Floyd Advisory

A Forensic Accountant's Review of the FY 2022 Financial Report of the United States Government

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Introduction and Our Objective

We are pleased to present you with our report, A Forensic Accountant's Review of the FY 2022 Financial Report of the United States Government.

The FY 2022 Financial Report of the United States Government (the "U.S. Financial Report" or "Financial Report") is prepared by the United States Department of the Treasury ("Department of Treasury" or "Treasury") and is audited by the United States Government Accountability Office ("GAO"). From a financial reporting perspective, the Department of Treasury serves in a role similar to the management of a business enterprise that bears responsibility for its company's financial statement assertions, whereas the GAO serves in a role similar to an independent certified public accounting firm that performs audit services and renders an opinion on such financial statements.

Our objective in preparing this report is to provide useful insights on the information contained in the U.S. Financial Report. Importantly, we highlight our observations on the quality and completeness of the reporting by the Department of Treasury based on the expectations, standards, and financial reporting requirements of a U.S. publicly traded company. We also discuss certain matters that we believe warrant special attention for users of the Financial Report, notably the citizens of the United States, as they relate to the financial condition of the U.S. Government. If you wish to review the Financial Report itself, you may find a copy at https://fiscal.treasury.gov/reports-statements/financial-report/.

As an independent consulting firm with financial and accounting expertise, we are committed to contributing thought leadership and relevant research regarding financial reporting matters that will assist our clients in today's fast-paced and demanding market. This report is just one example of how we continue to fulfill this commitment.

We welcome your comments and feedback, especially any additional analyses you would find helpful.

Floyd Advisory
MAY 2023

Observations About the U.S. Government's Financial Reporting

Based on our review of the U.S. Financial Report, we identified several issues that would be of particular interest to users of the financial statements of a public company:

- The GAO, as the auditor to the U.S. Government, considers the government's current financial state to be an **"*unsustainable long-term fiscal path,*"**[1] which is similar to a "going concern" opinion for a public registrant;
- The fiscal year ("FY") 2022 deficit of $1.4 trillion reflects the cash basis of accounting, whereas under the accrual basis of accounting, which is consistent with GAAP, the deficit would be approximately $4.2 trillion;[2]
- The U.S. Government's national debt included on the Financial Report's balance sheet is approximately $34.1 trillion.[3] However, "off-balance sheet" liabilities such as Social Security, Medicare, and other social programs would increase the actual debt to approximately $106.7 trillion;[4]
- Of significance, the GAO identified **"*significant material weaknesses*"** in the internal controls over financial reporting for the U.S. Government;[5]
- As a result of the material weaknesses, **"*the GAO issued a disclaimer of opinion,*"** indicating the U.S. Financial Report **"*may not be reliable.*"** Notably, since its first audit in fiscal year 1997, the GAO has issued a disclaimer of opinion every year;[6] and
- Since the issuance of the U.S. Financial Report, the U.S. Government's budget deficit has reached $1.1 trillion for the first six months of FY 2023 alone, close to the $1.4 trillion budget deficit for the entirety of FY 2022. The increase in the deficit in FY 2023 is primarily due to increases in educational spending, health care benefits, and interest payments on debt. The interest payments totaled $384 million in the first six months of FY 2023, representing a 32% increase over the same period in FY 2022.[7]

These topics and other observations are discussed more fully herein.

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[1] 2022 U.S. Financial Report, at pg. 229 (emphasis added).
[2] 2022 U.S. Financial Report, at pg. 1.
[3] *Ibid.*
[4] 2022 U.S. Financial Report, at pgs. 68 and 154.
[5] 2022 U.S. Financial Report, at pg. 224.
[6] 2022 U.S. Financial Report at pgs. 12 and 224 (emphasis added). *See also* https://www.gao.gov/assets/720/716146.pdf.
[7] https://www.bloomberg.com/news/articles/2023-04-12/us-budget-deficit-widens-to-1-1-trillion-in-fiscal-half-year.

Matching Financial Information with the Method of Accounting

Before analyzing or reviewing a financial schedule or set of financial statements, the reader or user should understand the method of accounting applied in the preparation of the information, as such information can be presented using different methods.

Generally accepted accounting principles[8] ("GAAP") require the use of the accrual basis of accounting, which reports economic events and transactions in the period earned or incurred, regardless of when cash is paid or received. The other common method of accounting is known as the cash basis, which, conversely, records events and transactions upon cash disbursement or receipt. Variations of the accrual and cash methods are referred to as hybrid methods and may be defined as the modified cash basis or modified accrual basis. To evaluate the financial reports of the U.S. Government, understanding the method of accounting is especially important because the Treasury presents information using more than one method.

Specific to the U.S. Financial Report, budgetary-related information is presented on the cash basis of accounting, and therefore references to budget deficit or surplus reflect net cash inflows and outflows in a period. In contrast, the information included in the financial statements (e.g., balance sheet, statement of operations, etc.) is based on a modified accrual basis. This method includes 1) expenses generally presented on an accrual basis, 2) revenues from taxes, duties, fines, and penalties presented on a cash basis, and 3) revenues for the delivery of products and services for fees presented on an accrual basis. Therefore, net operating costs or profits, as captured in the Financial Report, are reported using a modified accrual method and therefore are inconsistent with the cash-basis deficit figures presented in budget discussions.

While considering the multiple methods used by the U.S. Government, we will provide an overview and observations of the recently reported financial information for FY 2022 and offer insights on the beginning of FY 2023.

[8] The set of accounting standards that most U.S. businesses, not-for-profits, and state and local governments follow for financial reporting purposes.

Overview of Financial Condition and Results

Financial Statements of the U.S. Government

Below you will find information related to the U.S. Government's revenues, net costs, and assets and liabilities for the fiscal year 2022, as summarized from the U.S. Financial Report. Before analyzing the results, it is important to note that not all U.S. Government entities are included in this consolidated U.S. Financial Report.

The Statements of Federal Financial Accounting Standards ("SFFAS") provide guidance related to the financial reporting of the Federal Government. SFFAS No. 47 was established in 2014 to provide guidance to the Federal Government, defining which types of entities should have financial reports and establishing guidelines for the types of information that should be included.[9]

There are 164 entities that are included in the U.S. Financial Report.[10] The entities are trifurcated into the following categories: *24 Chief Financial Officer Act ("CFO") Consolidation Entities, 16 Additional Significant Consolidation Entities, and 124 Additional Consolidation Entities.* For purposes of this report, we have included the CFO Act Entities[11] in the table on the right (and continued on the next page) and the Additional Significant Entities in the table on the right of page 5 (and continued on page 6). Please refer to the Financial Report for a listing of the remaining 124 entities and funds, which include, for example, the Federal Trade Commission, the U.S. Senate, and the Government Accountability Office.

It is important to note that while SFFAS No. 47 governs the inclusion of certain entities for consolidated federal reporting, it also sets forth criteria for the omission of other entities. Some entities are excluded from the U.S. Financial Report because they qualify as Government Sponsored Entities ("GSEs"), including the Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac"). Others are excluded because their activities are not included in the federal budget (e.g., the Federal Reserve System). Additionally, any financial organization or commercial entity with which the Treasury holds either a direct, indirect, or beneficial equity investment is excluded (e.g., the National Railroad Passenger Corporation – also known as Amtrak). Lastly, in response to the COVID-19 pandemic, there are Special Purpose Vehicles ("SPVs") held to enhance the liquidity of the U.S. financial system that are excluded from the U.S. Financial Report.[12]

An introduction to the U.S. Government's Fiscal Year 2022 and 2021[13] financial results is featured in the snapshot on the next page:[14]

CFO Act Entities

Department of Agriculture

Department of Commerce

Department of Defense

Department of Education

Department of Energy

Department of Health and Human Services

Department of Homeland Security

Department of Housing and Urban Development

Department of the Interior

Department of Justice

Department of Labor

Department of State

Department of Transportation

Department of the Treasury

(continued on pg. 4)

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[9] files.fasab.gov/pdffiles/handbook_sffas_47.pdf, at para. 2.

[10] 2022 U.S. Financial Report, at pgs. 12, 13, and Appendix A.

[11] Such entities relate to the CFO Act of 1990, which mandated financial management reform. The act intended to establish a leadership structure, provide for long-term planning, require audited financial statements, and strengthen the accountability report (https://www.gao.gov/products/afmd-12.19.4).

[12] 2022 U.S. Financial Report, at pgs. 165 and 215.

[13] FY 2021 U.S. Government results were restated. The amounts contained herein are reflective of such restatements.

[14] 2022 U.S. Financial Report, at pg. 1. Note, the U.S. Government's fiscal year begins October 1st and ends September 30th.

(continued from pg. 3)

CFO Act Entities

Department of Veterans Affairs

Environmental Protection Agency

General Services Administration

National Aeronautics and Space Administration

National Science Foundation

Office of Personnel Management

Small Business Administration

Social Security Administration

U.S. Agency for International Development

U.S. Nuclear Regulatory Commission

NATION BY THE NUMBERS

A Snapshot of The Government's Financial Position & Condition

		2022		2021*
Financial Measures (Dollars in Billions):				
Net Cost:				
Gross Costs	$	(7,420.0)	$	(7,406.6)
Less: Earned Revenue	$	531.1	$	574.2
Gain/(Loss) from Changes in Assumptions	$	(2,207.9)	$	(518.4)
Total Net Cost	**$**	**(9,096.8)**	**$**	**(7,350.8)**
Less: Total Tax and Other Unearned Revenues	**$**	**4,925.9**	**$**	**4,255.9**
Net Operating Cost	**$**	**(4,170.9)**	**$**	**(3,094.9)**
Budget Deficit	**$**	**(1,375.5)**	**$**	**(2,775.6)**
Assets, comprised of:				
Cash and Other Monetary Assets	$	877.8	$	475.0
Inventory and Related Property, Net	$	406.9	$	399.2
Loans Receivable, Net	$	1,434.1	$	1,651.0
General Property, Plant, and Equipment, Net	$	1,197.5	$	1,176.9
Other	$	1,046.1	$	1,191.5
Total Assets	**$**	**4,962.4**	**$**	**4,893.6**
Less: Liabilities, comprised of:				
Federal Debt and Interest Payable	$	(24,328.0)	$	(22,344.8)
Federal Employee & Veteran Benefits Payable	$	(12,811.9)	$	(10,183.0)
Other	$	(1,882.4)	$	(2,249.9)
Total Liabilities	**$**	**(39,022.3)**	**$**	**(34,777.7)**
Unmatched Transactions and Balances[1]	$	(1.3)	$	(1.7)
Net Position[2]	**$**	**(34,061.2)**	**$**	**(29,885.8)**
Sustainability Measures (Dollars in Trillions):				
Social Insurance Net Expenditures	$	(75.9)	$	(71.0)
Total Federal Non-Interest Net Expenditures	$	(79.5)	$	(97.6)
Sustainability Measures as Percent GDP:				
Social Insurance Net Expenditures[3]		(4.3%)		(4.4%)
Total Federal Non-Interest Net Expenditures		(4.2%)		(5.7%)
Fiscal Gap[4]		(4.9%)		(6.2%)

[1] Unmatched transactions and balances are net adjustments needed to balance the financial statements and are due primarily to unresolved intra-governmental differences. Net unmatched transactions and balances of $0.2 billion for both FY 2022 and FY 2021 are also included in the Statements of Operations and Changes in Net Position. See Financial Statement Note 1.T.

[2] The government's net position is calculated in accordance with federal accounting standards. Per these standards, net position does not include the financial value of the government's sovereign power to tax, regulate commerce, or set monetary policy, or the value of nonoperational resources, such as national and natural resources, for which the government is a steward.

[3] Pursuant to federal accounting standards, for SOSI reporting, the federal government's social insurance programs include Social Security; Medicare Parts A, B, and D; DOL's Black Lung program; and the RRB.

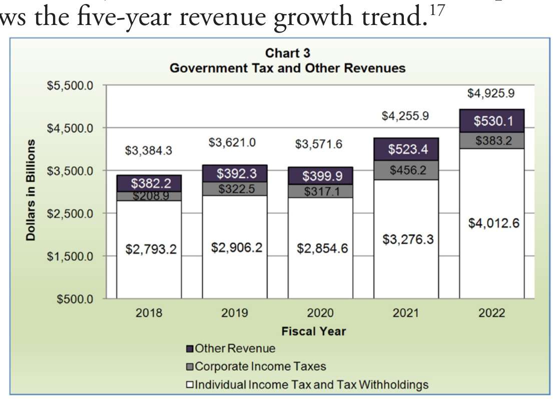
[4] To prevent the debt-to-GDP ratio from rising over the next 75 years, a combination of non-interest spending reductions and receipts increases that amount to 4.9 percent of GDP on average is needed (6.2 percent of GDP on average in 2021). See Financial Statement Note 24.

* Restated (see Financial Statement Note 1.V).

As displayed above, the total Net Operating Cost for FY 2022 was $4,170.9 billion. This amount is comprised of costs, revenue, and changes in assumptions. Net Operating Cost is calculated using the accrual basis of accounting, while the Budget Deficit for FY 2022 is reported at $1,375.5 billion and is calculated under the cash basis of accounting. Breaking this down, we discuss three main components in more detail:

1. Revenues *("Total Tax and Other Unearned Revenues")*

Total government revenues reported in the U.S. Financial Report increased by 15.7% ($670.0 billion) compared to FY 2021, primarily due to growth in individual income tax collections and tax withholdings.[15] This increase was offset entirely by the $1,746.0 billion increase in Net Cost in FY 2022 as compared to FY 2021. The "bottom line" Net Operating Cost increased by $1,076.0 billion (34.8%) as compared to FY 2021.[16] The graphic below shows the five-year revenue growth trend.[17]



[15] 2022 U.S. Financial Report, at pg. 5.

[16] 2022 U.S. Financial Report, at pg. 19.

[17] 2022 U.S. Financial Report, at pg. 5. Note, other revenues include Federal Reserve earnings, excise taxes, and customs duties.

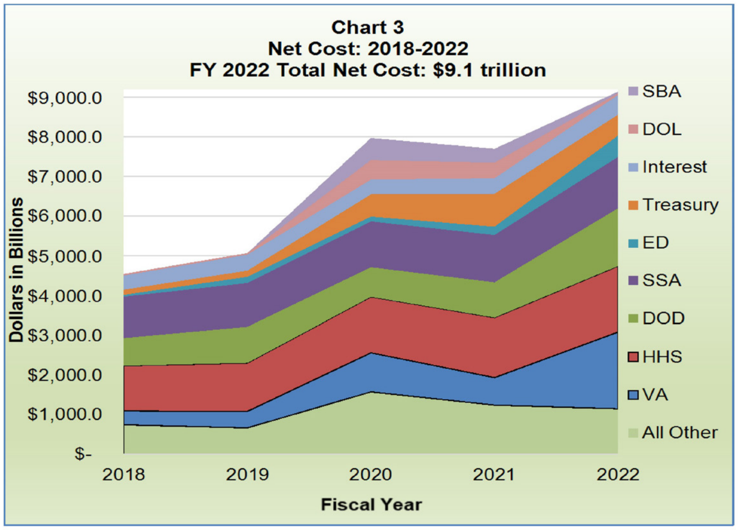
2. Expenses *("Net Cost")*

The Net Cost reported in the U.S. Financial Report is defined as follows:[18]

> ***"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."***

Net Cost represents agency and department expenses offset by earned revenues from the sale of products or delivery of services along with adjustments to accounting estimates. Therefore, the Net Cost balance does not consider tax revenues or budget allocations to fund agency and department costs and, therefore, represents a useful measure of expenditures offset by agency-specific items.

Interestingly, in FY 2022, over 85% of the U.S. Government's Net Cost was incurred by six major agencies – Department of Veterans Affairs ("VA"), Department of Health and Human Services ("HHS"), Department of Defense ("DOD"), Social Security Administration ("SSA"), Department of Education ("ED"), and Department of the Treasury ("Treasury") – in addition to interest. The remaining Net Cost relates to less significant agencies and all other consolidated government operations. The graphic below shows the five-year spending trends for each of these departments and categories.[19]



As shown above, the Net Cost for the VA and DOD increased in FY 2022 as compared to FY 2021. The VA net costs increased primarily due to changes in assumptions related to veteran benefit programs and the DOD net costs increased primarily due to changes in assumptions related to federal employee benefit programs.[20]

Notably, the DOD had a $527.6 billion, or 64.2%, increase in Net Cost of Operations as shown in the graph on the next page. This graph shows the five-year DOD trend in net cost analysis.[21]

[18] 2022 U.S. Financial Report, at pg. 19.
[19] 2022 U.S. Financial Report, at pg. 21.
[20] 2022 U.S. Financial Report, at pg. 4.
[21] DOD's 2022 Annual Financial Report, at pg. 44.

Additional Significant Entities

Export-Import Bank of the U.S.

Farm Credit System Insurance Corporation

Federal Communications Commission

Federal Deposit Insurance Corporation

General Fund of the U.S. Government

Millennium Challenge Corporation

National Credit Union Administration

National Railroad Retirement Investment Trust

Pension Benefit Guaranty Corporation

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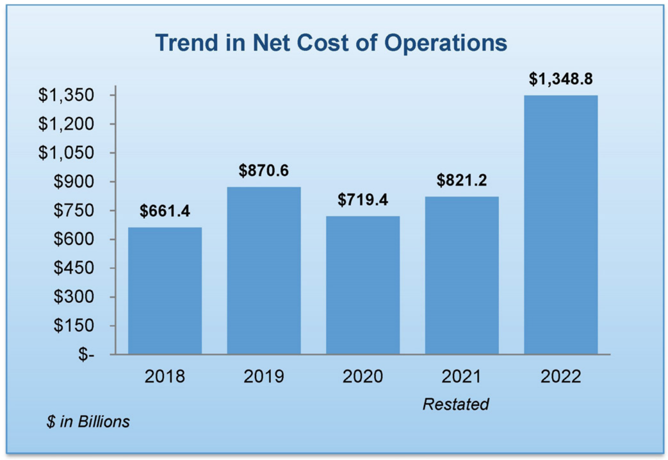
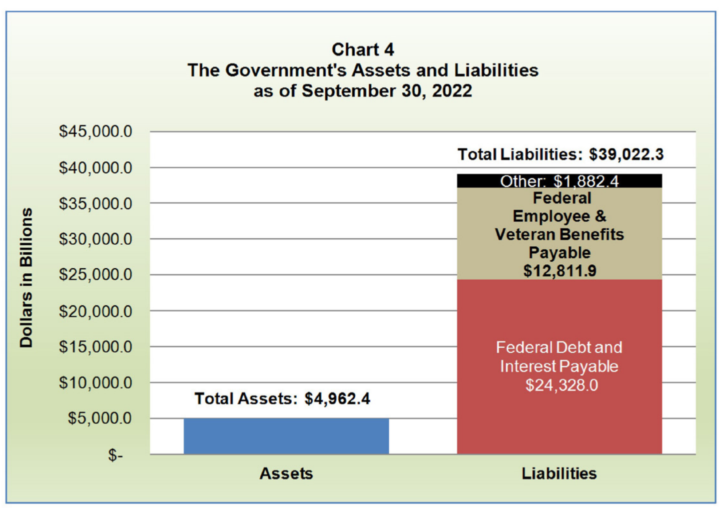


3. Financial Position

For FY 2022, the U.S. Government reported $5.0 trillion in total assets, nearly the same as the $4.9 trillion reported in FY 2021.[22] The asset number is comprised of five accounts: 1) Cash and Other Monetary Assets, 2) Inventory and Related Property, 3) Loans Receivable, 4) General Property, Plant, and Equipment, and 5) Other. The balances in these accounts remained steady between FY 2022 and FY 2021, with the exception of Cash and Other Monetary Assets, which increased by 85% as operating cash held by the Treasury increased from $418.6 billion to $617.0 billion in FY 2022 due to Treasury cash position decisions.[23]

The U.S. Government reported $39.0 trillion in total liabilities in FY 2022, which excludes certain "off-balance sheet" items that will be discussed later in this report. The liabilities are composed of 1) Federal Debt and Interest Payable, 2) Federal Employee & Veteran Benefits Payable, and 3) Other. The values of these accounts are generally consistent with the prior year.[24]

The graphic below shows the assets and liabilities reported on the U.S. Government's balance sheet for FY 2022.[25]



[22] 2022 U.S. Financial Report, at pg. 1.
[23] 2022 U.S. Financial Report, at pg. 5.
[24] 2022 U.S. Financial Report, at pg. 1.
[25] 2022 U.S. Financial Report, at pg. 5.

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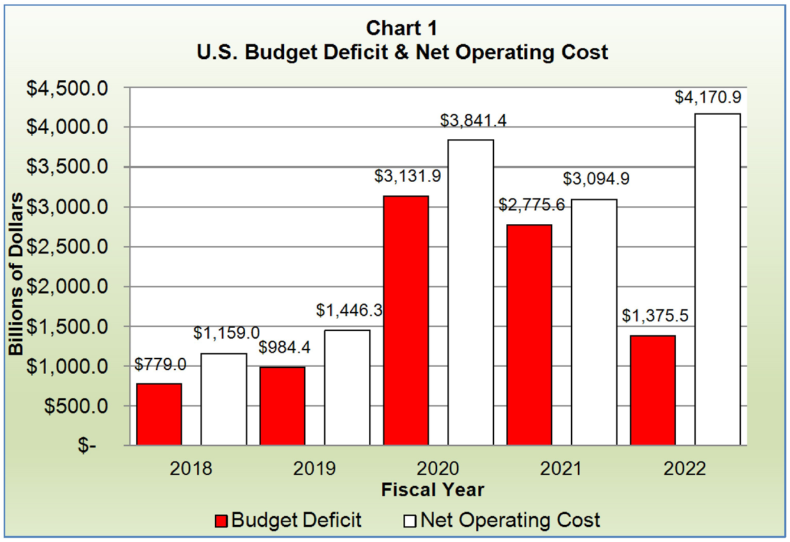
Budget of the U.S. Government

From a budgetary perspective, which is presented on the cash basis of accounting, the Federal Government collected $4.9 trillion in FY 2022, while it spent $6.3 trillion, operating at a $1.4 trillion Budget Deficit.[26] This deficit constituted a 50% decrease as compared to FY 2021 (when it collected $4.0 trillion and spent $6.8 trillion, operating at a $2.8 trillion Budget Deficit).[27] The graphic below shows the five-year deficit trend, as compared to the corresponding year's Net Operating Costs.[28]



The key factors driving the change are as follows:

1. Decreased Spending

From FY 2021 to FY 2022, the U.S. Financial Report indicates a $550.0 billion decrease in cash outlays from $6.8 to $6.3 trillion, an 8.1% decrease.[29] This decrease in spending is partially due to reductions in COVID-19 related spending, which were significant in fiscal years 2020 and 2021, such as unemployment insurance and Small Business Act programs. Although there was a decrease overall in outlays, other categories of spending increased compared to FY 2021, such as spending due to the COVID-19 suspension of student loans, Medicare outlays, and net interest expenses.[30]

2. Increase in Revenues

For the same periods, the U.S. Financial Report highlights a sharp increase in revenues of $850.1 billion (or 21.0%) from $4.0 to $4.9 trillion.[31] This increase is primarily due to increased individual and corporate income tax collections and an increase in receipts such as social insurance and retirement receipts.[32]

[26] 2022 U.S. Financial Report, at pg. 64.
[27] *Ibid.*
[28] 2022 U.S. Financial Report, at pg. 3.
[29] 2022 U.S. Financial Report, at pgs. 17 and 64.
[30] 2022 U.S. Financial Report, at pg. 17.
[31] 2022 U.S. Financial Report, at pgs. 17 and 64.
[32] 2022 U.S. Financial Report, at pg. 17.

Observations About the U.S. Financial Report

There are several items contained in the U.S. Financial Report that are worthy of further discussion. Key topics include the following: the GAO's disclaimer of opinion, the material weaknesses identified in the U.S. Government's accounting controls, the significant liabilities that are disclosed but not reported on the balance sheet, and the assertion by the Treasury that current fiscal policy is not sustainable.

Warning: Reported Results May Not Be Reliable

The GAO issued a disclaimer of opinion on the U.S. Government's Financial Report, as it has done consistently for the past 25 years. A disclaimer of opinion is a type of audit report in which "the auditor ***does not express an opinion*** on the accompanying financial statements."[33] The GAO stated that the reason for this conclusion was due to the following:[34]

> "***The federal government is not able to demonstrate the reliability of significant portions of the accompanying accrual-based consolidated financial statements as of and for the fiscal years ended September 30, 2022, and 2021, principally because of limitations related to certain material weaknesses in internal control over financial reporting and other limitations affecting the reliability of these financial statements and the scope of our work. As a result of these limitations, readers are cautioned that amounts reported in the accrual-based consolidated financial statements and related notes <u>may not be reliable.</u>***"

"As a result of these limitations, readers are cautioned that amounts reported in the accrual-based consolidated financial statements and related notes *may not be reliable.*"

For comparison's sake, when a public company receives a disclaimer of opinion from its auditors, it risks being delisted from the stock exchange(s) (e.g., NYSE, NASDAQ, etc.) where its shares are publicly traded.

Taxpayers Deserve Internal Controls Just Like Investors

Following the passage of the Sarbanes Oxley Act of 2002, publicly traded companies were required by law to annually document and test its system of internal controls over financial reporting.[35] In testing these controls, companies must generally ascertain that a control is 1) in place and 2) appropriately functioning according to its design. Issues identified with either or both of these elements may result in an auditor identifying a control deficiency. The most severe control deficiency assessment is known as a material weakness. A material weakness is defined as:[36]

> "***A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.***"

A material weakness can have an adverse impact on a public company as it may subject the business to increased auditor attention, costly initiatives to remediate issues identified, and shareholder scrutiny. Although such standards are not applicable to the U.S. Government, readers should be aware that the U.S. Government reported a voluminous list of material weaknesses in its Financial Report, indicating it has not met this public company benchmark.

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[33] AICPA AU-C §705.20a *Modifications to the Opinion in the Independent Auditor's Report* (emphasis added).
[34] 2022 U.S. Financial Report, at pg. 224 (emphasis added).
[35] 15 U.S.C. §7262 (2019) *Management Assessment of Internal Controls*.
[36] AICPA AU-C §265.07 *Communicating Internal Control Related Matters Identified in an Audit*.

All told, the GAO identified nine broad areas on which to focus its discussion of material weaknesses identified in the FY 2022 U.S. Financial Report. These include the following:[37]

Area of Material Weakness	Description
Property, Plant, and Equipment and Inventories and Related Property	The DOD did not maintain adequate systems or have sufficient records of its assets. Other entities reported deficiencies in internal control procedures related to property, plant, and equipment as well.
Loans Receivable and Loan Guarantee Liabilities	The auditor of the Small Business Administration reported several material weaknesses in internal control regarding the Paycheck Protection Program (PPP) and the COVID-19 Economic Injury Disaster Loan program. The SBA also did not properly design and implement effective entity-level controls.
Liabilities and Commitments and Contingencies	The Federal Government could not reasonably estimate or adequately support amounts reported for certain liabilities. Additionally, it could not determine whether commitments and contingencies were complete and properly reported.
Cost of Government Operations and Disbursement Activity	Reported net cost was affected by the material weaknesses. As a result, the Federal Government was unable to support significant portions, most notably those related to DOD, SBA, and Education.
Intragovernmental Activity and Balances	Federal entities continue to be unable to adequately account for and reconcile intragovernmental activity and balances between federal entities.
Preparation of Consolidated Financial Statements	The Federal Government continues to have inadequate systems, controls, and procedures to ensure that the consolidated financial statements are consistent with the underlying audited entity financial statements, properly balanced, and in accordance with GAAP.
Reconciliations of Budget Deficit to Net Operating Cost and Changes in Cash Balance	For several years, there have been considerable internal control deficiencies related to the monitoring, accounting, reconciliation, and reporting of budgetary transactions. Such deficiencies may affect the reporting and calculation of the net outlay amounts in the federal entities' Statements of Budgetary Resources, which in turn, may impact these entities' ability to report reliable budgetary information to the Treasury and the Office of Management and Budget.
Improper Payments	The Federal Government continues to face challenges in determining the full extent of its improper payments. Although progress has been made, internal control deficiencies over financial reporting continue to increase the risk that improper payments may not be detected promptly.
Information System Controls	Control deficiencies continue to be identified related to security management, access to computer data, equipment, and facilities, changes to and configuration of information system resources, segregation of incompatible duties, and contingency planning.

[37] 2022 U.S. Financial Report, at pgs. 240 - 250.

Disaggregating this further, the Financial Report states that the CFO Act Entities reported 50 material weaknesses, which continue to "prevent the government as a whole from achieving an audit opinion."[38] Taxpayers should not expect the deficiencies to be corrected in the near future. The DOD has reported long periods for correction of its identified deficiencies, some that range through FY 2028.[39]

The DOD is of particular relevance, as its FY 2022 reporting identified 37 material weaknesses of its own. The agency also accounts for a large portion of the government's reported assets and net costs, as we previously pointed out. Notably, none of the 37 material weaknesses disclosed by the DOD are expected to be corrected in the current fiscal year.[40]

"Off-Balance Sheet" Risks and Liabilities

The U.S. Financial Report does not reflect all of the government's obligations, as certain agencies are omitted from the consolidated reporting entities. Notably, the present value of social insurance obligations and the status of GSEs – to name a few – are in large part not reflected in the financial position of the U.S. Government.

Disaggregating this further, the Financial Report states that the CFO Act Entities reported 50 material weaknesses.

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The Treasury's Statements of Social Insurance report that as of September 30, 2022, the total present value estimate of future expenditures in excess of future revenue (in other words, the net obligation) for the Social Insurance programs is approximately $75.9 trillion.

Social Insurance Obligations

Given the fact that "Social Security and Medicare are among the largest expenditure categories of the U.S. federal budget,"[41] the exclusion of the related obligations in the U.S Financial Report materially understates the liabilities burdening the U.S. Government. The Treasury's Statements of Social Insurance[42] report that as of September 30, 2022, the total present value estimate of future expenditures in excess of future revenue (in other words, the net obligation) for the Social Insurance programs is approximately $75.9 trillion.[43] In weighing this projection, the Financial Report presents a $3.3 trillion total in Trust Fund Assets to cover the entirety of the Social Insurance programs.[44]

Relationship with Government Sponsored Enterprises

The Federal Government holds Senior Preferred Stock Purchase Agreements with Fannie Mae and Freddie Mac. These arrangements require a maximum remaining potential commitment of $254.1 billion to the GSEs.[45] Effectively, this could require potential future payments by the Federal Government to keep the GSEs solvent (i.e., maintain positive net assets).[46] The Treasury estimated there was no probable future funding draws, citing "challenges quantifying future market volatility or the timing, magnitude, and likelihood of such events," and as such, opted not to accrue a contingent liability as of September 30, 2022.[47] It did, however, determine that such non-recurring events and market volatility represented a "reasonably possible future funding liability."[48]

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[38] 2022 U.S. Financial Report, at pg. 39.
[39] DOD's 2022 Annual Financial Report, at pgs. 235 - 244.
[40] *Ibid.*
[41] 2022 U.S. Financial Report, at pg. 186.
[42] Per the Bureau of the Fiscal Service's website (fiscal.treasury.gov), "[the Statements of Social Insurance] provide estimates of the status of the most significant social insurance programs."
[43] 2022 U.S. Financial Report, at pg. 68.
[44] 2022 U.S. Financial Report, at pgs. 44, 153 - 154. The report balance is the total of the following social insurance programs: Social Security ($2.9 trillion as of January 1, 2022) and Medicare ($0.4 trillion as of January 1, 2022).
[45] 2022 U.S. Financial Report, at pgs. 97 - 100.
[46] *Ibid.*
[47] 2022 U.S. Financial Report, at pg. 99.
[48] *Ibid.*

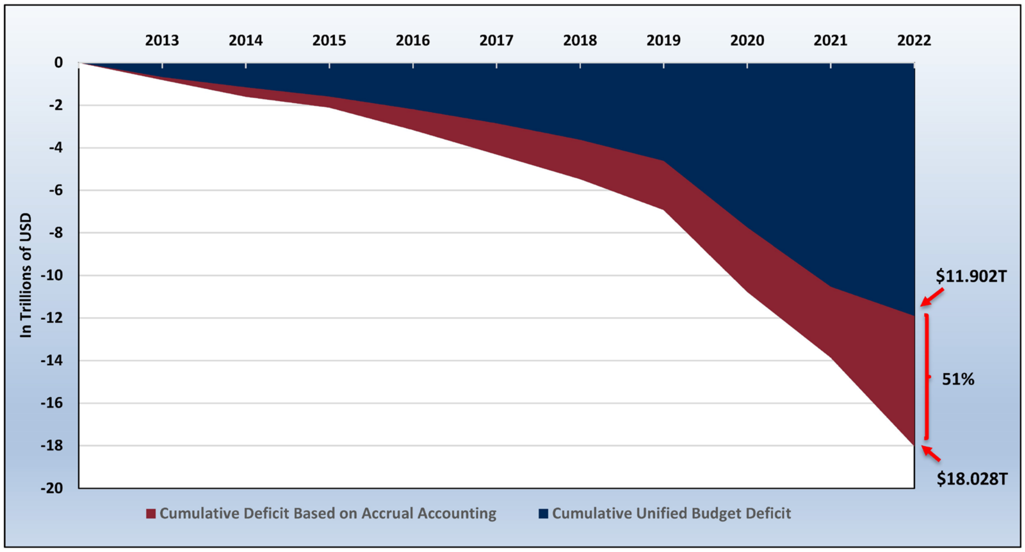
Current Budget Deficit Understates Government "Losses"

As discussed above, while the U.S. Financial Report uses the cash basis of accounting for budgetary purposes, the financial statements are reported on a modified accrual basis.

When comparing the results from these two reports that use very different methods of accounting for reporting U.S. Government financial information, a material difference arises. While both reflect negative results, the modified accrual basis of accounting, which is a more accurate economic measurement of financial position and profitability, resulted in a 51% higher cumulative "deficit" over the last decade than the annual budget process reflects.

The graph below depicts the accumulated budget deficit over the last ten years, as well as the additional incremental net operating costs incurred.[49] It shows the difference between the accrual basis (Net Operating Cost) and the cash basis (Budget Deficit) over time.

10 Year Cumulative Unified Budget Deficit vs. Net Operating Cost



Separately, when comparing year-by-year differences on a standalone basis, FY 2022 demonstrated one of the largest disparities in the cash versus the accrual deficit at approximately $2.8 trillion. Per the FY 2022 Financial Report, this difference was mainly attributed to the federal employee and veteran benefits programs.[50]

"An Unsustainable Fiscal Path"

As is underscored by the results of the U.S. Financial Report, the Treasury states that the "current policy is not sustainable."[51] Contrary to the current trend, a sustainable policy is one where the debt-to-GDP ratio is ultimately stable or declining.

GDP is a measurement of the nation's economy in terms of the total value of all final goods and services that are produced in a year. When considering financial results relative to GDP, the result is a useful indicator of our economy's ability to sustain the government's numerous programs.

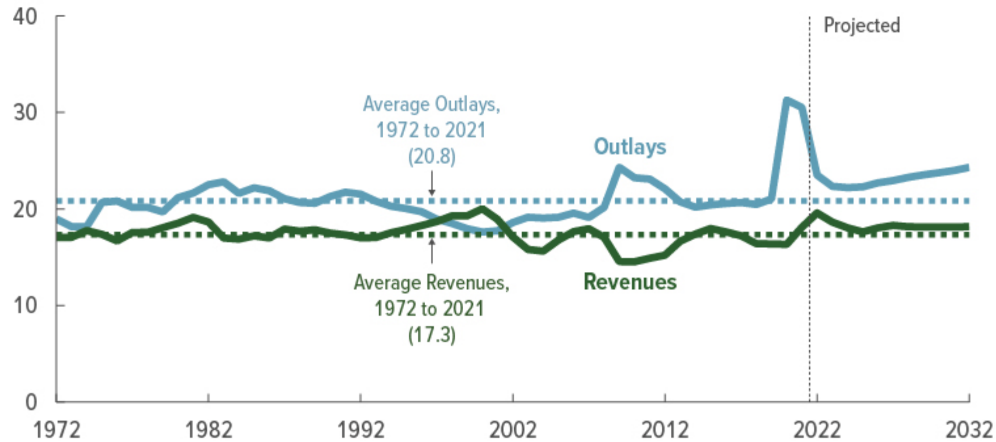
Fannie Mae and Freddie Mac's combined "off-balance sheet" liability exposure was $618.3 billion for the same year ended.

* * * * *

The modified accrual basis of accounting, which is a more accurate economic measurement of financial position and profitability, resulted in a 51% higher cumulative "deficit" over the last decade than the annual budget process reflects.

[49] Compiled from U.S. Government Reconciliations of Net Operating Cost and Unified Budget Deficit for the years ended September 30, 2013 through 2022.
[50] 2022 U.S. Financial Report, at pg. 63.
[51] 2022 U.S. Financial Report, at pg. 9.

Before analyzing the current debt-to-GDP ratio, it is helpful to first understand the broader picture in terms of the government's historical collections and spending, as a function of GDP. The chart below includes total government revenues and outlays as a percentage of GDP for the last 50 years.[52] Notably, while the average outlays for the past 50 years averaged 20.8% of GDP, revenues averaged just 17.3% for the same period.

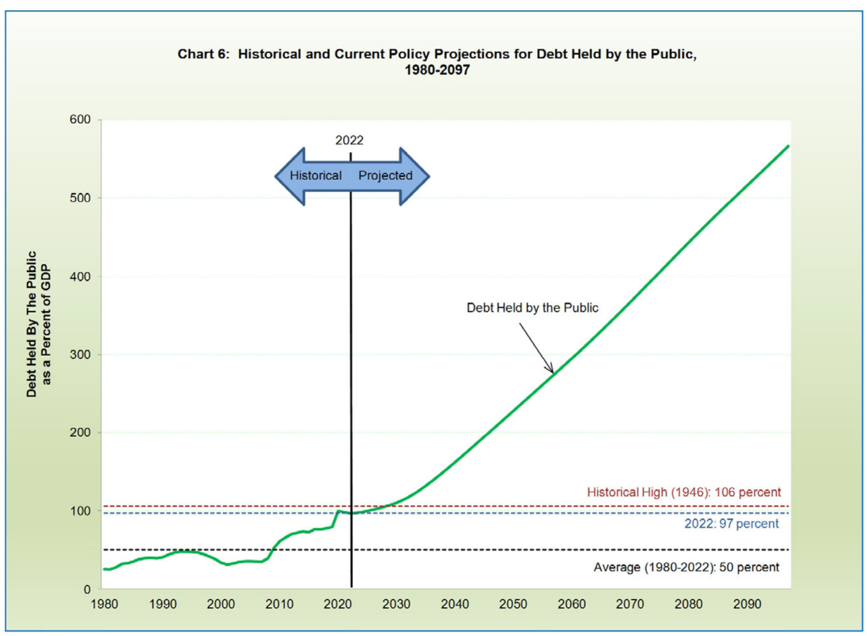


As is underscored by the results of the U.S. Financial Report, the Treasury states that the "current policy is not sustainable." Contrary to the current trend, a sustainable policy is one where the debt-to-GDP ratio is ultimately stable or declining. The debt-to-GDP ratio for FY 2018 was 97%. Under the current policy, this ratio is projected to reach 566% in 2097.

With this understanding, we can next consider debt-to-GDP.

The debt-to-GDP ratio for FY 2022 was 97%.[53] One of the main drivers, interest costs on publicly-held federal debt, increased by $104.5 billion in FY 2022.[54] This resulted from an increase in interest rates, inflation adjustments, and outstanding publicly-held federal debt.[55]

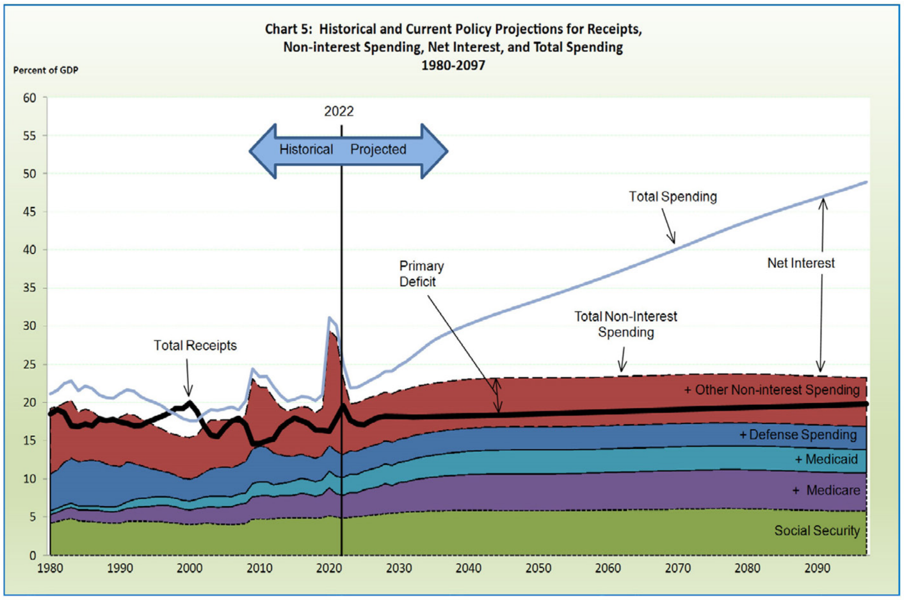
Under the current policy, this ratio is projected to increase precipitously each decade, reaching almost 600% by the end of the century,[56] as illustrated in the graphic below:[57]



[52] https://www.cbo.gov/publication/58147.
[53] 2022 U.S. Financial Report, at pg. 8.
[54] 2022 U.S. Financial Report, at pg. 5.
[55] *Ibid.*
[56] 2022 U.S. Financial Report, at pg. 8.
[57] *Ibid.*

To an auditor of a public company, trends and projections such as these would trigger questions about a company's ability to continue as a *going concern*.[58]

Regarding the collections and spending as a function of GDP, the following graph illustrates the impact that a current policy would have on projections for government spending and receipts.[59]



As articulated above, the gap between government receipts and government spending is expected to widen significantly over time, largely due to the current policy remaining static and the compounding impact of increasing net interest over time. Interestingly, it is estimated that net interest will represent about ***half*** of the total government spending by the end of the century.

Additionally, the GAO analyzed the cost of delaying fiscal reform policy. If action is delayed by 10 years, the estimated magnitude of primary surplus increases necessary to close the 75-year fiscal gap would increase by about 16 percent. However, if action is delayed by 20 years, the magnitude of reforms necessary would increase by about 43 percent.[60] As such, addressing the fiscal gap issues timely is the most fiscally responsible course of action.

Needless to say, from the perspective of a corporate shareholder, the data and analyses relayed herein would raise serious concerns about the U.S. Government's financial outlook and its ability to continue as a going concern.

[58] Accounting guidance defines substantial doubt about an entity's ability to continue as a *going concern* as follows: "conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable)." AICPA AU-C §570.A3 *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

[59] 2022 U.S. Financial Report, at pg. 7.

[60] 2022 U.S. Financial Report, at pg. 9.

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We hope you found our analyses and related observations insightful and welcome your comments and feedback.

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ABOUT Floyd Advisory
Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of SEC reporting, transaction advisory, investigations and compliance, litigation services, as well as business strategy and valuation.

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