2014, 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.[13] 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*" • Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them. • Receipts ("cash in"), taxes and other collections recorded when received. • Outlays ("cash out"), largely recorded when payment is made.	Prepared on an "*accrual and modified cash basis*" • Agency-based and retrospective – prior and present resources used to implement initiatives. • 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. • Costs: recognized when incurred, but not necessarily paid.

[12] 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.

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

Budget Deficit vs. Net Operating Cost

The Government's primarily cash-based[14] budget deficit decreased nearly 29 percent ($197 billion) from approximately $680.3 billion in FY 2013 to about $483.4 billion in FY 2014 (the lowest since 2008) due to a combination of higher receipts and stable outlays in FY 2014. The $246.9 billion (8.9 percent) increase in receipts can be attributed to a stronger economy and the expiration of certain tax provisions. Growth in wages and salaries made collections of individual and payroll taxes strong throughout the year. Another contributor to the increase was the expiration of the temporary cut in payroll taxes and the increase in tax rates on income above certain thresholds, which went into effect in January 2013. Outlays increased 1 percent ($50 billion). The comparatively small increase was due to the net effect of: (1) spending decreases across many agencies and programs, including the Department of Defense, the unemployment insurance program, and the Federal Deposit Insurance Corporation; and (2) spending increases for Social Security, Medicare, Medicaid, and student loans, along with lower dividend receipts from the GSEs, Fannie Mae and Freddie Mac which are recorded as offsets to spending.[15] The Government's largely accrual-based net operating cost also decreased, but only slightly by $13.8 billion (1.7 percent) from $805.1 billion to $791.3 billion during FY 2014. As explained below, net operating costs are affected by both changes in revenues and costs.

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***, as summarized in Table 3, shows how the Government's net operating cost from the primarily accrual-based financial statements relates to the more widely-known and primarily cash-based budget deficit. Table 3 shows how many of the elements described above contribute to the $307.9 billion net difference between the Government's budget deficit and net operating cost for FY 2014, more than half of which is attributable to: (1) a $134.3 billion increase in liabilities for

Table 3: Net Operating Cost vs. Budget Deficit

Dollars in Billions	2014	2013
Net Operating Cost	**$ (791.3)**	**$ (805.1)**
Change in:		
Federal Employee and Veteran Benefits Payable	$ 134.3	$ 264.3
Environmental and Disposal Liabilities	$ 20.0	$ 10.1
Property, Plant, and Equipment, Net[1]	$ 18.4	$ (41.7)
Investments in Government-Sponsored Enterprises (GSEs)	$ 44.4	$ (30.9)
Insurance and Guarantee Program Liabilities	$ 28.3	$ (26.4)
Yearend Upward/(Downward) Credit Reform Subsidy Reestimates, Net[2]	$ 22.9	$ (23.1)
Other, Net	$ 39.6	$ (27.5)
Subtotal - Net Difference:	$ 307.9	$ 124.8
Budget Deficit	**$ (483.4)**	**$ (680.3)**

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.

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

[15] 10/15/14 press release -- Joint Statement of Treasury Secretary Jacob J. Lew and OMB Director Shaun Donovan on Budget Results for Fiscal Year 2014.

Federal employee and veteran benefits payable, and (2) a $44.4 billion decrease in the value of Treasury's investments in two GSEs – Fannie Mae and Freddie Mac.[16] These and most of the other "Change in" amounts summarized in Table 3 affect net operating cost, but not the budget deficit.

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*.[17]

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

Dollars in Billions		2014		2013	Increase / (Decrease) $	%
Gross Cost	**$**	**(4,251.4)**	**$**	**(3,940.9)**	**$ 310.5**	**7.9%**
Less: Earned Revenue	$	417.9	$	415.5	$ 2.4	0.6%
Gain/(Loss) from Changes in Assumptions	$	(3.5)	$	(131.2)	$ 127.7	97.3%
Net Cost	**$**	**(3,837.0)**	**$**	**(3,656.6)**	**$ 180.4**	**4.9%**
Less: Taxes and Other Revenue	$	3,066.1	$	2,842.5	$ 223.6	7.9%
Unmatched Transactions and Balances	$	(20.4)	$	9.0	$ 29.4	326.7%
Net Operating Cost	**$**	**(791.3)**	**$**	**(805.1)**	**$ (13.8)**	**(1.7%)**

Table 4 shows that the Government's "bottom line" net operating cost decreased slightly from $805.1 billion in FY 2013 to $791.3 billion in FY 2014. This $13.8 billion (1.7 percent) decrease is attributable to a number of offsetting revenue and cost changes 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 dollars, 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 $3.8 trillion, a $180.4 billion increase (4.9 percent) over FY 2013.

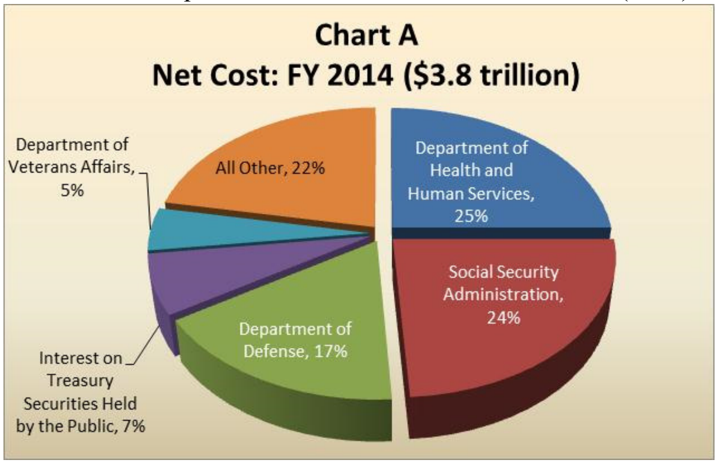
Typically, the Government's net cost is impacted by a variety of offsetting increases and decreases. The more significant drivers affecting the change in net cost during FY 2014 were:

- The loss on changes in assumptions associated with the Government's civilian and military benefits programs amounted to $3.5 billion in FY 2014 as compared to $131.2 billion in FY 2013, representing a

[16] Department of the Treasury FY 2014 Agency Financial Report, p. 27
[17] 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*.

$127.7 billion 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. The Department of Veterans Affairs (VA) and the Office of Personnel Management (OPM) reported significant decreases in losses from changes in these assumptions for FY 2014;

- Most of the Department of the Treasury's (Treasury's) $131.2 billion net cost increase is attributable to the effect of changes in the fair value of Treasury's investments in two GSEs – Fannie Mae and Freddie Mac – and to the decrease in dividend receipts from the GSEs[18];
- $55.8 billion and $39.4 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 $46.4 billion cost increase at the Department of Education, largely associated with increases in the projected long-term costs of its direct student loan programs due to changes in the types and availability of repayment plans and increases in default rates[19]; and
- a $26.5 billion decrease at the Department of Labor, primarily due to decreases in unemployment benefits provided under existing legislation and lower levels of unemployment as compared to FY 2013.[20]



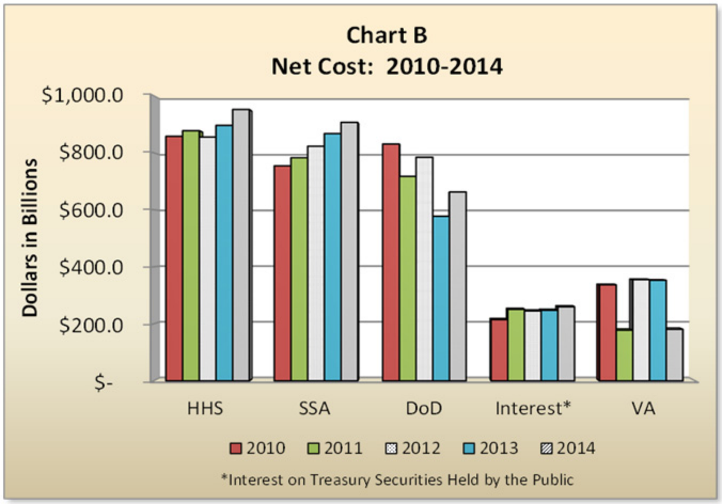


Chart A shows the composition of the Government's net cost. In FY 2014, two-thirds of total net cost came from DOD, the Social Security Administration (SSA), and the Department of Health and Human Services (HHS). These three agencies have consistently incurred the largest agency shares of the Government's total net cost in recent years (Chart B). As indicated above, HHS and SSA net costs for FY 2014 ($951.5 billion and $906.4 billion, respectively) are attributable to major social insurance programs administered by these agencies. The *Statement of Social Insurance* (SOSI) and the related information in this *Financial Report*, including the broader discussion of the Government's long-term fiscal projections, discuss the projected future revenues, expenditures, and sustainability of these programs in greater detail. DOD's net costs of $662.3 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 12 percent, and the other agencies included in the Government's FY 2014 Statement of Net Cost accounted for a combined 22 percent of the Government's total net cost for FY 2014.

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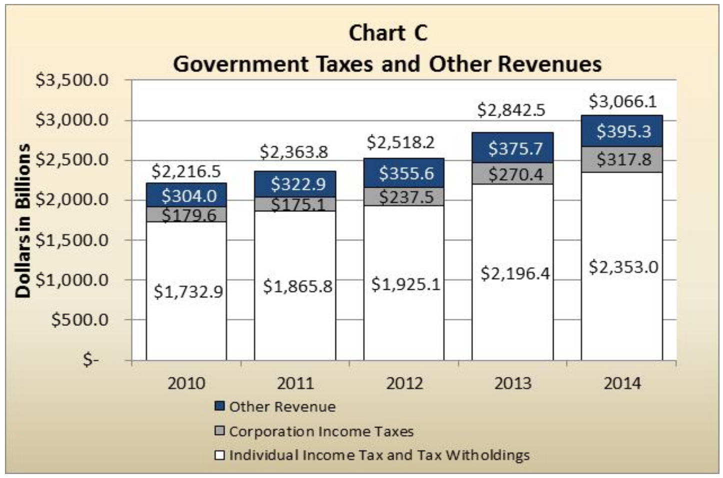
[18] Department of the Treasury FY 2014 Agency Financial Report, p. 22-23. See also Note 9 – Investments in GSEs – of this *Financial Report*.
[19] Department of Education FY 2014 Agency Financial Report, p. 30
[20] Department of Labor FY 2014 Agency Financial Report, p. 27

Taxes and Other Revenues - Getting to the "Bottom Line"

As noted earlier, taxes 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 taxes and other revenues by $223.6 billion (7.9 percent) to nearly $3.1 trillion for FY 2014. This change is primarily attributed to an overall increase in individual and corporation income tax collections.[21] As noted in the earlier discussion of budget receipts, these increases largely stem from a stronger economy and growth in wages and salaries, as well as and the expiration of certain tax provisions. 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 77 percent and 10 percent of total revenue, respectively in FY 2014; other revenues from Chart C include excise taxes, unemployment taxes, and customs duties.



As previously shown in Table 4, the increase in taxes and other revenues more than offset the increase in net costs, resulting in a slight total net decrease of $13.8 billion (1.7 percent) in the Government's net operating cost from $805.1 billion for FY 2013 to $791.3 billion for FY 2014.

[OMITTED Sections: Assets and Liabilites: "What We Own and What We Owe", The Economy in Fiscal Year 2014, The Long-Term Fiscal Outlook: "Where We Are Headed", Systems, Controls, and Legal Compliance; Financial Management Progress and Priorities]

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

[21] Department of the Treasury FY 2014 Agency Financial Report, p. 28

- *Trustees' Reports* for the Social Security and Medicare Programs.

Limitations of the Financial Statements

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

Management's Discussion and Analysis Requirements for the Government-wide Report

SFFAS 15 established requirements for management's discussion and analysis. The requirements apply to both the agency and the government-wide reports.

1. A report that presents a Federal reporting entity's financial statements in conformance with Federal accounting principles should include management's discussion and analysis (MD&A) of the financial statements and related information. MD&A should provide a clear and concise description of the reporting entity and its mission, activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition. MD&A should provide a balanced presentation that includes both positive and negative information about these topics. MD&A should be regarded as "required supplementary information" as that term is used in auditing standards.[22]

2. MD&A should contain sections that address the entity's:
- mission and organizational structure;
- performance goals, objectives, and results;
- financial statements; and
- systems, controls, and legal compliance.

3. MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the possible effects of anticipated future demands, events, conditions, and trends.[23] Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

4. MD&A should discuss important problems that need to be addressed, and actions that have been taken or planned. Actions needed, taken, and planned may be discussed within the sections listed above or in a separate section of MD&A.

5. Because MD&A must be concise if it is to be useful, management must select the most important matters to discuss. This means that some items that are material to the financial statements, notes, and other sections of the GPFFR may not be discussed in MD&A.

[22] See section 558, "Required Supplementary Information," in Codification of Statements on Auditing Standards, American Institute of Certified Public Accountants (AICPA)

[23] The word "anticipated" is used in a broad, generic sense in this document. In this context the term may encompass both "probable" losses arising from events that have occurred, which should be recognized on the face of the basic or "principal" financial statements, as well as "reasonably possible" losses arising from events that have occurred, which should be disclosed in notes to those statements. "Anticipated" may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label "projected" or "projection," and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity's financial statements; however, preparers and auditors may find useful background information in the AICPA's Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, "Financial Forecasts and Projections," of the AICPA's Codification of Statements on Standards for Attestation Engagements.

6. MD&A should deal with the “vital few” matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the GPFFR as a source of information. (The specific topics mentioned in Concepts for Management’s Discussion and Analysis are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- lead to significant actions or proposals by top management of the reporting unit;
- be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or
- significantly affect the judgment of citizens about the efficiency and effectiveness of their Federal Government.

7. Management of the reporting unit is responsible for the content MD&A.

SFFAS 37 supplemented the requirements for Management’s Discussion and Analysis established in SFFAS 15 for the government-wide report as follows:

23. Component entities that present a SOSI and the government-wide entity should discuss critical measures from their basic statements in a separate section of their management’s discussion and analysis (MD&A). They should explain the significance of key amounts, the major changes in those amounts during the reporting period, and the causes thereof. In particular, the entity should explain why the changes occurred and what they imply for the program’s operation. The entity should explain how costs and commitments incurred during the period were or will be financed. The entity should describe important existing and currently-known demands, risks, uncertainties, events, and conditions—both favorable and unfavorable—that affect the amounts reported in the basic financial statements. The discussion should go beyond a mere description of existing conditions and should encompass the possible future effects of anticipated future events, conditions, and trends regarding social insurance programs. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

24. At a minimum, component entities that present a SOSI and the government-wide entity should present and explain, as described in paragraph 23, the following measures except as noted:

a. From the statement of net cost and the statement of changes in net position (component entities) or statement of operations and changes in net position (government-wide entity):
   - i. Net costs
   - ii. Total financing sources and net change of cumulative results of operations (for component entities only) and
   - iii. Total revenue and net operating costs (for the government-wide entity only)

b. From the statement of financial position (balance sheet):
   - i. Total assets
   - ii. Total liabilities
   - iii. Net position

c. From the statement of social insurance and the statement of changes in social insurance amounts (SCSIA):
   - i. The open group measure; the entity should discuss the closed group measure in the narrative and explain how it differs from the open group measure[9] and the significance of the difference

ii. The change in the open group measure during the reporting period(s)

d. From the reconciliation of net operating cost and unified budget deficit (for the government-wide entity only): total unified budget deficit or surplus

e. From the statement of long-term fiscal projections (for the government-wide entity only): the net present value of the excess of spending over receipts.

25. In addition, MD&A should present the above measures in a table or other singular presentation (see the illustration for the government-wide entity at Appendix B: Illustrative Table of Key Measures). The closed group measure is not required to be presented in the table or other singular presentation. The table in Appendix B is for purposes of illustration only. The preparer should determine the most effective format for communicating the critical financial information and the reasons for changes during the prior period.

26. Each critical measure above (costs, net position, etc., see paragraph 24) may be disaggregated into sub-measures. For example, regarding assets, component entities may separately present Treasury securities held, and liabilities may be disaggregated into major items, i.e., into line items for employee pension liabilities and other liabilities.

Tax Expenditures Explained

Tax expenditures have been estimated and reported for several decades. The estimation process requires significant judgment and relies on data and models with inherent limitations. This paper provides an overview of the current reporting practices and their limitations.

Deleted: its

Background

"Tax expenditures" refers to preferences in tax law ensuring more money is available to certain subsets of taxpayers who engage in certain kinds of activities or face special circumstances. The government uses tax expenditures to accomplish public policy goals such as facilitating homeownership, reducing the cost of borrowing for state and local governments, encouraging higher education, or promoting domestic energy production. Tax expenditures can reduce taxes otherwise payable or provide cash in the form of a refundable tax credit.[1] Because tax expenditures reduce tax revenue to the federal government, instead of being a direct or appropriated outlay, they are often referred to as "hidden" spending.

Deleted: increasing home ownership rates

The Board is concerned with ensuring that federal financial reporting assists report users in evaluating the service efforts, costs, and accomplishments of the federal government and understanding how these efforts and accomplishments have been financed. Establishing reporting requirements that assist report users requires an understanding of this complex topic, the methods used to estimate tax expenditures, and limitations on those estimates. This appendix provides an overview of the topic to aid respondents in considering the Board's proposal.

Definition

The Congressional Budget and Impoundment Act of 1974 (the Budget Act) defines tax expenditures as

Deleted: In its simplest form, a tax is a specific rate applied equally to a specific tax base such as income. Taxes are rarely this simple though. Numerous federal goals are supported through the tax code in a variety of ways; making it a complex matter to identify "tax expenditures."

> "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." (Section 3(3) of Public Law 93-344)

The first step in identifying tax expenditures is determining what the tax base is so that the provisions considered "special" can be distinguished from those provisions consistent with a "normal" or baseline tax system. Those credits, deductions, special exceptions and allowances that reduce tax liability below the level implied by the baseline tax system are then considered tax expenditures. For the federal income tax, the baseline tax system is a comprehensive income tax with certain practical provisions. It includes personal exemptions, a standard deduction, and deduction of expenses incurred in earning income as well as a progressive rate structure.

[1] A refundable tax credit is provided even if the taxpayer owes no tax. The budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer's tax liability as outlays. So, this type of tax expenditure is included in the budget to the extent payments exceed the taxpayer's tax liability.

Types of Tax Expenditures

There are six types of tax expenditures—exclusions, exemptions, deductions, credits, preferential rates, and deferrals. Table 1 describes each and provides an example.

Table 1: Examples of Provisions That Are Tax Expenditures When They Are Exceptions to the Normal Tax Structure

Tax expenditure	Description	Examples
Exclusion	Excludes income that would otherwise constitute part of a taxpayer's gross income.	Employees generally pay no income taxes on contributions their employers make on their behalf for medical insurance premiums.
Exemption	Reduces gross income for taxpayers because of their status or circumstances.	Taxpayers may be able to reduce their tax liability if they have a dependent who is a child aged 19 through 23 and is a full-time student.
Deduction	Reduces gross income due to expenses taxpayers incur.	Taxpayers may be able to deduct state and local income taxes and property taxes.
Credit	Reduces tax liability dollar-for-dollar. Additionally, some credits are refundable meaning that a credit in excess of tax liability results in a cash refund.	Taxpayers with children under age 17 potentially can qualify for up to a $1,000 partially refundable, per child credit, provided their income does not exceed a certain level.
Preferential tax rate	Reduces tax rates on some forms of income.	Capital gains on certain income are subject to lower tax rates under the individual income tax.
Deferral	Delays recognition of income or accelerates some deductions otherwise attributable to future years.	Taxpayers may defer paying tax on interest earned on certain U.S. savings bonds until the bonds are redeemed.

Source: GAO-13-167SP: Guide for Evaluating Tax Expenditures.

In considering these six types, note that it may be possible to achieve the same outcome in a variety of ways. For example, it may be possible for some public policy purposes to be achieved through a preferential rate, a deduction, or a credit. Because a variety of approaches can produce the same cash effect, the types are different in form rather than substance.

Deleted: In considering these six types, note that the same outcome can be achieved in a variety of ways. For example, the same public policy purpose can be achieved through a preferential rate, a deduction, or a credit because each can be structured to provide the same reduction in tax liability.

Budget Act Requirements and History

The term "tax expenditures" was introduced in 1967 by Assistant Secretary for Tax Policy, Stanley Surrey, in a speech calling for a "full accounting" of them. Following his speech, estimates were prepared by the U.S. Department of the Treasury and later by the Joint Committee on Taxation (JCT). In 1974, the Budget Act charged the House and Senate Budget Committees with the duty "to request and evaluate continuing studies of tax expenditures, to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays, and to report the results of such studies" to Congress on a recurring basis. The Budget Act further required that the annual President's Budget include tax expenditure estimates.[2]

Estimates are now available annually from both the JCT and the President's Budget. The JCT estimates can be found at https://www.jct.gov/publications.html?func=select&id=5 and the President's Budget at https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/ap_14_expenditures.pdf

Estimates provided in the President's Budget cover the current fiscal year and the ten years following the current fiscal year. They are intended to support budget analysis and are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in determining the relative merits of achieving specific public goals through the use of tax expenditures.

Government Performance and Results Act – Modernization Act

The Government Performance and Results Act Modernization Act of 2010 (GPRA MA) (Public Law 111-352) requires OMB to 1) coordinate with agencies to develop a Federal Government performance plan to be updated no less than annually, 2) identify relevant tax expenditures contributing to priority goals within the plan, and 3) periodically assess whether tax expenditures are contributing as planned. Each agency's annual performance plans are also required to identify regulations, such as relevant tax expenditures, that contribute to performance goals.

[Update for any information about implementation immediately prior to issuance.]

[2] Kleinbard, Edward. Tax Expenditure Framework Legislation, *Research Paper Series and Legal Studies Research Paper Series, Paper No. C10-1.* USC Center in Law, Economics and Organization. 2010.

How the Department of the Treasury Prepares the Administration's Estimates

As noted in the definition, tax expenditures arise from special provisions allowing an exclusion, exemption, or deduction from gross income, a credit, a preferential rate of tax, or a deferral of liability. Deciding whether a provision of tax law is a special exception to the baseline income tax system is a matter of judgment. The baseline used by the Treasury is adapted from a comprehensive income tax in which income is the sum of consumption and the change in net wealth in a given period of time. This baseline assumes an individual income tax and a separate corporate income tax.[3]

Preparing tax expenditure estimates requires consideration of certain information about the economy; presently and in the future. The Treasury estimates for economic activity are consistent with the Administration's economic forecast and the current law baseline budget projections.[4]

Each tax expenditure is measured by the difference between tax liability under current law and the tax liability that would result if the tax expenditure provision were repealed. It is assumed that there is no behavioral response to the repeal of the provision and taxpayers simply recalculate their tax in the absence of the provision in question. For example, the ability to deduct mortgage interest expense on owner-occupied housing is considered to be a tax expenditure. The tax expenditure estimate reports the revenue change that would occur if this deduction were repealed but it does not take into account whether there would be a change in the taxpayer's behavior, such as the taxpayer's decision to own a home. However, in recalculating the tax due in the absence of this deduction, the tax expenditure estimate does assume the taxpayer would switch from itemizing deductions to claiming the standard deduction if that were tax minimizing in the absence of the ability to deduct mortgage interest.

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When possible, the Treasury uses samples of tax returns provided by the Internal Revenue Service to develop estimates of recent and future utilization of the tax credits, exemptions and deductions that make up each tax expenditure. For tax expenditures not reflected on tax returns, for example income exclusions, Treasury economists rely on other economic data to estimate the current utilization of the tax preference. The use of the preference is then projected into the future consistent with the Administration's economic forecast.

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Year-to-year differences in the calculations for each tax expenditure reflect changes in tax law, including phaseouts of tax expenditure provisions and changes that alter the baseline income tax structure, such as the tax rate schedule, the personal exemption amount, and the standard deduction. For example, the dollar value of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law.

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[3] Treasury and the Joint Committee on Taxation differ in the assumed baseline from which tax expenditures are measured. For a summary of the differences see Altshuler, Rosanne and Robert Dietz. "Reconsidering Tax Expenditure Estimation." *The National Tax Journal*, June 2011, 64 (2, Part 2), 459-490.

[4] "Current law baseline" refers to the budget estimates prepared by the Administration based on laws enacted at the time they are prepared. If a provision will expire under currently enacted law then the baseline projections reflects the effects of that expiration.

Limitations of Estimates

Tax expenditure estimates are developed to aid policymakers. It is important to understand the limitations inherent in the process. The major limitations are identified below.

Not Equivalent to Foregone Revenue. Estimates should be regarded as approximations and individual estimates do not necessarily equal the increase in federal revenues (or the change in the budget balance) that would result from repealing these special provisions because:

a. eliminating a tax expenditure may have incentive effects that alter economic behavior, and

b. tax expenditures are interdependent even without incentive effects.

Completeness. As noted earlier, significant judgment is required to identify special provisions of the income tax code. Given the complexity of the tax code, differences in judgment lead some to include provisions in tax expenditure lists that others would exclude and vice versa. In addition, special provisions can be included in taxes other than income taxes (for example, excise taxes) but these generally are not included in reports on tax expenditures. **Expiring Provisions.** Estimates are based on tax law enacted as of July 1 of the reporting year and assume that any provisions scheduled to expire will expire (for example, the research and experimentation credit and the American Opportunity Tax Credit). As noted above, provisions likely to be extended are ignored for estimation purposes until such legislation is enacted. In other words, estimates are based on current law rather than analyzing policy outcomes likely to occur. As a result, an extensive knowledge of tax policy may be required in order to understand multi-year tax expenditure projections when provisions are scheduled to expire.

Absence of Meaningful Totals. A grand total for the estimated tax expenditures is not provided in Analytical Perspectives because each tax expenditure is estimated independently assuming other parts of the Tax Code remain unchanged. The estimates might be different if two or more tax expenditures were changed simultaneously because of potential interactions among provisions.

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Cash Effects vs. Net Present Value. Estimates are provided for the cash (current revenue) effect for each fiscal year in the period covered by the projections. For tax expenditures that involve deferrals or other long-term revenue effects, a present value estimate for the activity in the current calendar year is provided as well. The present value effects are important because deferrals will reverse in later years. (Note that deferral provisions may result in expenditures for which the cash effect of the later reversals are wholly outside the ten year window used for the cash effect estimates. The present value estimates capture all of the future revenue impacts.)