United States Government Accountability Office

Report to the Secretary of the Treasury

November 2018

FINANCIAL AUDIT

Bureau of the Fiscal Service's Fiscal Years 2018 and 2017 Schedules of Federal Debt

GAO-19-113

GAO Highlights

Highlights of GAO-19-113, a report to the Secretary of the Treasury

November 2018

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Why GAO Did This Study

GAO audits the consolidated financial statements of the U.S. government. Because of the significance of the federal debt to the government-wide financial statements, GAO audits Fiscal Service's Schedules of Federal Debt annually to determine whether, in all material respects, (1) the schedules are fairly presented and (2) Fiscal Service management maintained effective internal control over financial reporting relevant to the Schedule of Federal Debt. Further, GAO tests compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements related to the Schedule of Federal Debt.

Federal debt managed by Fiscal Service consists of Treasury securities held by the public and by certain federal government accounts, referred to as intragovernmental debt holdings. Debt held by the public primarily represents the amount the federal government has borrowed to finance cumulative cash deficits. Intragovernmental debt holdings represent balances of Treasury securities held by federal government accounts—primarily federal trust funds such as Social Security and Medicare—that typically have an obligation to invest their excess annual receipts (including interest earnings) over disbursements in federal securities.

In commenting on a draft of this report, Fiscal Service concurred with GAO's conclusions.

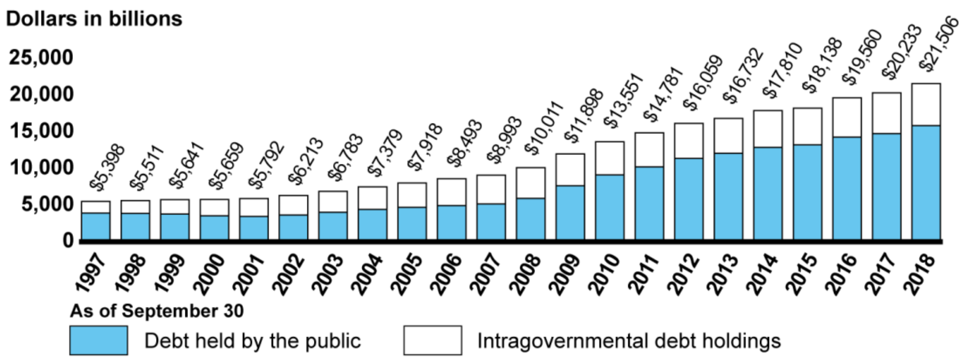
View GAO-19-113. For more information, contact Dawn B. Simpson at (202) 512-3406 or simpsondb@gao.gov.

What GAO Found

In GAO's opinion, the Bureau of the Fiscal Service's (Fiscal Service) Schedules of Federal Debt for fiscal years 2018 and 2017 are fairly presented in all material respects, and although internal controls could be improved, Fiscal Service maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018. GAO's tests of selected provisions of applicable laws, regulations, contracts, and grant agreements related to the Schedule of Federal Debt disclosed no instances of reportable noncompliance for fiscal year 2018. Although Fiscal Service made progress in addressing prior year deficiencies, unresolved and newly identified deficiencies continued to represent a significant deficiency in Fiscal Service's internal control over financial reporting related to information system controls, which although not a material weakness, is important enough to merit attention by those charged with governance of Fiscal Service.

From fiscal year 1997, the first year of audit, through September 30, 2018, total federal debt managed by Fiscal Service has increased by 298 percent and the debt limit has been raised 18 times.

Total Federal Debt Outstanding, September 30, 1997, through September 30, 2018



Source: GAO analysis of Bureau of the Fiscal Service information. | GAO-19-113
Note: A small amount of total federal debt is not subject to the debt limit.

During fiscal year 2018, total federal debt increased by about $1.3 trillion, with about $1.1 trillion of the increase in debt held by the public. The primary factor for the increase in debt held by the public was the federal deficit, which was reported as $779 billion for fiscal year 2018—up from $666 billion for fiscal year 2017. In fiscal year 2018, the debt limit was raised once and temporarily suspended for about 10 months. Additionally, interest on debt held by the public increased to $357 billion in fiscal year 2018—up from $296 billion in fiscal year 2017.

As GAO has previously reported, federal spending continues to outpace revenue. Absent action to address this structural imbalance, the federal government faces an unsustainable growth in debt. In addition, the debt limit is not a control on debt but rather an after-the-fact measure that restricts the Department of the Treasury's (Treasury) authority to borrow to finance decisions already enacted by Congress and the President. GAO has recommended that Congress consider alternative approaches for managing the level of debt.

Contents

Abbreviations

Fiscal Service	Bureau of the Fiscal Service
FMFIA	Federal Managers' Financial Integrity Act
GDP	gross domestic product
Overview	Overview on Federal Debt Managed by the Bureau of the Fiscal Service
Schedule of Federal Debt	Schedule of Federal Debt Managed by the Bureau of the Fiscal Service
Treasury	Department of the Treasury

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

November 8, 2018

The Honorable Steven T. Mnuchin
Secretary of the Treasury

Dear Mr. Secretary:

The accompanying independent auditor's report presents the results of our audits of the fiscal years 2018 and 2017 Schedules of Federal Debt Managed by the Bureau of the Fiscal Service (Schedule of Federal Debt). The independent auditor's report contains (1) our opinion that the Schedules of Federal Debt for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles; (2) our opinion that although internal controls could be improved, the Bureau of the Fiscal Service (Fiscal Service) maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018; and (3) the results of our tests of Fiscal Service's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements related to the Schedule of Federal Debt, which identified no instances of reportable noncompliance. The report also discusses deficiencies that we identified in information system controls that collectively represent a significant deficiency in internal control over financial reporting relevant to the Schedule of Federal Debt.[1]

The Schedules of Federal Debt present the beginning balances, increases and decreases, and ending balances for (1) Federal Debt Held by the Public and Intragovernmental Debt Holdings, (2) the related Accrued Interest Payables, and (3) the related Net Unamortized Premiums and Discounts managed by the Department of the Treasury's (Treasury) Fiscal Service, and include accompanying notes. As of

[1]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

September 30, 2018, and 2017, federal debt managed by Fiscal Service totaled $21,506 billion and $20,233 billion, respectively, primarily for borrowings to fund the federal government's operations. As shown on the Schedules of Federal Debt, these balances consisted of approximately (1) $15,761 billion as of September 30, 2018, and $14,673 billion as of September 30, 2017, of debt held by the public and (2) $5,745 billion as of September 30, 2018, and $5,560 billion as of September 30, 2017, of intragovernmental debt holdings.

Debt held by the public primarily represents the amount the federal government has borrowed from the public to finance cumulative cash deficits. When a cash surplus occurs, the annual excess funds can be used to reduce debt held by the public. In other words, annual cash deficits or surpluses generally represent the annual net change in the amount of federal government borrowing from the public. Debt held by the public represents federal debt issued by Treasury and held by investors outside of the federal government, including individuals, corporations, state or local governments, the Federal Reserve, and foreign governments. The majority of debt held by the public consists of marketable Treasury securities, such as bills, notes, bonds, floating rate notes, and Treasury Inflation-Protected Securities that are sold through auctions and can be resold by whoever owns them. Treasury also issues a smaller amount of nonmarketable securities, such as savings securities and State and Local Government Series securities.

As we have noted in previous years, Treasury reporting shows that foreign ownership of Treasury securities represents a significant portion of debt held by the public.[2] As of June 30, 2018, the reported amount of Treasury securities held by foreign and international investors represented an estimated 40 percent of debt held by the public. This percentage is lower than the 43 percent of debt held by the public as of June 30, 2017, but considerably higher than the estimated 30 percent of debt held by the public as of June 30, 2001. Treasury estimated that the amount of Treasury securities held by foreign and international investors has increased from $983 billion as of June 30, 2001, to $6,212 billion as of June 30, 2018—an increase of $5,229 billion.[3] Estimates of foreign

[2]GAO, *Financial Audit: Bureau of the Fiscal Service's Fiscal Years 2017 and 2016 Schedules of Federal Debt*, GAO-18-134 (Washington, D.C.: Nov. 9, 2017).

[3]Department of the Treasury, *Major Foreign Holders of Treasury Securities*, accessed November 1, 2018, http://ticdata.treasury.gov/Publish/mfh.txt.

ownership of Treasury securities are derived from information reported under the Treasury International Capital reporting system, not from the financial system used to prepare the Schedule of Federal Debt.[4] These estimates are not reported on the Schedules of Federal Debt, and as such, we do not audit these amounts.

Intragovernmental debt holdings represent federal debt owed by Treasury to federal government accounts—primarily federal trust funds such as Social Security and Medicare—that typically have an obligation to invest their excess annual receipts (including interest earnings) over disbursements in federal securities. Most federal government accounts invest in special nonmarketable Treasury securities that represent legal obligations of the Treasury and are guaranteed for principal and interest by the full faith and credit of the U.S. government. The federal government uses the federal government accounts' invested cash surpluses to assist in funding other federal government operations. Unlike debt held by the public, intragovernmental debt holdings are not shown as balances on the federal government's consolidated financial statements because they represent loans from one part of the federal government to another. Under U.S. generally accepted accounting principles, when the federal government's financial statements are consolidated, those offsetting balances are eliminated.

Debt held by the public and intragovernmental debt holdings are very different. Debt held by the public represents a claim on today's taxpayers and absorbs resources from today's economy. In addition, the interest paid on this debt may reduce budget flexibility because, unlike most of the budget, it cannot be controlled directly. In contrast, intragovernmental debt holdings reflect a claim on taxpayers and the economy in the future. Specifically, when federal government accounts redeem Treasury securities to obtain cash to fund expenditures, Treasury usually borrows from the public to finance these redemptions.[5]

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[4]The data reported under the Treasury International Capital reporting system are collected primarily from U.S.-based custodians. According to Treasury, since U.S. securities held in overseas custody accounts may not be attributed to the actual owners, the data may not provide a precise accounting of individual country ownership of Treasury securities.

[5]For more information regarding the federal debt, see GAO, *America's Fiscal Future: Federal Debt*, accessed November 1, 2018, https://www.gao.gov/americas_fiscal_future?t=federal_debt#understanding_the_debt.

We have audited the Schedule of Federal Debt since fiscal year 1997. Over this period, total federal debt has increased by 298 percent. During the last 4 fiscal years, as noted in the Overview on Federal Debt Managed by the Bureau of the Fiscal Service (Overview), total federal debt has increased by $3,696 billion, or 21 percent, from $17,810 billion as of September 30, 2014, to $21,506 billion as of September 30, 2018. Of the total increase, $2,976 billion was from an increase in debt held by the public and $720 billion was from an increase in intragovernmental debt holdings. During fiscal year 2018, total federal debt increased by $1,273 billion, consisting of a (1) $1,088 billion increase in debt held by the public and (2) $185 billion increase in intragovernmental debt holdings. The primary factor for the increase in debt held by the public was the federal deficit, which was reported as $779 billion for fiscal year 2018. The fiscal year 2018 increase in debt held by the public of $1,088 billion was greater than the reported fiscal year 2018 federal deficit of $779 billion primarily because of an increase in the government's cash balance and in federal direct student loans.

Also since 1997, the statutory debt limit has been raised 18 times, from $5,950 billion to $20,456 billion.[6] Notably, delays in raising the debt limit have occurred in each of the last 8 fiscal years, resulting in Treasury deviating from its normal debt management operations and taking extraordinary actions consistent with relevant laws to avoid exceeding the debt limit.[7] For fiscal year 2018, the debt limit was temporarily suspended for about 10 months of the fiscal year over two separate periods. First, the debt limit suspension that began in fiscal year 2017 continued through December 8, 2017, in accordance with the Continuing Appropriations Act, 2018 and Supplemental Appropriations for Disaster Relief Requirements Act, 2017.[8] Pursuant to this act, the statutory debt limit established in 31

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[6]A small amount of total federal debt reported on the Schedule of Federal Debt is not subject to the debt limit. This amount is primarily composed of unamortized discounts on Treasury bills and Zero Coupon Treasury bonds.

[7]Actions that are not part of Treasury's normal cash and debt management operations are considered "extraordinary actions" by Treasury.

[8]The Continuing Appropriations Act, 2018 and Supplemental Appropriations for Disaster Relief Requirements Act, 2017 suspended the debt limit from September 8, 2017, through December 8, 2017, and established a process that resulted in an increase of the debt limit on December 9, 2017. The debt limit was increased by the change in qualifying federal debt securities outstanding on December 9, 2017, compared to those outstanding on September 8, 2017. Pub. L. No. 115-56, div. C, § 101, 131 Stat. 1129, 1139 (Sept. 8, 2017).

U.S.C. § 3101(b) did not apply for the suspension period. An increase in the debt limit was not enacted before the expiration of this suspension period; therefore, on Monday, December 11, 2017, Treasury began taking certain extraordinary actions to avoid exceeding the debt limit. Many extraordinary actions taken by Treasury during the period of December 11, 2017, through February 8, 2018, resulted in federal debt securities not being issued to certain federal government accounts. The Overview provides details on the extraordinary actions taken by Treasury from December 11, 2017, through February 8, 2018.

On February 9, 2018, the Bipartisan Budget Act of 2018 was enacted, temporarily suspending the debt limit from February 9, 2018, through March 1, 2019.[9] On the same day, February 9, 2018, Treasury restored the uninvested principal resulting from its use of extraordinary actions to the affected federal government accounts in accordance with relevant laws, thereby increasing the federal debt. Treasury, in accordance with relevant laws, restored interest for one of the affected federal government accounts on February 12, 2018, and restored interest for the remaining affected federal government accounts at the next semiannual interest payment date of June 29, 2018. The Overview provides details on Treasury's restoration of uninvested principal and related interest subsequent to the start of the current temporary debt limit suspension period. If an increase in the debt limit is not enacted by the end of the current suspension period, then the debt limit will be increased on March 2, 2019, by the change in qualifying federal debt securities outstanding on this date, compared to those outstanding on February 9, 2018, in accordance with the Bipartisan Budget Act of 2018.

As we have previously reported, the debt limit does not restrict Congress and the President's ability to enact spending and revenue legislation that affects the level of federal debt, nor does it otherwise constrain fiscal policy.[10] Rather, the debt limit is an after-the-fact measure that restricts

[9]Section 30301 of the Bipartisan Budget Act of 2018, Pub. L. No. 115-123, § 30301, 132 Stat. 64 (Feb. 9, 2018), temporarily suspended the statutory debt limit. Pursuant to this act, 31 U.S.C. § 3101(b) does not apply for the period of February 9, 2018, through March 1, 2019. The act established a process that may result in an increase of the statutory debt limit on March 2, 2019.

[10]GAO, *Debt Limit: Market Response to Recent Impasses Underscores Need to Consider Alternative Approaches*, GAO-15-476 (Washington, D.C.: July 9, 2015); *Debt Limit: Analysis of 2011-2012 Actions Taken and Effect of Delayed Increase on Borrowing Costs*, GAO-12-701 (Washington, D.C.: July 23, 2012); and *Debt Limit: Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market*, GAO-11-203 (Washington, D.C.: Feb. 22, 2011).

Treasury's authority to borrow to finance the decisions already enacted by Congress and the President. The United States benefits from the confidence investors have that debt backed by the full faith and credit of the United States will be honored. However, as we have also previously reported, delays in raising the debt limit have created uncertainty and disruptions in the Treasury market and increased borrowing costs in both 2011 and 2013. GAO has recommended that Congress consider alternative approaches that better link decisions about the debt limit with decisions about spending and revenue at the time those decisions are made.[11]

The reported federal deficit increased for the third consecutive year to $779 billion in fiscal year 2018—up from $666 billion, $587 billion, and $439 billion for fiscal years 2017, 2016, and 2015, respectively. The increasing deficit and the need to refinance maturing debt mean that federal financing needs continued to grow over the last year. Debt held by the public as a share of gross domestic product (GDP) was approximately 78 percent at the end of fiscal year 2018, up from approximately 76 percent at the end of fiscal year 2017. As we have previously reported, federal spending continues to outpace revenue.[12] Furthermore, over the longer term, debt held by the public as a share of GDP is expected to continue to grow as a result of the structural imbalance between revenue and spending. Federal spending on health care programs—driven by an aging population and the increase in health care spending per beneficiary—and interest on the debt held by the public are the key drivers of spending growth in the long term. Health care spending for federal programs such as Medicare and Medicaid has historically grown faster than the overall economy and is expected to continue to grow at an increased rate. Specifically, enrollment in the Medicare program has grown and is expected to grow as the number of people age 65 and older increases and life expectancy continues to increase.[13] Additionally, interest on the debt held by the public increased to $357 billion in fiscal year 2018—up from $296 billion in fiscal year 2017. As we have also

[11]GAO-15-476, and GAO, *The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future*, GAO-18-299SP (Washington, D.C.: June 21, 2018).

[12]GAO-18-299SP.

[13]In addition to most individuals 65 years of age and older, Medicare beneficiaries also include individuals under age 65 who are receiving benefits from Social Security or the Railroad Retirement Board on the basis of a disability, and those having end stage renal disease.

previously reported, in recent years interest rates on Treasury securities have remained low, so interest costs have been low.[14] However, the Congressional Budget Office (CBO) projects those interest rates will rise in the short and long term, increasing the interest costs on the debt. CBO also projects that over the next 10 years spending on interest on the debt will grow more quickly than any other component of the budget. In addition, as the debt held by the public grows, greater interest payments would result than would otherwise exist with less debt. The key drivers of spending will continue to put upward pressure on the budget. Absent action to address the growing imbalance between spending and revenue, the federal government faces an unsustainable growth in debt. In taking action to change the federal government's growth in debt, it will be important for Congress to consider alternative approaches for managing the level of debt.

We are sending copies of this report to interested congressional committees, the Fiscal Assistant Secretary of the Treasury, the Commissioner of the Bureau of the Fiscal Service, the Inspector General of the Department of the Treasury, the Director of the Office of Management and Budget, and other interested parties. In addition, this report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-3406 or simpsondb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,

Dawn Simpson

Dawn B. Simpson
Director
Financial Management
and Assurance

[14]GAO-18-299SP.

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

Independent Auditor's Report

To the Commissioner of the Bureau of the Fiscal Service

In our audits of the fiscal years 2018 and 2017 Schedules of Federal Debt Managed by the Bureau of the Fiscal Service (Schedule of Federal Debt), we found

- the Schedules of Federal Debt for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- although internal controls could be improved, the Bureau of the Fiscal Service (Fiscal Service) maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018; and
- no reportable noncompliance for fiscal year 2018 with provisions of applicable laws, regulations, contracts, and grant agreements we tested related to the Schedule of Federal Debt.

The following sections discuss in more detail (1) our report on the Schedules of Federal Debt and on internal control over financial reporting, which includes other information included with the Schedules of Federal Debt;[1] (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments.

[1]Other information consists of the Overview on Federal Debt Managed by the Bureau of the Fiscal Service.

Report on the Schedules of Federal Debt and on Internal Control over Financial Reporting

In connection with fulfilling our requirement to audit the consolidated financial statements of the U.S. government, we have audited the Schedules of Federal Debt because of the significance of the federal debt to the federal government's consolidated financial statements.[2] The Schedules of Federal Debt present the beginning balances, increases and decreases, and ending balances for (1) Federal Debt Held by the Public and Intragovernmental Debt Holdings, (2) the related Accrued Interest Payables, and (3) the related Net Unamortized Premiums and Discounts managed by the Department of the Treasury's (Treasury) Fiscal Service, and include accompanying notes.[3] We also have audited Fiscal Service's internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility

Fiscal Service management is responsible for (1) the preparation and fair presentation of the Schedules of Federal Debt in accordance with U.S. generally accepted accounting principles; (2) preparing and presenting other information included in documents containing the audited Schedules of Federal Debt and auditor's report, and ensuring the consistency of that information with the audited Schedules of Federal Debt; (3) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of Schedules of Federal Debt that are free from material misstatement, whether due to fraud or error; (4) evaluating the effectiveness of internal control over financial

[2] 31 U.S.C. § 331(e)(2). Because Fiscal Service is a bureau within the Department of the Treasury, federal debt and related activity and balances managed by it are also significant to the consolidated financial statements of the Department of the Treasury (see 31 U.S.C. § 3515(b)).

[3] Debt held by the public represents federal debt issued by Treasury and held by investors outside of the federal government, including individuals, corporations, state or local governments, the Federal Reserve, and foreign governments. Intragovernmental debt holdings represent federal debt owed by Treasury to federal government accounts, primarily federal trust funds such as Social Security and Medicare.

reporting based on the criteria established under FMFIA; and (5) its assessment about the effectiveness of internal control over financial reporting as of September 30, 2018, included in the accompanying Management's Report on Internal Control over Financial Reporting Relevant to the Schedule of Federal Debt in appendix I.

Auditor's Responsibility

Our responsibility is to express an opinion on the Schedules of Federal Debt and an opinion on Fiscal Service's internal control over financial reporting relevant to the Schedule of Federal Debt based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the Schedules of Federal Debt are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to the other information included with the Schedules of Federal Debt.

An audit of the Schedule of Federal Debt involves performing procedures to obtain audit evidence about the amounts and disclosures in the Schedule of Federal Debt. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the Schedule of Federal Debt, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Schedule of Federal Debt in order to design audit procedures that are appropriate in the circumstances. An audit of the Schedule of Federal Debt also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Schedule of Federal Debt.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[4] The procedures selected depend on the auditor's judgment,

[4]A material weakness is a deficiency, or 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered Fiscal Service's process for evaluating and reporting on internal control over financial reporting relevant to the Schedule of Federal Debt based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting relevant to the Schedule of Federal Debt was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting relevant to the Schedule of Federal Debt that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

Internal control over financial reporting relevant to the Schedule of Federal Debt is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the Schedule of Federal Debt in accordance with U.S. generally accepted accounting principles and (2) transactions related to the Schedule of Federal Debt are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the Schedule of Federal Debt.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion on the Schedules of Federal Debt

In our opinion, the Schedules of Federal Debt present fairly, in all material respects, Federal Debt Managed by Fiscal Service and the related Accrued Interest Payables and Net Unamortized Premiums and Discounts as of September 30, 2018, and 2017, and the related increases and decreases for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Opinion on Internal Control over Financial Reporting

In our opinion, although internal controls could be improved, Fiscal Service maintained, in all material respects, effective internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018, based on criteria established under FMFIA. As discussed below in more detail, our fiscal year 2018 audit continued to identify deficiencies in Fiscal Service's information system controls that collectively represent a significant deficiency in internal control over financial reporting.[5] We considered this significant deficiency in determining the nature, timing, and extent of our audit procedures on Fiscal Service's fiscal year 2018 Schedule of Federal Debt.

Although the significant deficiency in internal control did not affect our opinion on Fiscal Service's fiscal year 2018 Schedule of Federal Debt, misstatements may occur in unaudited financial information reported internally and externally by Fiscal Service because of this significant deficiency.

We will be reporting additional details concerning this significant deficiency separately to Fiscal Service management, along with recommendations for corrective actions. In addition to the significant deficiency in internal control over Fiscal Service's information system controls, we also identified other deficiencies in Fiscal Service's internal control over financial reporting relevant to the Schedule of Federal Debt that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant Fiscal Service management's attention. We have communicated these matters to Fiscal Service management and, where appropriate, will report on them separately.

[5]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Significant Deficiency in Information System Controls

During our fiscal year 2018 audit, we determined that unresolved information system control deficiencies from prior audits along with new control deficiencies collectively represent a significant deficiency in Fiscal Service's internal control over financial reporting. These control deficiencies relate to information system general controls in the areas of security management, access controls, and configuration management.[6] The potential effect of these new and continuing deficiencies on the Schedule of Federal Debt financial reporting for fiscal year 2018 was mitigated primarily by Fiscal Service's compensating management and reconciliation controls designed to detect potential misstatements on the Schedule of Federal Debt. Nevertheless, these general control deficiencies increase the risk of unauthorized access to, modification of, or disclosure of sensitive data and programs and disruption of critical operations.

Fiscal Service's corrective action plan for addressing the information system control deficiencies from prior audits did not include descriptions of the deficiencies and the planned corrective actions in sufficient detail to facilitate a common understanding of the deficiencies or the steps and resources needed to fully resolve them. Further, the corrective actions taken often only addressed the previously identified conditions and did not adequately resolve their underlying causes. Specifically, we found that Fiscal Service either had not adequately enhanced its policies and procedures or had not developed and implemented processes to reasonably assure compliance with such policies and procedures. As a result, many of the previously reported information system control deficiencies that Fiscal Service informed us it had addressed continued to be present, and most of the deficiencies that contributed to the significant deficiency we reported as of September 30, 2017, remained unresolved as of September 30, 2018. For example, we continued to identify instances in which known information system vulnerabilities were not being remediated on a timely basis. We also continued to identify instances in which implemented configuration settings were not effectively monitored against baseline security requirements. Furthermore, we

[6]Security management provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. Access controls limit or detect access to computer resources, such as data, programs, equipment, and facilities, thereby protecting them against unauthorized modification, loss, and disclosure. Configuration management prevents unauthorized changes to information system resources, such as software programs and hardware configurations, and provides reasonable assurance that systems are configured and operating securely and as intended.

continued to identify instances in which mainframe security controls were not employed in accordance with the concept of least privilege—some of which represent potentially significant security exposures. In addition to identifying continued instances of previously identified control deficiencies, we also identified new deficiencies, such as Fiscal Service's use of a tool for identifying changes to key mainframe data sets that was not properly configured to send alerts to the organizational unit responsible for monitoring such changes.

While additional efforts are needed, Fiscal Service management has made progress in addressing prior year deficiencies. Fiscal Service has initiated several bureau-wide projects that are relevant to many of the control deficiencies we have previously identified and, if successfully completed, may address the underlying causes for certain conditions. For example, Fiscal Service is in the early stages of developing a means for enforcing role-based access control, or role-based security, within the mainframe environment.[7] Additionally, Fiscal Service is currently in the midst of a large-scale, multiphased effort to strengthen its cybersecurity posture. Continued and consistent management commitment and attention will be essential to completing these projects and improving Fiscal Service's information system general controls. Additionally, it will be important for Fiscal Service management to consider and mitigate any risks associated with recent and ongoing organizational changes, which could hamper Fiscal Service's ability to reasonably assure that information system controls are effective.

Other Matter

Other Information

Fiscal Service's other information contains a wide range of information, some of which is not directly related to the Schedules of Federal Debt. This information is presented for purposes of additional analysis and is not a required part of the Schedules of Federal Debt. We read the other information included with the Schedules of Federal Debt in order to identify material inconsistencies, if any, with the audited Schedules of Federal Debt. Our audit was conducted for the purpose of forming an opinion on the Schedules of Federal Debt. We did not audit and do not express an opinion or provide any assurance on the other information.

[7]Role-based access is based on users' responsibilities, or roles. When properly implemented, role-based access control allows organizations to assign and manage access privileges in a manner that aligns with the organization's structure.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

In connection with our audits of the Schedules of Federal Debt, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

Fiscal Service management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to Fiscal Service.

Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to Fiscal Service that have a direct effect on the determination of material amounts and disclosures in the Schedules of Federal Debt, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to Fiscal Service.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2018 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to Fiscal Service. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Agency Comments

In commenting on a draft of this report, Fiscal Service concurred with our conclusions. The complete text of Fiscal Service's response is reproduced in appendix II.

Dawn Simpson

Dawn B. Simpson
Director
Financial Management
and Assurance

November 1, 2018

Overview, Schedules, and Notes

Overview on Federal Debt Managed by the Bureau of the Fiscal Service

Overview on Federal Debt Managed by the Bureau of the Fiscal Service

Gross Federal Debt Outstanding

Federal debt managed by the Bureau of the Fiscal Service (Fiscal Service) comprises debt held by the public and debt held by certain federal government accounts (issued under 31 U.S.C. §§ 3101-3113), the latter of which is referred to as intragovernmental debt holdings. As of September 30, 2018 and September 30, 2017, outstanding gross federal debt managed by Fiscal Service totaled $21,506 billion and $20,233 billion, respectively.[1] The increase in gross federal debt of $1,273 billion during fiscal year 2018 was due to an increase in gross debt held by the public of $1,088 billion and an increase in gross intragovernmental debt holdings of $185 billion. As Figure 1 illustrates, debt held by the public and intragovernmental debt holdings increased by $2,976 billion and $720 billion, respectively, from September 30, 2014 to September 30, 2018. The increases in debt held by the public are due primarily to total federal spending exceeding total federal revenues. The primary reason for the increases in intragovernmental debt holdings is the excess annual receipts (including interest earnings) over disbursements in the Military Retirement and Health Care funds, Medicare trust funds, and the Civil Service Retirement and Disability Fund (CSRDF).[2]

There were delays in raising the statutory debt limit in both fiscal years 2013 and 2015, which continued into fiscal years 2014 and 2016 respectively, during which the Department of the Treasury (Treasury) had to take extraordinary actions to meet the government's obligations as they came due without exceeding the statutory debt limit. The extraordinary actions impacting intragovernmental debt holdings included (1) the suspension of investments in CSRDF, Postal Service Retiree Health Benefits Fund (Postal Benefits Fund), and the Exchange Stabilization Fund (ESF), (2) redeeming certain investments held by CSRDF earlier than normal, and (3) exchanging Treasury securities held by the CSRDF for securities issued by the Federal Financing Bank. Once the delays in raising the statutory debt limit ended, the uninvested principal and related interest were restored, thereby increasing intragovernmental debt holdings, and normal debt management operations resumed. These extraordinary actions contributed to a decrease in intragovernmental debt holdings of $11 billion between September 30, 2014 and September 30, 2015, and an increase of $373 billion between September 30, 2015 and September 30, 2016.

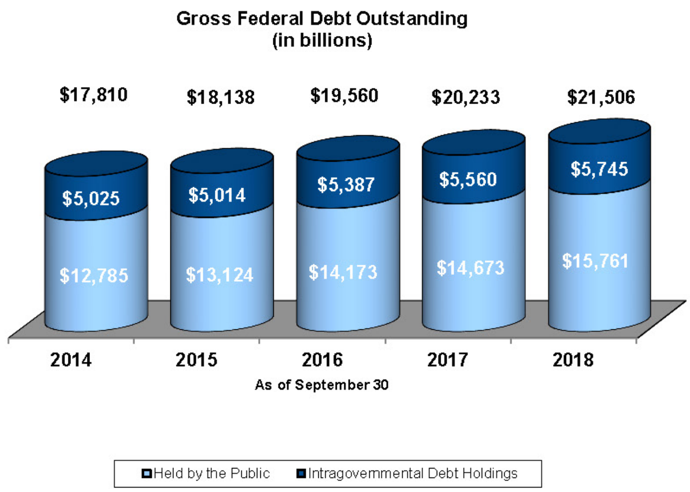
[1] Federal debt outstanding reported here differs from the amount reported in the Financial Report of the United States Government because of the securities not maintained or reported by Fiscal Service which are issued by the Federal Financing Bank and other federal agencies.

[2] The Military Retirement and Health Care funds consist of the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund. The Medicare trust funds are made up of the Federal Hospital Insurance Trust Fund and the Federal Supplementary Medical Insurance Trust Fund.

Gross Federal Debt Outstanding, cont.

Gross federal debt (with some adjustments) is subject to a statutory debt limit. On February 9, 2018, the Bipartisan Budget Act of 2018 (Public Law 115-123) was enacted suspending the statutory debt limit through March 1, 2019. Per the act, if an increase in the debt limit is not enacted by the end of this suspension period, then the debt limit will be increased on March 2, 2019 by the change in qualifying federal debt securities outstanding on this date, compared to those outstanding on February 9, 2018. On September 8, 2017, the Continuing Appropriations Act, 2018 and Supplemental Appropriations for Disaster Relief Requirements Act, 2017 (Public Law 115-56) was enacted suspending the statutory debt limit through December 8, 2017. Per the act, the statutory debt limit was increased on December 9, 2017 to $20,456 billion. On November 2, 2015, the Bipartisan Budget Act of 2015 (Public Law 114-74) was enacted which suspended the statutory debt limit through March 15, 2017. Per the act, the statutory debt limit was increased on March 16, 2017 to $19,809 billion. As of September 30, 2018 and September 30, 2017, outstanding debt obligations subject to the statutory debt limit were $21,475 billion and $20,209 billion, respectively.

Figure 1



Interest Expense

Interest expense incurred during fiscal year 2018 consists of (1) interest accrued and paid on debt held by the public or credited to accounts holding intragovernmental debt during the fiscal year, (2) interest accrued during the fiscal year, but not yet paid on debt held by the public or credited to accounts holding intragovernmental debt, and (3) net amortization of premiums and discounts. The primary components of interest expense are interest paid on the debt held by the public and interest credited to federal government trust funds and other federal government accounts that hold Treasury securities. The interest paid on the debt held by the public affects the current spending of the federal government and represents the burden of servicing its debt (i.e., payments to outside creditors). Interest credited to federal government trust funds and other federal government accounts, on the other hand, does not result in an immediate outlay of the federal government because one part of the government pays the interest and another part receives it. However, this interest represents a claim on future budgetary resources and hence an obligation on future taxpayers. This interest, when reinvested by the trust funds and other federal government accounts, is included in the programs' excess funds not currently needed in operations, which are invested in federal securities. For fiscal year 2018, interest expense incurred totaled $528 billion; this consisted of interest expense on debt held by the public of $357 billion, and $171 billion in interest incurred for intragovernmental debt holdings.

As Figure 2 illustrates, total interest expense decreased from fiscal year 2014 to 2015, from $433 billion to $407 billion. This decrease resulted from a decrease in interest expense on debt held by the public and intragovernmental debt holdings of $9 billion and $17 billion, respectively. The $9 billion decrease in interest expense on debt held by the public primarily resulted from (1) a decrease in inflation adjustments and (2) the continued decrease in average interest rates for Treasury bonds and Treasury Inflation-Protected Securities (TIPS), offset by the overall increase in outstanding debt. The $17 billion decrease in interest expense on intragovernmental debt holdings primarily resulted from (1) a decrease in inflation adjustments and (2) a decrease in the average interest rates on intragovernmental debt holdings.

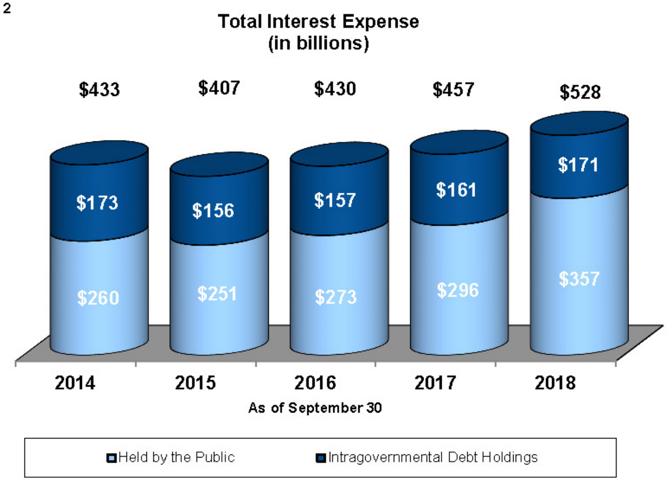
From fiscal year 2015 to 2016, total interest expense increased from $407 billion to $430 billion. This increase resulted from an increase in interest expense on debt held by the public and intragovernmental debt holdings of $22 billion and $1 billion, respectively. The $22 billion increase in interest expense on debt held by the public primarily resulted from (1) an increase in the outstanding debt held by the public and (2) an increase in inflation adjustments. The $1 billion increase in interest expense on intragovernmental debt holdings resulted from (1) an increase in outstanding intragovernmental debt holdings, (2) the restoration of interest to CSRDF and Postal Benefits Fund, and (3) an increase in inflation, which were offset by a decrease in the average interest rates.

Interest Expense, cont.

From fiscal year 2016 to 2017, total interest expense increased from $430 billion to $457 billion. This increase resulted from an increase in interest expense on debt held by the public and intragovernmental debt holdings of $23 billion and $4 billion, respectively. The $23 billion increase in interest expense on debt held by the public primarily resulted from (1) an increase in the outstanding debt held by the public, (2) an increase in inflation adjustments, and (3) an increase in average interest rates. The $4 billion increase in interest expense on intragovernmental debt holdings resulted from (1) an increase in inflation adjustments, (2) a decrease in net amortization, and (3) an offsetting decrease in accrued interest.

From fiscal year 2017 to 2018, total interest expense increased from $457 billion to $528 billion. This increase resulted from an increase in interest expense on debt held by the public and intragovernmental debt holdings of $61 billion and $10 billion, respectively. The $61 billion increase in interest expense on debt held by the public primarily resulted from (1) an increase in the outstanding debt held by the public, (2) an increase in inflation adjustments, and (3) an increase in average interest rates. The $10 billion increase in interest expense on intragovernmental debt holdings primarily resulted from an increase in inflation adjustments. Average interest rates on principal balances outstanding as of September 30, 2018 and 2017, are disclosed in the Notes to the Schedules of Federal Debt.

Figure 2



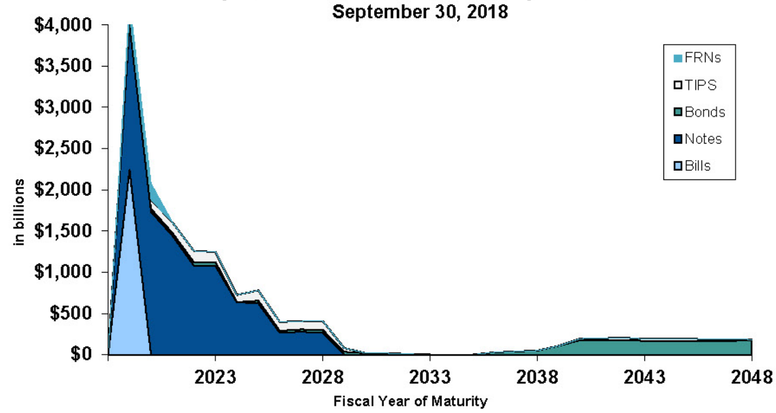
Debt Held by the Public

Debt held by the public primarily represents the amount the federal government has borrowed to finance cumulative cash deficits by the issuance of United States (U.S.) Treasury securities that are guaranteed for principal and interest by the full faith and credit of the U.S. Government. During fiscal year 2018, Treasury used the existing suite of securities to meet the borrowing needs of the federal government. Treasury increased its offerings of Treasury bills to help achieve the objective of lowest cost of funding over time and enhance market functioning and liquidity. Treasury bills, notes, bonds, TIPS, and Floating Rate Notes (FRNs) increased by $440 billion, $351 billion, $167 billion, $90 billion, and $27 billion, respectively in fiscal year 2018. As of September 30, 2018 and 2017, gross debt held by the public totaled $15,761 billion and $14,673 billion, respectively (see Figure 1), an increase of $1,088 billion. This increase was primarily the result of borrowings needed to finance the government's fiscal year 2018 deficit. Due primarily to an increase in short-term debt issuances, as compared to the prior year, the total dollar amount of activity for both borrowings and repayments of debt held by the public increased for fiscal year 2018.

As of September 30, 2018, $15,250 billion, or 97 percent, of the securities that constitute debt held by the public were marketable, meaning that once the federal government issues them, they can be resold by whoever owns them. Marketable debt is made up of Treasury bills, Treasury notes, Treasury bonds, TIPS, and FRNs with maturity dates ranging from less than one year out to 30 years. Of the marketable securities currently held by the public as of September 30, 2018, $9,230 billion, or 61 percent, will mature within the next four years (see Figure 3). As of September 30, 2018 and 2017, total marketable debt held by the public maturing within the next 10 years totaled $13,185 billion and $12,233 billion, respectively, an increase of $952 billion.

Figure 3

Maturity Dates of Marketable Debt Held by the Public as of September 30, 2018



Debt Held by the Public, cont.

The federal government also issues to the public nonmarketable securities, which cannot be resold, and have maturity dates ranging from on demand out to 40 years. As of September 30, 2018, nonmarketable securities totaled $511 billion, or 3 percent of debt held by the public. As of that date, nonmarketable securities primarily consisted of Government Account Series (GAS) securities totaling $251 billion, U.S. Savings Securities totaling $157 billion, and State and Local Government Series (SLGS) securities totaling $72 billion. During fiscal year 2018, GAS securities increased by $27 billion, and U.S. Savings Securities and SLGS securities decreased by $5 billion, and $9 billion, respectively. As of September 30, 2018 and 2017, total nonmarketable securities totaled $511 billion and $498 billion, respectively, an increase of $13 billion.

The Federal Reserve Banks (FRBs) act as fiscal agents for Treasury, as permitted by the Federal Reserve Act. As fiscal agents for Treasury, the FRBs play a significant role in the processing of marketable book-entry securities and paper U.S. savings bonds. For marketable book-entry securities, selected FRBs receive bids, issue book-entry securities to awarded bidders, collect payments on behalf of Treasury, and make interest and redemption payments from Treasury's account to the accounts of security holders. For paper U.S. savings bonds, selected FRBs issue savings bonds purchased with federal income tax refunds, and redeem savings bonds, including handling the related transfers of cash.

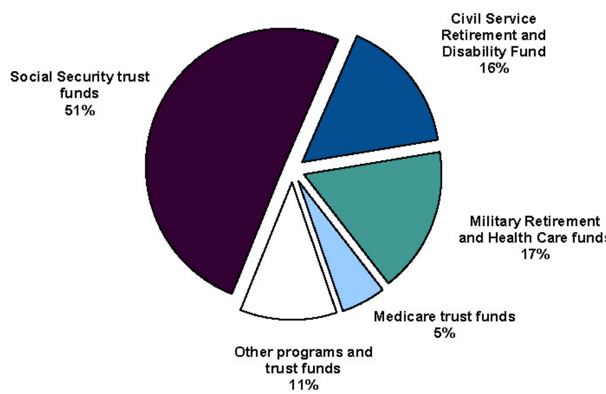
Intragovernmental Debt Holdings

Intragovernmental debt holdings represent balances of Treasury securities held by federal government accounts. There are at least 250 individual federal government accounts with either the authority or the requirement to invest excess receipts in special Treasury securities that are guaranteed for principal and interest by the full faith and credit of the U.S. Government. Intragovernmental debt holdings primarily consist of balances in the Social Security trust funds, Military Retirement and Health Care funds, CSRDF, and Medicare trust funds.[3] As of September 30, 2018, such funds accounted for $5,092 billion, or 89 percent, of the $5,745 billion intragovernmental debt holdings balance (see Figure 4). As of September 30, 2018 and 2017, gross intragovernmental debt holdings totaled $5,745 billion and $5,560 billion, respectively (see Figure 1), an increase of $185 billion. This increase is primarily the result of (1) an increase in the Military Retirement and Health Care funds of $97 billion, (2) an increase in the Medicare trust funds of $33 billion, (3) an increase in CSRDF of $19 billion, (4) an increase in the Deposit Insurance Fund of $16 billion, and (5) an increase in the Unemployment Trust Fund of $12 billion.

The majority of intragovernmental debt holdings are GAS securities. GAS securities consist of par value securities and market-based securities, with terms ranging from on demand out to 30 years. Par value securities are issued and redeemed at par (100 percent of the face value), regardless of current market conditions. Market-based securities, however, can be issued at a premium or discount and are redeemed at par value on the maturity date or at market value if redeemed before the maturity date.

Figure 4

Components of Intragovernmental Debt Holdings as of September 30, 2018



[3] The Social Security trust funds consist of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Military Retirement and Health Care funds consist of the Military Retirement Fund and the Medicare-Eligible Retiree Health Care Fund. The Medicare trust funds are made up of the Federal Hospital Insurance Trust Fund and the Federal Supplementary Medical Insurance Trust Fund.

Significant Events in Fiscal Year 2018

Delay in Raising the Statutory Debt Limit

Due to a delay in raising the statutory debt limit, from December 11, 2017 through February 8, 2018, Treasury departed from its normal debt management procedures and invoked legal authorities to avoid exceeding the statutory debt limit. Extraordinary actions taken by Treasury during this period to ensure the statutory debt limit was not exceeded included (1) suspending investments in the Government Securities Investment Fund (G-Fund) of the federal employees' Thrift Savings Plan, CSRDF, and Postal Benefits Fund, (2) redeeming certain investments held by CSRDF and Postal Benefits Fund earlier than normal, and (3) suspending new issuances of SLGS securities.

On February 9, 2018, the Bipartisan Budget Act of 2018 (Public Law 115-123) was enacted suspending the statutory debt limit through March 1, 2019. On February 9, 2018, Treasury discontinued its use of the extraordinary actions and resumed normal debt management operations. On this date, in accordance with relevant laws, Fiscal Service restored uninvested principal amounts to the G-Fund, CSRDF, and Postal Benefits Fund of $156,702 million, $18,045 million, and $862 million, respectively. In accordance with relevant laws, Fiscal Service restored the interest related to the uninvested principal during the period of December 12, 2017 through February 8, 2018, to the G-Fund on February 12, 2018, in the amount of $485 million. Interest related to the uninvested principal during the period of December 11, 2017 through February 8, 2018, for CSRDF and Postal Benefits Fund was restored on June 29, 2018, the next semi-annual interest payment date, in the amounts of $218 million and $29 million, respectively.

Historical Perspective

Federal debt outstanding is the largest legally binding obligation of the federal government. Nearly all the federal debt has been issued by Treasury with a small portion being issued by other federal agencies. Treasury issues debt securities for two principal reasons, (1) to borrow needed funds to finance the current operations of the federal government and (2) to provide an investment and accounting mechanism for certain federal government accounts' (primarily federal trust funds) excess receipts. As shown in Figure 5, gross federal debt outstanding has increased over the past 25 years from $4,411 billion as of September 30, 1993, to $21,506 billion as of September 30, 2018.

Even in those years where debt held by the public declined, gross federal debt increased because of increases in intragovernmental debt holdings. By law, federal government accounts, including trust funds, have the authority or are required to invest their excess annual receipts (including interest earnings) over disbursements in federal securities. As a result, the intragovernmental debt holdings primarily represent the cumulative surplus of funds due to the trust funds' cumulative annual excess of tax receipts, interest credited, and other collections compared to spending.

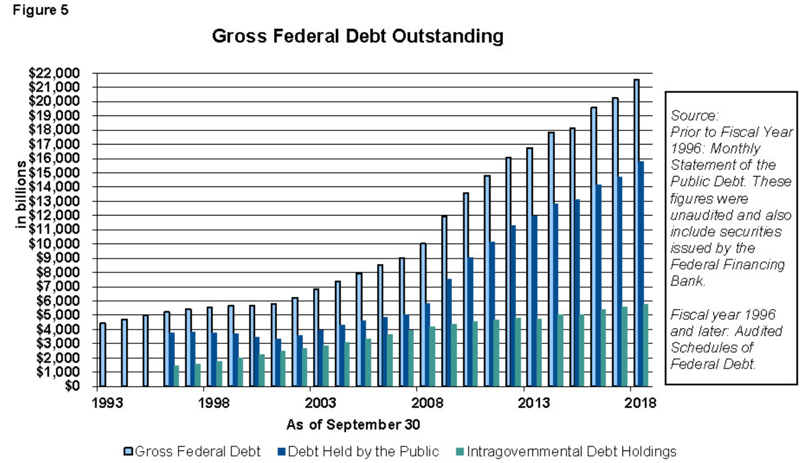
Budget deficits continued through 1997, which resulted in the continued increase in the gross federal debt from $4,411 billion to $5,398 billion as of September 30, 1993 and September 30, 1997, respectively. For fiscal years 1998 through 2001, the federal budget was in a surplus. During this period, the amount of debt held by the public fell by $476 billion, from $3,815 billion to $3,339 billion. However, the gross federal debt continued to increase due to increases in intragovernmental holdings of $870 billion, from $1,583 billion to $2,453 billion, from fiscal year 1998 through fiscal year 2001.

Beginning in fiscal year 2002, the federal budget returned to an annual deficit position, which resulted in an increase in debt held by the public. Federal debt held by the public increased from $3,339 billion to $5,049 billion from fiscal year 2002 through fiscal year 2007, an increase of 51 percent. From fiscal year 2008 through fiscal year 2018, federal debt held by the public has more than tripled, rising by $10,712 billion. Since fiscal year 2002, debt held by the public has increased from $3,339 billion as of September 30, 2001 to $15,761 billion as of September 30, 2018. Intragovernmental debt holdings increased from $2,453 billion to $5,745 billion during the same time period.

As shown in Figure 5, fiscal years 2014 and 2016 show a significant increase in the gross federal debt as compared to the previous year's increase due to the delays in raising the statutory debt limit that occurred during fiscal years 2013 and 2015. These delays required Treasury to take extraordinary actions to remain below the statutory debt limit. Extraordinary actions decreased the outstanding debt subject to the statutory debt limit, to allow Treasury to issue new securities to the public as a means of generating cash to pay the obligations of the federal government. This activity caused the gross federal debt to be lower than it otherwise would have been if a delay were not in effect. Consequently, the gross federal debt increased after the delays ended and the uninvested principal and related interest were restored.

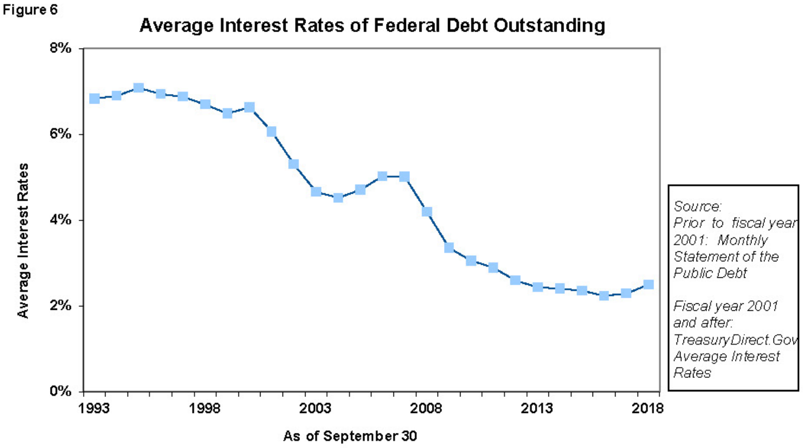
Historical Perspective, cont.

Figure 5



As shown in Figure 6, interest rates have fluctuated over the past 25 years. The average interest rates reflected here represent the original issue weighted effective yield on debt held by the public and intragovernmental debt holdings outstanding, excluding inflation-indexed securities and FRNs, at the end of the fiscal year. The rise in average interest rates that began in fiscal year 2017 continued into fiscal year 2018.

Figure 6



Schedules of Federal Debt Managed by the Bureau of the Fiscal Service

Schedules of Federal Debt

Managed by the Bureau of the Fiscal Service
For the Fiscal Years Ended September 30, 2018 and 2017
(Dollars in Millions)

	Federal Debt					
	Held by the Public			Intragovernmental Debt Holdings		
	Principal (Note 2)	Accrued Interest Payable	Net Unamortized Premiums/ (Discounts)	Principal (Note 3)	Accrued Interest Payable	Net Unamortized Premiums/ (Discounts)
Balance as of September 30, 2016	**$14,173,424**	**$57,110**	**($33,800)**	**$5,386,997**	**$39,692**	**$72,737**
Increases						
Borrowings from the Public	8,726,049		(22,437)			
Net Increase in Intragovernmental Debt Holdings				173,017		6,013
Accrued Interest (Note 4)		279,253			167,001	
Total Increases	**8,726,049**	**279,253**	**(22,437)**	**173,017**	**167,001**	**6,013**
Decreases						
Repayments of Debt Held by the Public	8,226,044					
Interest Paid		270,901			167,844	
Net Amortization (Note 4)			(17,033)			6,596
Total Decreases	**8,226,044**	**270,901**	**(17,033)**	**0**	**167,844**	**6,596**
Balance as of September 30, 2017	**14,673,429**	**65,462**	**(39,204)**	**5,560,014**	**38,849**	**72,154**
Increases						
Borrowings from the Public	10,082,298		(44,676)			
Net Increase in Intragovernmental Debt Holdings				184,550		4,313
Accrued Interest (Note 4)		318,177			177,759	
Total Increases	**10,082,298**	**318,177**	**(44,676)**	**184,550**	**177,759**	**4,313**
Decreases						
Repayments of Debt Held by the Public	8,994,572					
Interest Paid		310,111			177,314	
Net Amortization (Note 4)			(39,114)			6,602
Total Decreases	**8,994,572**	**310,111**	**(39,114)**	**0**	**177,314**	**6,602**
Balance as of September 30, 2018	**$15,761,155**	**$73,528**	**($44,766)**	**$5,744,564**	**$39,294**	**$69,865**

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service

For the Fiscal Years Ended September 30, 2018 and 2017

(Dollars in Millions)

Note 1. Significant Accounting Policies

Basis of Presentation

The Schedules of Federal Debt Managed by the Bureau of the Fiscal Service (Fiscal Service) have been prepared to report fiscal year 2018 and fiscal year 2017 balances and activity relating to monies borrowed from the public and certain federal government accounts under 31 U.S.C. §§ 3101- 3113 to fund the operations of the United States (U.S.) Government. Permanent, indefinite appropriations are available for the payment of interest on the federal debt and the redemption of Treasury securities.

Reporting Entity

The Constitution empowers the Congress to borrow money on the credit of the U.S. The Congress has authorized the Secretary of the Treasury to borrow monies to operate the federal government within a statutory debt limit. Title 31, U.S. Code authorizes the Department of the Treasury (Treasury) to prescribe the debt instruments and otherwise limit and restrict the amount and composition of the debt. Fiscal Service, an organizational entity within Treasury, is responsible for issuing Treasury securities in accordance with such authority and to account for the resulting debt. In addition, Fiscal Service maintains an investment program for federal government accounts, including trust funds that have legislative authority to invest temporary cash reserves not needed for current benefits and expenses. Fiscal Service issues and redeems Treasury securities for these federal government accounts based on data provided by the respective program agencies and other Treasury entities.

The Fiscal Service reporting entity does not consolidate the Federal Reserve Banks (FRBs), based on criteria established under U.S. generally accepted accounting principles (GAAP). The FRBs serve as Treasury's fiscal agent, executing certain transactions related to the issuance, payment of interest, and redemption of Treasury securities held by the public. The FRBs also hold Treasury securities in the FRB's System Open Market Account (SOMA) for the purpose of conducting monetary policy. The relevant activity and balances for the SOMA are disclosed in Note 2.

Basis of Accounting

The schedules were prepared in accordance with U.S. GAAP and from Fiscal Service's automated debt accounting system. Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official body for setting accounting standards of the federal government. The FASAB issued the Statement of Federal Financial Accounting Standards (SFFAS) No. 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board* in July 2009. SFFAS No. 34 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of general purpose financial reports of federal reporting entities that are presented in accordance with federal generally accepted accounting principles.

Interest costs are recorded as expenses when incurred, instead of when paid. Certain Treasury securities are issued at a discount or premium. These discounts and premiums are amortized over the term of the security using an interest method for all long-term securities and the straight line method for short-term securities. Treasury also issues Treasury Inflation-Protected Securities (TIPS). The principal for TIPS is adjusted daily over the life of the security based on the Consumer Price Index for all Urban Consumers.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service
For the Fiscal Years Ended September 30, 2018 and 2017
(Dollars in Millions)

Note 2. Federal Debt Held by the Public

As of September 30, 2018 and 2017, Federal Debt Held by the Public consisted of the following:

	2018		2017	
	Amount	Average Interest Rates	Amount	Average Interest Rates
Marketable:				
Treasury Bills	$2,239,473	2.1 %	$1,799,570	1.1 %
Treasury Notes	9,150,301	2.0 %	8,798,940	1.8 %
Treasury Bonds	2,114,982	4.1 %	1,948,414	4.2 %
TIPS	1,376,180	0.8 %	1,286,123	0.8 %
Floating Rate Notes	369,142	2.2 %	342,630	1.2 %
Total Marketable	$15,250,078		$14,175,677	
Nonmarketable	$511,077	2.8 %	$497,752	2.3 %
Total Federal Debt Held by the Public	$15,761,155		$14,673,429	

Treasury issues marketable bills usually at a discount, but may also issue at par, and pays the par amount of the security upon maturity. The average interest rate on Treasury bills represents the original issue effective yield on securities outstanding as of September 30, 2018 and 2017. Treasury bills are issued with a term of one year or less.

Treasury issues marketable notes and bonds as long-term securities that pay semi-annual interest based on the security's stated interest rate. These securities are issued at either par value or at an amount that reflects a discount or a premium. The average interest rate on marketable notes and bonds represents the stated interest rate adjusted by any discount or premium on securities outstanding as of September 30, 2018 and 2017. Treasury notes are issued with a term of two to 10 years and Treasury bonds are issued with a term of more than 10 years.

Treasury issues TIPS that have interest and redemption payments that are tied to the Consumer Price Index for all Urban Consumers, a widely used measure of inflation. TIPS are issued with a term of five years or more. At maturity, TIPS are redeemed at the inflation-adjusted principal amount, or the original par value, whichever is greater. TIPS pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal. The average interest rate on TIPS represents the stated interest rate on principal plus inflation, adjusted by any discount or premium on securities outstanding as of September 30, 2018 and 2017. The TIPS Federal Debt Held by the Public inflation-adjusted principal balance includes inflation of $134,057 million and $103,738 million as of September 30, 2018 and 2017, respectively.

Treasury issues marketable Floating Rate Notes (FRNs), which pay interest quarterly based on the interest rate at the time of payment. The interest rate of FRNs can change over time and is indexed to the highest accepted discount rate of the most recent 13-week marketable bill auction. These securities, like marketable notes and bonds, are issued at either par value or at an amount that reflects a discount or premium. The average interest rate on marketable FRNs represents the highest accepted discount rate of the most recent 13-week marketable auction as of September 30, 2018 and 2017, adjusted by any discount or premium on securities outstanding as of these dates. These notes are currently issued with a term of two years.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service

For the Fiscal Years Ended September 30, 2018 and 2017

(Dollars in Millions)

Note 2. Federal Debt Held by the Public (continued)

Federal Debt Held by the Public includes federal debt held outside of the U.S. Government by individuals, corporations, FRBs, state and local governments, and foreign governments and central banks. As of September 30, 2018, the FRBs had total holdings of $1,782,452 million, which (1) excludes $531,790 million in Treasury securities used in overnight reverse repurchase transactions and (2) includes a net of $1,032 million in Treasury securities held by the FRBs as collateral for securities lending activities. As of September 30, 2017, the FRBs had total holdings of $1,964,690 million, which (1) excludes $501,993 million in Treasury securities used in overnight reverse repurchase transactions and (2) includes a net of $1,265 million in Treasury securities held by the FRBs as collateral for securities lending activities. As of September 30, 2018 and 2017, the FRBs earned interest revenue on Treasury securities of $64,092 million and $63,777 million respectively.

Treasury issues nonmarketable securities at either par value or at an amount that reflects a discount or a premium. The average interest rate on the nonmarketable securities represents the original issue weighted effective yield on securities outstanding as of September 30, 2018 and 2017. Nonmarketable securities are issued with a term of on demand out to 40 years.

As of September 30, 2018 and 2017, nonmarketable securities consisted of the following:

	2018	2017
Domestic Series	$29,995	$29,995
Foreign Series	264	264
State and Local Government Series	71,753	80,359
United States Savings Securities	156,809	161,705
Government Account Series	250,680	223,787
Other	1,576	1,642
Total Nonmarketable	$511,077	$497,752

Government Account Series (GAS) securities are nonmarketable securities issued to federal government accounts. Federal Debt Held by the Public includes GAS securities issued to certain federal government accounts. One example is the GAS securities held by the Government Securities Investment Fund (G-Fund) of the federal employees' Thrift Savings Plan. Federal employees and retirees who have individual accounts own the GAS securities held by the fund. For this reason, these securities are considered part of the Federal Debt Held by the Public rather than Intragovernmental Debt Holdings. The GAS securities held by the G-Fund consist of overnight investments redeemed one business day after their issue. As of September 30, 2018 and 2017, the GAS securities held by the G-Fund were $245,480 million and $217,930 million, respectively. The net increase in the fund's principal balance during fiscal year 2018 is included in the Borrowings from the Public amount reported on the Schedules of Federal Debt. The net decrease in the fund's principal balance during fiscal year 2017 is included in the Repayments of Debt Held by the Public amount reported on the Schedules of Federal Debt.

Fiscal years-end September 30, 2018 and 2017, occurred on a Sunday and Saturday, respectively. As a result, $92,487 million and $90,914 million of marketable Treasury notes, and $67 million and $45 million of GAS securities, matured but not repaid are included in the balance of the Federal Debt Held by the Public as of September 30, 2018 and 2017 respectively. Settlement of these debt repayments occurred on Monday, October 1, 2018 and Monday, October 2, 2017.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service

For the Fiscal Years Ended September 30, 2018 and 2017

(Dollars in Millions)

Note 3. Intragovernmental Debt Holdings

As of September 30, 2018 and 2017, Intragovernmental Debt Holdings are owed to the following:

		2018	2017
SSA:	Federal Old-Age and Survivors Insurance Trust Fund	$2,801,254	$2,820,200
OPM:	Civil Service Retirement and Disability Fund	912,654	893,646
DOD:	Military Retirement Fund	743,421	660,970
DOD:	Medicare-Eligible Retiree Health Care Fund	240,183	225,847
HHS:	Federal Hospital Insurance Trust Fund	202,805	197,835
HHS:	Federal Supplementary Medical Insurance Trust Fund	98,197	70,589
FDIC:	Deposit Insurance Fund	96,431	80,161
SSA:	Federal Disability Insurance Trust Fund	93,401	69,669
DOL:	Unemployment Trust Fund	72,576	60,711
DOE:	Nuclear Waste Disposal Fund	53,449	53,013
OPM:	Postal Service Retiree Health Benefits Fund	47,145	49,491
OPM:	Employees Life Insurance Fund	46,616	45,680
DOT:	Highway Trust Fund	41,212	52,332
DOL:	Pension Benefit Guaranty Corporation	31,659	28,442
OPM:	Employees Health Benefits Fund	27,367	26,018
HUD:	FHA, Mutual Mortgage Insurance Capital Reserve Account	26,975	30,879
Treasury:	Exchange Stabilization Fund	22,311	22,090
DOS:	Foreign Service Retirement and Disability Fund	19,184	18,792
HUD:	Guarantees of Mortgage-Backed Securities Capital Reserve Account	16,169	17,124
NCUA:	National Credit Union Share Insurance Fund	14,895	13,089
DOT:	Airport and Airway Trust Fund	14,212	13,404
USPS:	Postal Service Fund	10,493	10,965
Other Programs and Funds		111,955	99,067
Total Intragovernmental Debt Holdings		$5,744,564	$5,560,014

Social Security Administration (SSA); Office of Personnel Management (OPM); Department of Defense (DOD); Department of Health and Human Services (HHS); Federal Deposit Insurance Corporation (FDIC); Department of Labor (DOL); Department of Energy (DOE); Department of Transportation (DOT); Department of Housing and Urban Development (HUD); Federal Housing Administration (FHA); Department of the Treasury (Treasury); Department of State (DOS); National Credit Union Administration (NCUA); United States Postal Service (USPS).

Intragovernmental Debt Holdings primarily consist of GAS securities. Treasury issues GAS securities at either par value or at an amount that reflects a discount or a premium. GAS securities are issued with a term of on demand out to 30 years. GAS securities include TIPS, which are reported at an inflation-adjusted principal balance using the Consumer Price Index for all Urban Consumers. As of September 30, 2018 and 2017, the inflation-adjusted principal balance of Intragovernmental Debt Holdings included inflation of $159,793 million and $138,468 million, respectively. The average interest rates on Intragovernmental Debt Holdings, excluding TIPS and FRNs, for both fiscal years were 2.8 percent. The average interest rates on TIPS for both fiscal years were 1.3 percent. The average interest rate represents the original issue weighted effective yield on securities outstanding as of September 30, 2018 and 2017.

Fiscal years-end September 30, 2018 and 2017, occurred on a Sunday and Saturday, respectively. As a result, $2,724 million and $2,415 million of GAS securities held by federal government accounts matured but not repaid is included in the balance of the Intragovernmental Debt Holdings as of September 30, 2018 and 2017 respectively. Settlement of these debt repayments occurred on Monday, October 1, 2018 and Monday, October 2, 2017.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service
For the Fiscal Years Ended September 30, 2018 and 2017
(Dollars in Millions)

Note 4. Interest Expense

Interest expense on federal debt for fiscal years 2018 and 2017 consisted of the following:

	2018	2017
Federal Debt Held by the Public		
Accrued Interest	$318,177	$279,253
Net Amortization of (Premiums) and Discounts	39,114	17,033
Total Interest Expense on Federal Debt Held by the Public	357,291	296,286
Intragovernmental Debt Holdings		
Accrued Interest	177,759	167,001
Net Amortization of (Premiums) and Discounts	(6,602)	(6,596)
Total Interest Expense on Intragovernmental Debt Holdings	171,157	160,405
Total Interest Expense on Federal Debt Managed by Fiscal Service	$528,448	$456,691

The valuation of TIPS is adjusted daily over the life of the security based on the Consumer Price Index for all Urban Consumers. This daily adjustment is an interest expense for federal debt managed by Fiscal Service. Accrued interest on Federal Debt Held by the Public includes inflation adjustments of $38,457 million and $21,136 million for fiscal years 2018 and 2017, respectively. Accrued interest on Intragovernmental Debt Holdings includes inflation adjustments of $22,070 million and $11,907 million for fiscal years 2018 and 2017, respectively.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service
For the Fiscal Years Ended September 30, 2018 and 2017
(Dollars in Millions)

Note 5. Gain on Operational Readiness Buybacks

A buyback occurs when Treasury redeems outstanding marketable Treasury securities prior to their maturity dates. In a buyback, the owner of the security sells it to Treasury on a voluntary basis at a price determined by a competitive auction process. The first of these buybacks occurred in 2000 and continued through 2002. Treasury did not conduct buybacks again until fiscal year 2015, when it conducted two small-value buybacks to ensure operational readiness of its buyback infrastructure. Treasury expects to continue to conduct regular small-value buyback operations periodically to ensure operational readiness. These small-value buyback operations are not a precursor or signal of any pending policy changes regarding Treasury's use of buybacks more broadly. On January 19, 2000, Treasury issued a final rule adding part 375 to 31 CFR, setting out the terms and conditions by which outstanding, unmatured marketable Treasury securities may be redeemed through Treasury buying back the securities.

Buybacks of Treasury securities are conducted by Treasury's fiscal agent, the Federal Reserve Bank of New York (FRBNY). Only primary dealers, as designated by FRBNY, may submit offers.

During fiscal years 2018 and 2017, there were two operational readiness buyback operations in each year, which involved the following:

	2018	2017
Total Amount Paid for Debt Buybacks, excluding accrued interest	$48	$50
Principal Amount of Debt Buybacks	50	50
Discount on Debt Buybacks	$(2)	-
Write off of Net Unamortized Discounts on Debt Buybacks	-	-
Gain on Debt Buybacks	$(2)	-

Appendix I: Management's Report on Internal Control over Financial Reporting Relevant to the Schedule of Federal Debt

DEPARTMENT OF THE TREASURY
BUREAU OF THE FISCAL SERVICE
WASHINGTON, DC 20227

November 1, 2018

Management's Report on Internal Control over Financial Reporting
Relevant to the Schedule of Federal Debt

The Bureau of the Fiscal Service's (Fiscal Service) internal control over financial reporting relevant to the Schedule of Federal Debt is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the Schedule of Federal Debt in accordance with U.S. Generally Accepted Accounting Principles; and (2) transactions related to the Schedule of Federal Debt are executed in accordance with provisions of applicable laws, including those governing the use of budget authority; regulations; contracts; and grant agreements, noncompliance with which could have a material effect on the Schedule of Federal Debt.

Fiscal Service management is responsible for maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the Schedule of Federal Debt that is free from material misstatement, whether due to fraud or error. Fiscal Service management evaluated the effectiveness of Fiscal Service's internal control over financial reporting relevant to the Schedule of Federal Debt as of September 30, 2018, based on the criteria established under 31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we conclude that, as of September 30, 2018, Fiscal Service's internal control over financial reporting relevant to the Schedule of Federal Debt was effective.

Kimberly A. McCoy
Commissioner

D. Michael Linder
Assistant Commissioner,
Fiscal Accounting

Theresa J. Kohler
Chief Financial Officer and
Assistant Commissioner,
Office of Management

Lauren Buschor
Chief Information Officer and
Assistant Commissioner,
Information and Security Services

Appendix II: Comments from the Bureau of the Fiscal Service

DEPARTMENT OF THE TREASURY
BUREAU OF THE FISCAL SERVICE
WASHINGTON, DC 20227

November 2, 2018

Ms. Dawn B. Simpson, Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Simpson:

This letter is in response to your audit of the Schedules of Federal Debt Managed by the Bureau of the Fiscal Service for the fiscal years ended September 30, 2018 and 2017. We agree with the conclusions of your audit report.

This year we were faced with a brief Debt Issuance Suspension Period (DISP), which began in December, followed by a suspension of the Statutory Debt Limit in February that continued for the remainder of the fiscal year. We appreciate the knowledge and experience displayed by your audit team as we encountered unique reporting requirements during these circumstances. Your team's experience related to our accounting operations provided timeliness and efficiency to the audit process, in addition to continued accuracy and consistency. We would like to thank you and your staff for the thorough audit of these schedules as we finalize the twenty-second year of our professional relationship. We look forward to sustaining a productive and successful relationship with your staff.

Sincerely,

Kimberly A. McCoy
Commissioner
Bureau of the Fiscal Service

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