

Editor's Note: For background on this sample USA 10-K, see the opinion piece titled, "USA 10-K: Why America Needs an Annual Report," published in Knowledge@Wharton. This document was written by the authors of that piece.

USA 10-K

America's Annual Report for 2012

Fellow Americans:

This report is the collective effort of the Executive and Legislative branches of your government. It offers our assessment of the performance of America and our prospects for the future. We have strived to present the key issues we face as a nation in a limited number of pages, with balance, candor and clarity being our guides.

History and Background

Two hundred and thirty-six years ago, "We the People" declared our independence from a distant government that did not know its people and provided no representation or accountability. In the ensuing decades, our citizens have made unprecedented sacrifices for, and investments in, the future of our country. As a result, we have grown to become the embodiment of achievable ideals, betterment and sustainable growth.

We recognize that our people will always be our country's most important assets. Our government exists to ensure the rights and freedoms that protect life, liberty, tranquility, property and the pursuit of happiness, for current and future generations. This ideal has been essential to enabling and preserving American opportunity, individualism and exceptionalism. And, by staying true to these common bonds, through triumphs and tragedies, we have continued our journey to make good on the promises of individual and collective betterment, equality under law and new beginnings.

We, as your elected representatives, are stewards of this great nation. We are humbled by the sacrifices and achievements of the many great generations that have come before us. Yet, we readily accept that it is our task to leave the country in a better position than we found it. Today, as in times past, we have work to do.

The Performance of Your Government; Our Fiscal 2012 Condition; and Our Future

Summary of our Financial Condition

As many families know all too well, while money is not the only thing that matters, in times of strain, its significance casts a cloud over virtually all matters. Our financial condition has weakened in the past decade. While there are different views about how to address this trend, there is a real risk that, if current trends continue, our ability to meet our social and financial commitments will be undermined.

How did we get here? For each year in the past decade, we have run a growing deficit, spending more money than we have received. In 2011, we spent \$1.3 trillion (or 56%) more than we took in. We have raised the cash to fund our yearly deficits by borrowing and, as a result, we increased our national debt by \$1.3 trillion in 2011 and \$6.1 trillion over the past decade. Our national debt held by the public (including foreign governments) totaled \$10.1 trillion at the end of 2011.

The size of our yearly deficit has been increasing. In 2005, we received \$2.15 trillion in revenues, and we received \$2.3 trillion in fiscal year 2011. However, our expenditures have grown from \$2.47 trillion in 2005 (a deficit of \$320 billion) to \$3.6 trillion in 2011. At current rates, our total additional deficit for the next five years will be \$6.5 trillion and our national debt will be \$20 trillion by the end of 2015. Reversing this trend will require hard work and painful decisions.

The national debt and deficit numbers do not include all of the government's past expenditures and future obligations. For various reasons, including national security, we have decided to consider certain items "off balance sheet" (for example, certain defense costs like the emergency funding for the wars in Iraq and Afghanistan). We also have future commitments to Social Security, Medicare and other programs that we expect will require us to spend substantial sums, but we do not reflect those amounts in our calculation of current debt.

Many signs point to a continuing decline in the strength of our financial condition. Unless we change course, we will continue to spend more than we collect for the next decade and beyond because of our increasing obligations for health care and Social Security. We project an increase in spending in these areas from approximately \$1.7 trillion in 2013 (or about 10.6% of GDP) to \$3.0 trillion in 2022 (or about 12.2% of GDP). In considering these and other projections, you should recognize that, in many cases, our past projections of future costs, benefits and GDP growth have been too optimistic.

Why is the government spending substantially more than it is collecting? At various points in our history, it has been prudent policy to operate with a deficit and, as a result, increase our national debt, including to defend our country and to stimulate our economy in troubled times. We believe there have been good reasons to justify a deficit over the past decade. However, national debt cannot be perpetually increased. Carrying a large and increasing national debt poses a number of risks. It limits our ability to increase spending to deal with future threats to our country, our economy or our way of life. It increases the risk that we will face a financial shock that undermines confidence and ripples through our economy, and it leaves us vulnerable to foreign powers that have become our key lenders.

Our Performance

How we evaluate our Performance. Over the past decade, your government has had many successes, but it also has underperformed by many measures. We will not focus on our successes, but rather on cases where we have missed the mark, because that is where we must improve if we are to enable our people to do better.

For these purposes we view the government as acting through three overlapping channels: (1) establishing and enforcing rights and responsibilities among people and organizations through laws and regulations (for example, protecting freedom of speech and prohibiting

discrimination in employment); (2) allocating financial resources; and (3) securing and furthering America's position in the world.

Establishing and Enforcing Rights and Responsibilities. Over our history, we have made incredible and enviable strides in enforcing the rights of minorities, women, the handicapped and the underprivileged. Many of our strides towards equality and continued prosperity have been achieved only after great pain and sacrifice. While we must remain vigilant in protecting the rights of the few, the underprivileged and the underrepresented, we should recognize that institutions are in place, and laws have been written, that can give voice to the voiceless.

When it comes to establishing new rights and obligations, we hear from virtually every group we serve that our laws and regulations should reflect their views, both broad and narrow, and if their views conflict with the views of others, the others should yield. There is nothing wrong with this. It's our job to hear these requests (and also to think about what those who may not have a voice would request) and balance them in light of our shared history, values, objectives and our place in the world.

For these and other reasons, our laws have grown too long and complicated. As an example, the Glass-Steagall banking reform act of 1933 was comprehensive in 37 pages, but the Dodd-Frank financial reform legislation of 2010 runs to 2,319 pages, not including the tens of thousands of pages of related rules and regulations.

As another example, our tax code currently is approximately 74,900 pages in length. Ten years ago it was approximately 54,900 pages and fifty years ago it was less than 15,000 pages. This increase is in large part the result of our desire to drive behavior by providing tax preferences or subsidies for some things and penalties for others.

This state of affairs is widely recognized. Karen Petrou, a bank analyst, has recently coined the phrase "complexity risk," to describe the current state of regulatory affairs. "If we don't understand the cross-cutting effects and inherent contradictions in all of the stringent standards now being written into final form, we risk doing real damage to the sound, stable and — yes — profitable financial industry regulators say they support and the economies sorely need," she said last November. Why should we be concerned about the growing complexity of our laws and regulations? Joe Nocera of *The New York Times*, a strong critic of deregulation, describes a few of the problems of surrendering simplicity: Companies will find ways of gaming the system; contradictory regulations, no matter how well intentioned, don't make the system any safer; and complexity risk is counterproductive for companies, particularly in a fragile economy.

At this length and level of complexity, many of our laws are accessible only to specialized lawyers, regulators and a tiny handful of politicians. Individuals and small businesses spend significantly more today than they did a decade ago complying with federal laws. We find it distressing and unacceptable that the majority of the American people who pay taxes have to pay someone else to tell them how much they owe. Our large companies have hundreds, in some cases thousands, of lawyers and compliance officers. It is broadly accepted, and we agree, that the country would be better off if more of our brightest and most creative citizens pursued careers in science, industry and medicine instead of devoting their talents to influencing and interpreting laws.

We intend to improve our performance by recognizing that just because innovations in communications and technology, such as e-mail and word processing, have increased the demand for laws and made it easier to draft new laws, that does not mean we need to make more voluminous laws -- we should be using these and other innovations to make laws that are smarter and more easily understood and communicated.

Raising and Allocating Financial Resources. Our current debt, in combination with the expectation that deficit spending will continue and our lack of a clear commitment to bringing our spending and revenues into line over time, has caused Standard & Poor's, the credit rating agency, to remove our "Triple A" rating. One of the fundamental problems with deficit spending is that the more we do it, the more risk the resulting increase in debt places on our future and, as a result, the more difficult it is to justify deficit spending in response to a future crisis.

The challenge we face is bringing down our deficit without harming our economy, our people or our shared values. The challenge is particularly acute now because our economy has been weakened by the financial crisis and its effects as well as by foreign competition. Moreover, our economy has become dependent on government spending. Economies thrive on confidence and recede in the face of uncertainty.

Our current debt and our expected deficits are threatening that confidence, but each of the most obvious cures, cutting spending and increasing taxes, creates uncertainty and substantial personal costs. As an illustration, to immediately bring our spending and revenues into line using spending cuts alone would require budget cuts of approximately 30% (if defense and Social Security are not cut, everything else would have to be cut by approximately 50%); and, if we were to use tax increases alone, taxes would need to be increased by 45%. Our search for a solution should also be informed by the fact that we are out of step with historic and international norms, particularly in the areas of health care and social security. We spend almost twice as much per person on health care as other advanced nations (with little or no additional benefit by many measures) and we expect that by 2035, total spending on health care could reach 25% of GDP. In 1960, there were five workers contributing to Social Security to support one beneficiary. Today, it's three workers per beneficiary, and by 2030 the ratio will be two to one.

And here is where one of the most significant risks to our future prosperity and harmony lies. We know the issues; we know the risks of inaction are becoming more severe and we have expended a great effort to find a solution, including the recently failed Simpson/Bowles "Super Committee," yet we have been unable to find an acceptable path forward. We know this will be an area of substantial focus in the years to come, and we also know that the country will benefit if we establish a way forward before we face a "crisis" or "cliff."

This is where we turn back to our most important asset, our people. We can take direct action with respect to government spending and revenues (taxes). A third-key variable is productivity, which is often discussed in terms of employment and GDP growth. We can and, if we are to maintain our position in the world, must, reduce unemployment and put more people to work and realign the balance between work and support. Due to increases in lifespan and other factors, ordinary Americans now expect to work approximately one-third of their lives and be supported, at least in part, by government spending for more than one-third of their lives. This is a dramatic shift in our society from just a generation ago. You

should recognize that in a competitive world, it is unlikely we will be able to maintain our standard of living if we do not change this work-support balance.

Securing and Furthering America's Position in the World. America is the most influential participant in international relations and global economics. Our influence also affects cultural development and individual perspectives around the globe. Even our absence or withdrawal from an international political or economic matter can have broad effects. We enjoy this position as a result of our economic and military strength, our social stability and our shared culture of freedom, responsibility and collective betterment and our judicious exercise of our powers.

The task of furthering America's position in the world has undergone dramatic changes in recent decades and has grown in importance, primarily due to the continued integration of the world's economy, the wider distribution of substantial military power and the instantaneous and ubiquitous nature of communications and access to information. In assessing our performance in this area, we begin by recognizing that our country has enjoyed a period of peace within its borders and economic prosperity that is unprecedented for any nation, and the benefits to the country and its citizens of this economic strength and hard won peace are great but are difficult to measure with precision.

With this context, we turn to our performance over the past decade. There have been many successes for which we should feel proud. We have continued as the world's incubator for new technology and business; lasting peace has come to Eastern Europe and Northern Ireland; and the evil of totalitarian and terroristic regimes has been contained. However, there is substantial room for improvement, including, most significantly, in the areas of global economic leadership and the coordination of our domestic and international efforts.

At the governmental level, our economic condition is no stronger, and by many measures is weaker, than it was a decade ago. This has affected our ability to influence public and private actors abroad. As an extreme but illuminating example, we find ourselves in the extraordinary position that our largest creditors are significant economic competitors and potentially military foes. In statecraft as in business, power and a healthy balance sheet go hand in hand.

National Security is among our highest priorities. The safety of our people, economy and infrastructure is essential to the preservation of our nation and way of life. Your government is involved in efforts, both foreign and domestic, to combat transnational threats, including state-sponsored terrorism, nuclear proliferation, organized crime, drug trafficking, cyber-security and human rights violations. For various reasons, including not adversely affecting our ongoing security efforts and the safety of personnel involved, we are unable to disclose the full extent of these risks and the full scope of our efforts, accomplishments and failures. You should know that many individuals have made great and, in too many cases the ultimate, personal sacrifice for their families and their fellow citizens in the effort to preserve our security.

While we have achieved many successes, there remain significant and, in some cases growing, threats that we know, as well as threats that have yet to emerge. Threats within our borders that we expect to increase include cyber-attacks against public and private infrastructures and systems and the invasion of narcotics and violence from abroad. We also

continue to face more familiar and serious threats from hostile nations and groups, some of which have substantial resources.

Battling and containing these threats and risks presents many challenges. It is our obligation to safeguard our country in a manner consistent with the rights secured by our Constitution, including freedom from unreasonable search, freedom of speech and due process. Fulfilling this obligation presents difficult questions of policy and practice, and as has been the case in the past, there will be mistakes and controversies. In addition, the effectiveness of our efforts often depends significantly on the cooperation and assistance of other nations and organizations. These are states and entities with whom we have influence, but do not control, and their interests and motivations often will not be aligned with, and may be adverse to, America's.

Our Management, Oversight and Disclosure

Our Management. We believe we are qualified for the positions we hold and, collectively, provide a beneficial diversity in experience, expertise and perspective. Our self-belief is buttressed by the fact that, with each election, our constituents have the opportunity to review our qualifications and performance in detail. If we do not perform as we should, you should replace us. However, you should recognize that this review by ballot box process does have limitations. For example, it is inherently local in nature. Our nation and, in particular, our economy is increasingly affected by national and international factors, and to make and implement policies effectively, it is critical that we take account of the activities and reactions of non-U.S. entities and global markets. Our collective experience with, and knowledge of, national and international matters has not increased in step with globalization.

Compensation; Compensation Policy and Incentives. Our leaders are compensated with a significant salary and also receive other benefits, including substantial health care and pension benefits and travel allowances, as well as the prestige and influence of their position both during and following their service. In short, the economic and other benefits of our positions are significant and substantially exceed our stated salaries (e.g., \$174,000 per year for most members of the House and Senate, who typically need to maintain residences in Washington and their represented areas).

The goal of our compensation policy should be to align the incentives of our leaders with the immediate as well as the long-term interests of the American people. (We are mindful of the comedic suggestion that one way to solve the deficit would be to put lawmakers on commission.) Incentive alignment through compensation is different in the case of leaders of a country (who are subject to removal by ballot if they do not serve properly) from the case of leaders of a business, and there are aspects of our compensation system and the election process that produce incentives that may not be in appropriate alignment with the interests of the American people.

To continue to receive our salaries and generous benefits, we must win re-election. Election campaigns often are expensive and depend in large part on the financial and other support of individuals and organizations. On the other hand, the ability to influence our lawmaking and enforcement can be extremely valuable to individuals and organizations. This great value in influence, in combination with the need for electoral support, is the source of potentially corrosive dynamics -- in many cases, the promise of campaign financing and

voter turnout will at a minimum provide access to our elected leaders. In addition, the extreme value in influencing the legislative process may motivate some of our more experienced leaders and government employees to retire from public service but remain involved in the legislative process to increase their wealth by marketing the influence they have gained from government service.

Financial Reporting; Forecasting; and Internal controls. As in the management of a household or a business, an accurate understanding of America's financial condition is fundamental to good government. America's financial statements are prepared by the Treasury in close coordination with the White House Office of Management and Budget, and our budgets, which are proposed by the President, are analyzed by the Congressional Budget Office. We are generally pleased with their work. However, there are areas, particularly in assessing the costs and other financial effects of proposed legislation, forecasting future revenues and expenses, and discussing the effects of long-term commitments, where their estimates have proven to be incorrect and, in most cases, over-optimistic by a wide margin.

With respect to controls -- in other words, ensuring that your money is not being wasted -- we are fortunate to have the Government Accountability Office (GAO), whose sole job is to ensure the efficiency and effectiveness of our spending and operations. Unfortunately, when the GAO reviewed our 2010 consolidated financial statements, it was unable to give full comfort that our financial statements are accurate, noting "widespread material internal control weaknesses, significant uncertainties and other limitations." In fact, 19 of 24 major government agencies, including the Departments of Defense, Homeland Security and Labor, failed to meet the criteria for clean opinions. We need to improve our internal controls and we need to heed them -- all too often, we have ignored our own controls (including the conclusions of our own auditors) and have failed to meet our own deadlines.

Conclusion

Mindful of Lincoln's model for national leadership, we recognize that we are but the representatives of the hopes of Americans, temporary occupants of seats of power. Our power comes from you, and we hope that this report furthers your understanding of the issues we all face and fosters a basis for finding consensus in our continuing journey as the world's beacon of hope, opportunity and progress.

We await your comments.