United States General Accounting Office

GAO

Report to the Secretary of the Treasury

November 2002

FINANCIAL AUDIT

Bureau of the Public Debt's Fiscal Years 2002 and 2001 Schedules of Federal Debt

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Highlights

Highlights of GAO-03-199, a report to the Secretary of the Treasury

Why GAO Did This Study

Because of the significance of the federal debt held by the public to the consolidated financial statements of the U.S. government, which GAO is required to audit, GAO audits the Bureau of the Public Debt's (BPD) Schedules of Federal Debt annually. This is done to determine whether, in all material respects, (1) the schedules prepared are reliable, (2) BPD management maintained effective internal control relevant to the Schedule of Federal Debt, and (3) BPD complies with selected provisions of significant laws related to the Schedule of Federal Debt.

Federal debt managed by BPD consists of Treasury securities held by the public and by certain federal government accounts (intragovernmental debt holdings). The level of debt held by the public reflects how much of the nation's wealth has been absorbed by the federal government to finance prior federal spending in excess of total federal revenues. Intragovernmental debt holdings represent balances of Treasury securities held by federal government accounts, primarily federal trust funds such as Social Security, that typically have an obligation to invest their excess annual receipts over disbursements in federal securities.

www.gao.gov/cgi-bin/getrpt?GAO-03-199.

For a fuller understanding of GAO's opinion on BPD's fiscal years 2002 and 2001 Schedules of Federal Debt, readers should refer to the complete audit report, available by clicking the link above, which includes information on audit objectives, scope, and methodology. For additional information, contact Gary T. Engel (202-512-3406).

FINANCIAL AUDIT

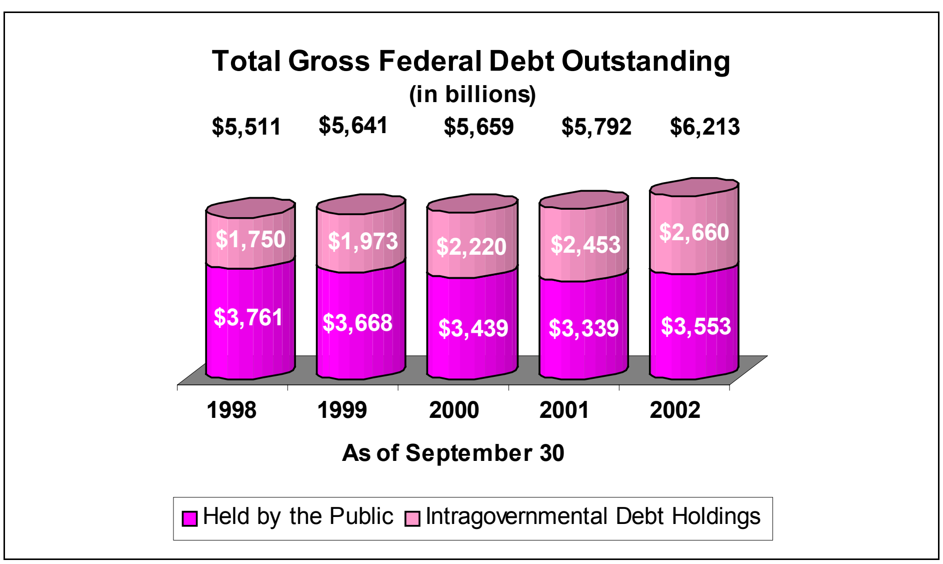
Bureau of the Public Debt's Fiscal Years 2002 and 2001 Schedules of Federal Debt

What GAO Found

In GAO's opinion, in all material respects, BPD's Schedules of Federal Debt for fiscal years 2002 and 2001 were reliable and BPD maintained effective internal control related to the Schedule of Federal Debt as of September 30, 2002. GAO also found no instances of noncompliance in fiscal year 2002 with selected provisions of the statutory debt limit and debt issuance suspension period laws we tested.

As of September 30, 2002 and 2001, federal debt managed by BPD totaled about $6,213 billion and $5,792 billion, respectively. For the first time since fiscal year 1993, as a result of the current weak economy coupled with various tax and spending decisions, debt held by the public as a percentage of the annual size of the U.S. economy increased. Further, certain trust funds continue to run cash surpluses, resulting in increased intragovernmental debt holdings. These debt holdings represent a priority call on future budgetary resources. During fiscal year 2002, two debt issuance suspension periods were invoked to avoid breaching the statutory debt limit. On June 28, 2002, legislation was enacted to raise the debt limit by $450 billion to $6.4 trillion. Current projections are that this new limit will be reached in fiscal year 2003.

As shown below, total federal debt increased each year over the last 4 years. Debt held by the public decreased as a result of cash surpluses for the 3 fiscal years ended September 30, 2001, but increased during fiscal year 2002, with the return to a deficit. Intragovernmental debt holdings steadily increased during this 4 year period primarily due to excess receipts over disbursements in federal trust funds.



Source: BPD.

Contents

Abbreviations

BPD	Bureau of the Public Debt
OMB	Office of Management and Budget

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Accountability * Integrity * Reliability

Comptroller General
of the United States

United States General Accounting Office
Washington, D.C. 20548

November 1, 2002

The Honorable Paul H. O'Neill
The Secretary of the Treasury

Dear Mr. Secretary:

The accompanying auditor's report presents the results of our audits of the Schedules of Federal Debt Managed by the Bureau of the Public Debt for the fiscal years ended September 30, 2002 and 2001. 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 bureau.[1]

The auditor's report contains our (1) opinion on the Schedules of Federal Debt for the fiscal years ended September 30, 2002 and 2001, (2) opinion on the effectiveness of related internal control as of September 30, 2002, (3) conclusion on the bureau's compliance in fiscal year 2002 with laws we tested, and (4) conclusion on the consistency between information in the Schedules of Federal Debt and the Overview on Federal Debt Managed by the Bureau of the Public Debt.

As of September 30, 2002 and 2001, federal debt managed by the bureau totaled about $6,213 billion and $5,792 billion, respectively, for moneys borrowed to fund the government's operations. As shown on the Schedules of Federal Debt, these balances consisted of approximately (1) $3,553 billion as of September 30, 2002, and $3,339 billion as of September 30, 2001, of debt held by the public and about (2) $2,660 billion as of September 30, 2002, and $2,453 billion as of September 30, 2001, of intragovernmental debt holdings.

The level of debt held by the public reflects how much of the nation's wealth has been absorbed by the federal government to finance prior federal spending in excess of total federal revenues. It best represents the cumulative effect of past federal borrowing on today's economy and the federal budget. To finance a cash deficit, the government borrows from the

[1]Intragovernmental Debt Holdings represent federal debt issued by Treasury and held by certain federal government accounts, such as the Social Security and Medicare trust funds.

public. When a cash surplus occurs, the annual excess funds can then be used to reduce debt held by the public. In other words, cash deficits or surpluses generally approximate the annual net change in the amount of government borrowing from the public.

Cash surpluses during fiscal years 1998 through 2001 enabled Treasury to reduce debt held by the public by $476 billion, from $3,815 billion as of September 30, 1997, to $3,339 billion as of September 30, 2001. Treasury reduced this debt by redeeming maturing debt, reducing the number of auctions and size of new debt issues, conducting "buybacks" of debt before its maturity date, and redeeming callable securities when the opportunities arose.[2] However, because of the return to a deficit, in fiscal year 2002, debt held by the public increased by $214 billion. Notwithstanding the increase in fiscal year 2002, debt held by the public as a percentage of total federal debt has decreased from approximately 71 percent as of September 30, 1997, to approximately 57 percent as of September 30, 2002.

Intragovernmental debt holdings represent balances of Treasury securities held by federal government accounts, primarily federal trust funds, that typically have an obligation to invest their excess annual receipts over disbursements in federal securities. Most federal trust funds invest in special U.S. Treasury securities that are guaranteed for principal and interest by the full faith and credit of the U.S. government. These securities are nonmarketable; however, they represent a priority call on future budgetary resources. Certain of these trust funds, such as the Social Security and federal civilian employee and military retirement trust funds, have been running cash surpluses, which are loaned to the Treasury and reduce the current need for the government to borrow from the public. Primarily as a result of such trust fund surpluses, intragovernmental debt holdings have increased by approximately $1,077 billion during fiscal years 1998 through 2002, from $1,583 billion as of September 30, 1997, to $2,660 billion as of September 30, 2002, with about $207 billion of this increase occurring in fiscal year 2002. Intragovernmental debt holdings as a percentage of total federal debt have increased from approximately 29 percent as of September 30, 1997, to approximately 43 percent as of September 30, 2002.

[2]During this period, Treasury eliminated the 3-year note and the 52-week bill. On October 31, 2001, Treasury suspended issuance of the 30-year bond.

The transactions relating to the use of the federal government accounts' surpluses net out on the government's consolidated financial statements because, in effect, they represent loans from one part of the government to another. Importantly, these intragovernmental debt holdings also constitute future obligations of the Treasury since the Treasury must provide cash to redeem these securities in order for the individual accounts to pay their benefits or other obligations as they come due. When this occurs, if sufficient cash surpluses are not available to redeem the securities, the government would either need to increase borrowing from the public, raise future taxes, reduce future spending, retire less debt (if the budget as a whole is in surplus), or some combination thereof.

While both are important, debt held by the public and intragovernmental debt holdings are very different. Debt held by the public approximates the federal government's competition with other sectors in the credit markets. Federal borrowing absorbs resources available for private investment and may put upward pressure on interest rates. In addition, interest on debt held by the public is paid in cash and represents a burden on current taxpayers. It reflects the amount the government pays to its outside creditors. In contrast, intragovernmental debt holdings perform an accounting function but typically do not require cash payments from the current budget or represent a burden on the current economy. In addition, from the perspective of the budget as a whole, interest payments to the federal government accounts by the Treasury are entirely offset by the income received by such accounts—in effect, one part of the government pays the interest and another part receives it. This intragovernmental debt and the interest on it represents a claim on future resources and hence a burden on future taxpayers and the future economy. However, these intragovernmental debt holdings may not fully reflect the government's total future commitment to trust fund financed programs. They primarily represent the cumulative cash surpluses of those trust funds and also reflect future priority claims on the U.S. Treasury. They do not have the current economic effects of borrowing from the public and do not currently compete with the private sector for available funds in the credit markets. However, when trust funds redeem Treasury securities to obtain cash to fund expenditures, and Treasury borrows from the public to finance these redemptions, there is competition with the private sector and thus an effect on the economy.

During fiscal year 2002, Treasury faced the challenge of managing the debt within the statutory debt limit as a result of an earlier-than-anticipated return to deficits. Treasury twice from April 4 to April 16 and from May 16 to June 28 announced debt issuance suspension periods that required it to depart from its normal debt management procedures and to invoke legal authorities provided to avoid breaching the debt limit. Actions taken by Treasury included suspending investment of receipts of the Government Securities Investment Fund (G-Fund) of the federal employees' Thrift Savings Plan and the Civil Service Retirement and Disability Trust Fund (Civil Service fund), redeeming Civil Service fund securities early, suspending the sales of State and Local Government Series nonmarketable Treasury securities, and recalling compensating balances held at some commercial banks. In addition, because the debt subject to the limit was so close to the ceiling during these periods, Treasury turned to issuing bills with maturity dates of 19 days or less to manage short-term financing needs. On June 28, 2002, legislation was enacted to raise the statutory debt limit by $450 billion to $6.4 trillion. Subsequently, Treasury restored all losses to the G-Fund and Civil Service fund. Current projections are that this new debt limit will be reached in fiscal year 2003.

Today the challenges of combating terrorism and ensuring homeland security have come to the forefront as urgent claims on the federal budget. While there are indications that a modest economic recovery may be under way, the recession of 2001 has had real consequences for the budget. At the same time, the known long-term fiscal pressures created by the retirement of the baby boom generation and rising health care costs remain the same. Absent substantive reform of federal entitlement programs, a rapid escalation of federal spending for Social Security, Medicare, and Medicaid beginning less than 10 years from now is virtually certain to overwhelm the rest of the federal budget. Indeed, the current weak economy coupled with various tax and spending decisions have resulted in debt held by the public as a percentage of the annual size of the U.S. economy increasing in 2002 for the first time since 1993. Ultimately, restoring our long-term fiscal flexibility and preventing debt held by the public from rising to unsustainable levels will involve reforming existing federal entitlement programs and promoting the saving and investment necessary for robust long-term economic growth. Correspondingly, the task of addressing today's compelling national needs without unduly exacerbating the long-range fiscal challenge has become much more difficult.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Appropriations; the Senate Committee on Governmental Affairs; the Senate Committee on the Budget; the Subcommittee on Treasury and General Government, Senate

Committee on Appropriations; the House Committee on Appropriations; the House Committee on Government Reform; the House Committee on the Budget; the Subcommittee on Treasury, Postal Service, and General Government, House Committee on Appropriations; and the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations, House Committee on Government Reform. We are also sending copies of this report to the Commissioner of the Bureau of the Public Debt, the Inspector General of the Department of the Treasury, the Director of the Office of Management and Budget, and other agency officials. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If I can be of further assistance, please call me at (202) 512-5500. This report was prepared under the direction of Gary T. Engel, Director, Financial Management and Assurance. Should you or members of your staff have any questions concerning this report, please contact Mr. Engel at (202) 512-3406. Another key contact and staff acknowledgments are provided in appendix II.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

To the Commissioner of the Bureau of the Public Debt

In connection with fulfilling our requirement to audit the financial statements of the U.S. government, we audited the Schedules of Federal Debt Managed by the Bureau of the Public Debt (BPD) because of the significance of the federal debt to the federal government's financial statements.[3]

This auditor's report presents the results of our audits of the Schedules of Federal Debt Managed by BPD for the fiscal years ended September 30, 2002 and 2001. 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 BPD.[4]

In our audits of the Schedules of Federal Debt for the fiscal years ended September 30, 2002 and 2001, we found the following:

- the Schedules of Federal Debt are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- BPD had effective internal control over financial reporting and compliance with laws and regulations related to the Schedule of Federal Debt as of September 30, 2002; and
- no reportable noncompliance in fiscal year 2002 with laws we tested.

The following sections discuss, in more detail, (1) these conclusions and our conclusion on the Overview on Federal Debt Managed by the Bureau of the Public Debt and (2) the scope of our audits.

[3]31 U.S.C. 331(e) (2000).

[4]Intragovernmental Debt Holdings represent federal debt issued by Treasury and held by certain federal government accounts, such as the Social Security and Medicare trust funds.

Opinion on Schedules of Federal Debt

The Schedules of Federal Debt including the accompanying notes present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the balances as of September 30, 2002, 2001, and 2000, for Federal Debt Managed by BPD; the related Accrued Interest Payables and Net Unamortized Premiums and Discounts; and the related increases and decreases for the fiscal years ended September 30, 2002 and 2001.

Opinion on Internal Control

BPD maintained, in all material respects, effective internal control relevant to the Schedule of Federal Debt related to financial reporting and compliance with applicable laws and regulations as of September 30, 2002. The internal control provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the Schedule of Federal Debt for the fiscal year ended September 30, 2002, would be prevented or detected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. 3512(c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act) and the Office of Management and Budget (OMB) Circular A-123, *Management Accountability and Control*.

We found matters involving computer controls that we do not consider to be reportable conditions.[5] We will communicate these matters to BPD's management, along with our recommendations for improvement, in a separate letter to be issued at a later date.

Compliance with Laws and Regulations

Our tests in fiscal year 2002 disclosed no instances of noncompliance with selected provisions of laws that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit of the Schedule of Federal Debt for the fiscal year ended September 30, 2002, was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

[5]Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to meet the internal control objectives described in the Objectives, Scope, and Methodology section of this report.

Consistency of Other Information

BPD's Overview on Federal Debt Managed by the Bureau of the Public Debt contains information, some of which is not directly related to the Schedules of Federal Debt. We do not express an opinion on this information. However, we compared this information for consistency with the schedules and discussed the methods of measurement and presentation with BPD officials. Based on this limited work, we found no material inconsistencies with the schedules.

Objectives, Scope, and Methodology

Management is responsible for the following:

- preparing the Schedules of Federal Debt in conformity with U.S. generally accepted accounting principles;
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met; and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the Schedules of Federal Debt are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles and (2) management maintained effective related internal control as of September 30, 2002, the objectives of which are the following:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of the Schedule of Federal Debt for the fiscal year ended September 30, 2002, in conformity with U.S. generally accepted accounting principles.
- Compliance with laws and regulations: Transactions related to the Schedule of Federal Debt for the fiscal year ended September 30, 2002, are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the Schedule of Federal Debt.

We are also responsible for testing compliance with selected provisions of laws and regulations that have a direct and material effect on the Schedule of Federal Debt. Further, we are responsible for performing limited procedures with respect to certain other information appearing with the Schedules of Federal Debt.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the Schedules of Federal Debt;

- assessed the accounting principles used and any significant estimates made by management;

- evaluated the overall presentation of the Schedules of Federal Debt;

- obtained an understanding of internal control relevant to the Schedule of Federal Debt as of September 30, 2002, related to financial reporting and compliance with laws and regulations (including execution of transactions in accordance with budget authority);

- tested relevant internal controls over financial reporting and compliance, and evaluated the design and operating effectiveness of internal control related to the Schedule of Federal Debt as of September 30, 2002;

- considered the process for evaluating and reporting on internal control and financial management systems under the Federal Managers' Financial Integrity Act; and

- tested compliance in fiscal year 2002 with selected provisions of the following laws: statutory debt limit (31 U.S.C. 3101(b), as amended), suspension and early redemption of investments from the Civil Service Retirement and Disability Trust Fund (5 U.S.C. 8348(j)(k)), and suspension of investments from the G-Fund (5 U.S.C. 8438(g)).

We did not evaluate all internal controls relevant to operating objectives as broadly described by the Federal Managers' Financial Integrity Act, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation 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 controls may deteriorate.

We did not test compliance with all laws and regulations applicable to BPD. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the Schedule of Federal Debt for the fiscal year ended September 30, 2002. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our work in accordance with U.S. generally accepted government auditing standards and applicable OMB audit guidance.

Agency Comments

In commenting on a draft of this report, BPD concurred with the facts and conclusions in our report. The comments are reprinted in appendix I.

David M. Walker
Comptroller General
of the United States

October 24, 2002

Overview, Schedules, and Notes

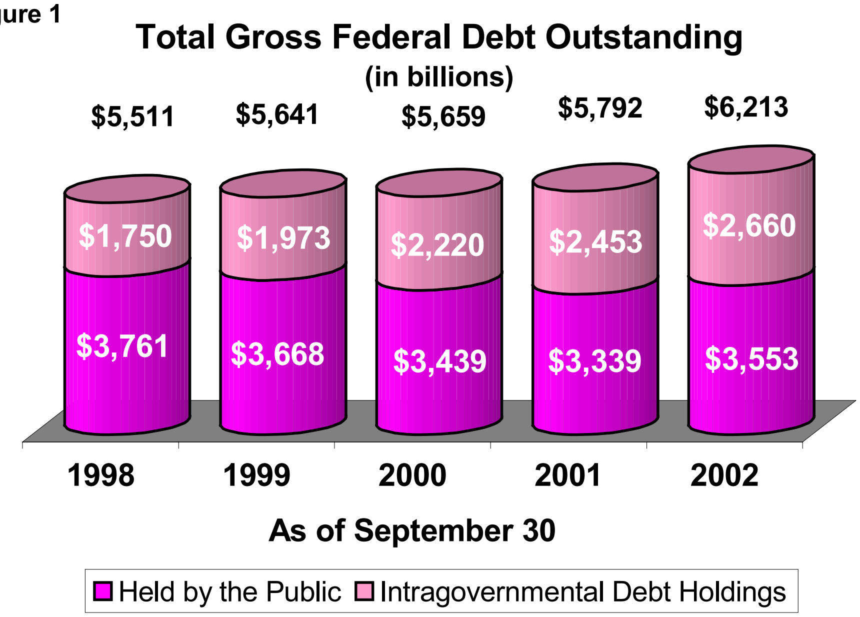
Overview on Federal Debt Managed by the Bureau of the Public Debt

Overview on Federal Debt Managed by the Bureau of the Public Debt

Gross Federal Debt Outstanding[1]

Federal debt managed by the Bureau of the Public Debt comprises debt held by the public and debt held by certain federal government accounts, the latter of which is referred to as intragovernmental debt holdings. As of September 30, 2002 and 2001, outstanding gross federal debt managed by the bureau totaled $6,213 and $5,792 billion, respectively. The increase in gross federal debt of $421 billion during fiscal year 2002 was due to an increase in gross intragovernmental debt holdings of $207 billion and an increase in gross debt held by the public of $214 billion. As Figure 1 illustrates, intragovernmental debt holdings have steadily increased since fiscal year 1998 and debt held by the public has decreased from fiscal years 1998 through 2001, but increased this fiscal year. The primary reason for the increases in intragovernmental debt holdings is the annual cash surpluses in the Federal Old-Age and Survivors Insurance, Federal Disability Insurance, Military Retirement, and Civil Service Retirement and Disability trust funds. The fiscal year 2002 increase in debt held by the public is due primarily to total federal spending exceeding total federal revenues. As of September 30, 2002, gross debt held by the public totaled $3,553 billion and gross intragovernmental debt holdings totaled $2,660 billion.

Figure 1

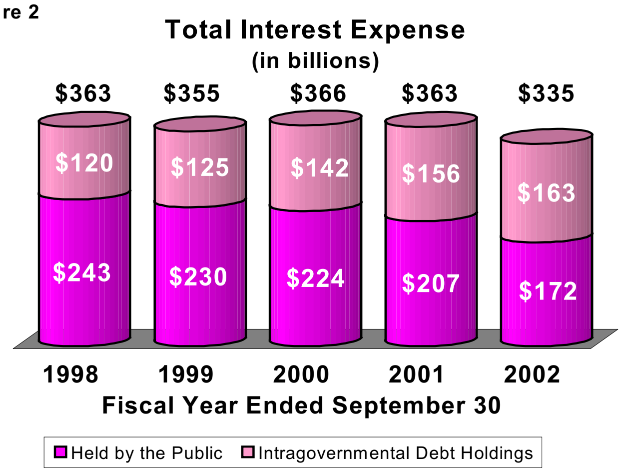


[1] Federal debt outstanding reported here differs from the amount reported in the Financial Report of the United States Government because of the securities not maintained or reported by the bureau and which are issued by the Federal Financing Bank and other federal government agencies.

Interest Expense

Interest expense incurred during fiscal year 2002 consists of (1) interest accrued and paid on debt held by the public or credited to accounts holding intragovernmental debt during fiscal year 2002, (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 in 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. During fiscal year 2002, interest expense incurred totaled $335 billion, interest expense on debt held by the public was $172 billion, and $163 billion was interest incurred for intragovernmental debt holdings. Although the amount of outstanding debt held by the public increased during fiscal year 2002, the related fiscal year 2002 interest expense on such debt decreased as a result of overall lower interest rates on securities. Figure 2 shows total interest expense incurred during fiscal years 1998 through 2002. Average interest rates on principal balances outstanding as of fiscal year end are disclosed in the Notes to the Schedules of Federal Debt. Average interest rates on Treasury bills decreased from 3.5 percent as of September 30, 2001, to 1.7 percent as of September 30, 2002. This decrease was primarily due to the reduction of the federal funds rate during the fiscal year.

Figure 2



Debt Held by the Public

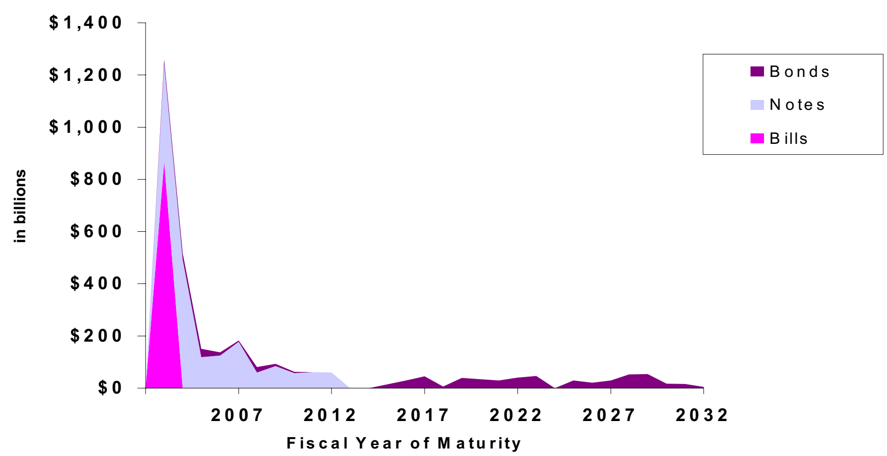
Debt held by the public reflects how much of the nation's wealth has been absorbed by the federal government to finance prior federal spending in excess of total federal revenues. As of September 30, 2002 and 2001, gross debt held by the public totaled $3,553 billion and $3,339 billion, respectively (see Figure 1), an increase of $214 billion. The borrowings and repayments of debt held by the public increased from fiscal year 2001 to 2002 primarily due to Treasury's decision to finance current operations using more short-term securities.

As of September 30, 2002, $3,121 billion, or 88 percent, of the securities that constitute debt held by the public were marketable, meaning that once the government issues them, they can be resold by whoever owns them. Marketable debt is made up of Treasury bills, notes, and bonds with maturity dates ranging from less than 1 year out to 30 years. Of the marketable securities currently held by the public as of September 30, 2002, $2,066 billion or 66 percent will mature within the next 4 years (see Figure 3).

The government also issues to the public, state and local governments, and foreign governments and central banks nonmarketable securities, which cannot be resold, and have maturity dates from on demand to more than 10 years. As of September 30, 2002, nonmarketable securities totaled $432 billion, or 12 percent of debt held by the public. As of that date, nonmarketable securities primarily consisted of savings securities totaling $193 billion and special securities for state and local governments totaling $144 billion.

Figure 3

Maturity Dates[2] of Marketable Debt Held by the Public as of September 30, 2002



[2] Callable securities mature between 2007 and 2014, but are reported by their call date, 5 years earlier – this explains the gap in the figure.

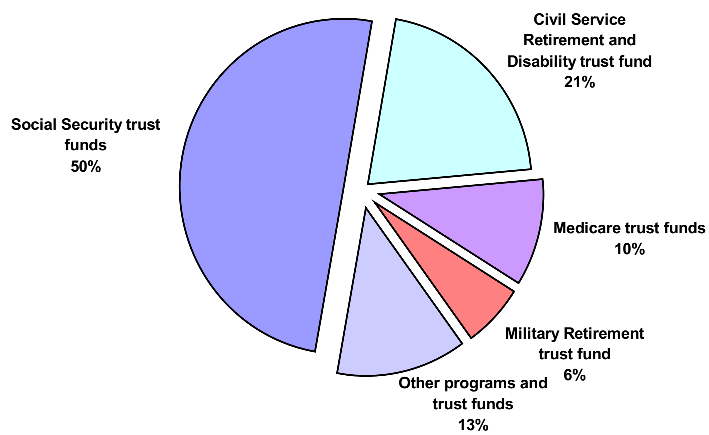
Intragovernmental Debt Holdings

Intragovernmental debt holdings represent balances of Treasury securities held by 228 individual federal government accounts with either the authority or the requirement to invest excess receipts in special U.S. 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, Medicare, Military Retirement, and Civil Service Retirement and Disability trust funds.[3] As of September 30, 2002, such funds accounted for $2,318 billion, or 87 percent, of the $2,660 billion intragovernmental debt holdings balances (see Figure 4). As of September 30, 2002 and 2001, gross intragovernmental debt holdings totaled $2,660 billion and $2,453 billion, respectively (see Figure 1), an increase of $207 billion.

The majority of intragovernmental debt holdings are Government Account Series (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, 2002



[3] The Social Security trust funds consist of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. In addition, 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 FY 2002

30-Year Bond Issues Suspended

On October 31, 2001, Treasury determined that the 30-year bond was no longer necessary to meet the government's current and expected financing needs. As a result, it announced the cancellation of the auction of 30-year securities scheduled in February 2002 and noted that no further auctions of the 30-year bond are planned. The last issuance of the 30-year bond was on October 15, 2001, for $5 billion.

Debt Buyback Program Changes

On October 31, 2001, Treasury announced that the debt buyback program would be adjusted consistent with the ebb and flow of Treasury's cash position. Treasury's last buyback operation was conducted on April 29, 2002, and no future buyback operations are currently scheduled.

Statutory Debt Ceiling Raised

On December 11, 2001, Treasury requested that the statutory debt ceiling be raised from $5,950 billion to $6,700 billion. During fiscal year 2002 before the debt ceiling was raised, Treasury twice—from April 4 to April 16 and from May 16 to June 28—faced debt issuance suspension periods that required it to depart from its normal debt management procedures and to invoke legal authorities provided to avoid breaching the debt limit. Actions taken by Treasury included suspending investment of receipts of the Government Securities Investment Fund (G-Fund) of the federal employees' Thrift Savings Plan and the Civil Service Retirement and Disability trust fund (Civil Service fund); redeeming Civil Service fund securities early; and suspending the sales of State and Local Government Series securities. In addition, because the debt subject to the limit was so close to the ceiling during these periods, Treasury issued cash management bills to manage short-term financing needs. On June 28, 2002, Public Law 107-199 was enacted, which raised the statutory debt ceiling by $450 billion to $6.4 trillion.

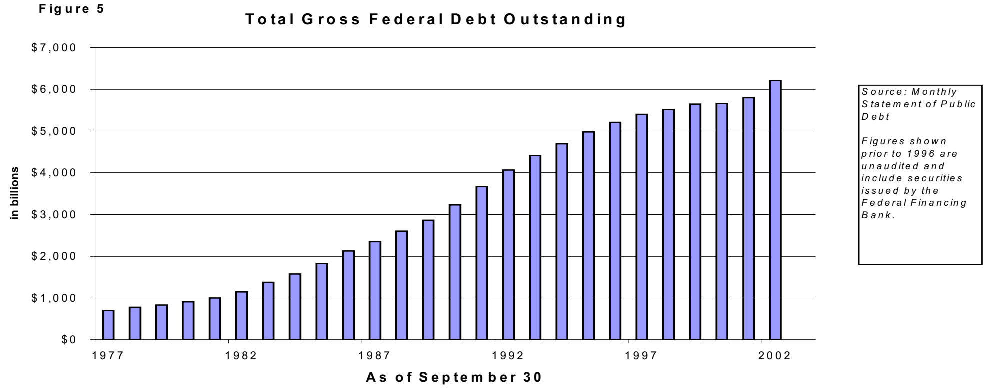
Historical Perspective

Federal debt outstanding is one of the largest legally binding obligations of the federal government. Nearly all the federal debt has been issued by the Treasury with a small portion being issued by other federal government 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 mechanism for certain federal government accounts' excess receipts, primarily trust funds.

Historical Perspective, cont.

Total gross federal debt outstanding has dramatically increased over the past 25 years from $699 billion as of September 30, 1977 to $6,213 billion as of September 30, 2002 (see Figure 5). Large budget deficits emerged during the 1970's as the economy was disrupted by oil crises and inflation. Through fiscal year 1997, annual federal deficits continued to be large and debt continued to grow at a rapid pace. As a result, total federal debt increased nearly five fold since 1980. However, by fiscal year 1998, federal debt held by the public was beginning to decline. In fiscal years 1998 through 2001, the amount of debt held by the public fell by $476 billion, from $3,815 billion to $3,339 billion. As a consequence of the changes in the federal government's financing needs, resulting from increased federal outlays for the international war on terrorism and homeland security efforts, tax policy decisions, and the deterioration of overall economic performance, debt held by the public rose during fiscal year 2002 by $214 billion. Even in those years where debt held by the public declined, total federal debt increased because of increases in intragovernmental debt holdings. In fiscal years 1998 through 2002, intragovernmental debt holdings increased by $1,077 billion, from $1,583 billion to $2,660 billion. By law, trust funds have the authority or are required to invest surpluses in federal securities. As a result, the intragovernmental debt holdings balances 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.

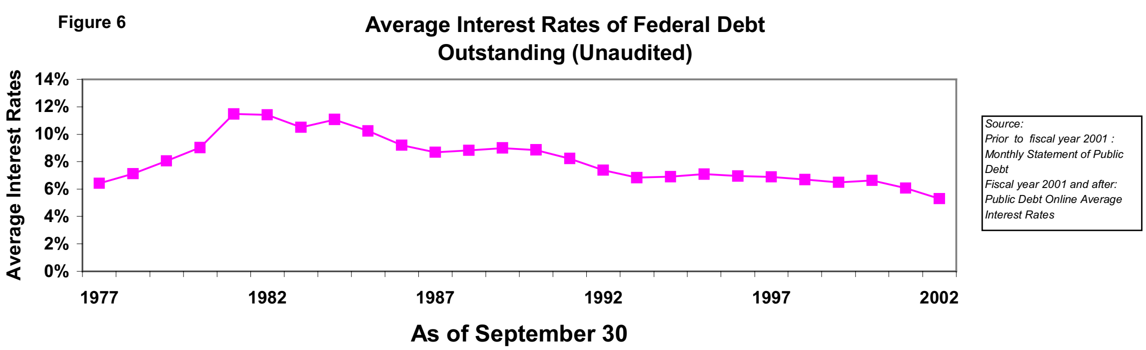
Figure 5



Historical Perspective, cont.

As shown in Figure 6, interest rates have fluctuated over the past 25 years. The highest interest rates occurred from the early 1980's through the early 1990's, periods when the federal deficits grew substantially.

Figure 6



Recent Change Affecting Federal Debt

The following event will affect future gross federal debt balances. The Railroad Retirement and Survivors' Improvement Act of 2001 was enacted into law on December 21, 2001, and transferred responsibility for the investment of the Railroad Retirement System Trust funds from the Railroad Retirement Board to a newly created National Railroad Retirement Investment Trust. The law provides for the transfer of Railroad Retirement funds from GAS securities to non-governmental assets. The first transfer occurred September 18, 2002, in the amount of $1.5 billion. Transfers of $1.5 billion are planned to occur semi-monthly through February 2003. It is the Railroad Retirement Board's intention to eventually move the majority of its $23 billion portfolio of GAS securities held as of September 30, 2002, to the new trust.

Schedules of Federal Debt

Schedules of Federal Debt

Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2002 and 2001
(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, 2000	$3,439,023	$44,221	($56,150)	$2,220,155	$37,252	($4,330)
Increases						
Borrowings from the Public	2,556,481		(25,904)			
Net Increase in Intragovernmental Debt Holdings				232,998		(4,624)
Accrued Interest (Note 4)		171,034			153,072	
Total Increases	2,556,481	171,034	(25,904)	232,998	153,072	(4,624)
Decreases						
Repayments of Debt Held by the Public	2,656,194					
Interest Paid		175,759			150,338	
Net Amortization (Note 4)			(36,044)			(2,784)
Total Decreases	2,656,194	175,759	(36,044)	0	150,338	(2,784)
Balance as of September 30, 2001	3,339,310	39,496	(46,010)	2,453,153	39,986	(6,170)
Increases						
Borrowings from the Public	3,803,649		(12,861)			
Net Increase in Intragovernmental Debt Holdings				206,903		3,309
Accrued Interest (Note 4)		152,038			161,627	
Total Increases	3,803,649	152,038	(12,861)	206,903	161,627	3,309
Decreases						
Repayments of Debt Held by the Public	3,589,779					
Interest Paid		158,660			160,537	
Net Amortization (Note 4)			(19,596)			(1,347)
Total Decreases	3,589,779	158,660	(19,596)	0	160,537	(1,347)
Balance as of September 30, 2002	$3,553,180	$32,874	($39,275)	$2,660,056	$41,076	($1,514)

The accompanying notes are an integral part of these schedules.

Notes to the Schedules of Federal Debt

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt

For the Fiscal Years Ended September 30, 2002 and 2001

(Dollars in Millions)

Note 1. Significant Accounting Policies

Basis of Presentation

The Schedules of Federal Debt Managed by the Bureau of the Public Debt (BPD) have been prepared to report fiscal year 2002 and 2001 balances and activity relating to monies borrowed from the public and certain federal government accounts to fund the U.S. government's operations. Permanent, indefinite appropriations are available for the payment of interest on the federal debt, the redemption of Treasury securities, and the loss on marketable securities bought back prior to maturity through competitive redemption processes.

Reporting Entity

The Constitution empowers Congress to borrow money on the credit of the United States. 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.C. authorizes Treasury to prescribe the debt instruments and otherwise limit and restrict the amount and composition of the debt. BPD, an organizational entity within the Fiscal Service of the Department of the Treasury, is responsible for issuing Treasury securities in accordance with such authority and to account for the resulting debt. In addition, BPD has been given the responsibility to issue Treasury securities to trust funds for trust fund receipts not needed for current benefits and expenses. BPD issues and redeems Treasury securities for the trust funds based on data provided by program agencies and other Treasury entities.

Basis of Accounting

The schedules were prepared in conformity with U.S. generally accepted accounting principles and from BPD's automated accounting system, Public Debt Accounting and Reporting System. 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 zero-coupon bonds and the straight line method, which is not materially different from the interest method, for the other securities. The Department of the Treasury also issues inflation-indexed securities. Inflation-indexed securities accrue principal over the life of the security based on the Consumer Price Index for all Urban Consumers. For marketable securities bought back prior to maturity through competitive redemption processes, the difference between the reacquisition price and the net carrying value of the extinguished debt is recognized as a gain or loss in the period of extinguishment. Beginning in fiscal year 2003, discounts and premiums for all long-term securities (terms greater than one year) will be amortized using an interest method.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt

For the Fiscal Years Ended September 30, 2002 and 2001

(Dollars in Millions)

Note 2. Federal Debt Held by the Public

As of September 30, 2002 and 2001, Federal Debt Held by the Public consisted of the following:

	2002		2001	
	Amount	Average Interest Rates	Amount	Average Interest Rates
Marketable:				
Treasury Bills	$868,221	1.7%	$734,856	3.5%
Treasury Notes	1,615,309	4.7%	1,528,095	5.8%
Treasury Bonds	637,827	8.0%	652,274	8.0%
Total Marketable	$3,121,357		$2,915,225	
Nonmarketable	$431,823	6.0%	$424,085	6.3%
Total Federal Debt Held by the Public	$3,553,180		$3,339,310	

Treasury issues marketable bills at a discount 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, 2002 and 2001, respectively. 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 securities' 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, 2002 and 2001, respectively. Treasury notes are issued with a term of 2 – 10 years and Treasury bonds are issued with a term of more than 10 years. As of September 30, 2002, Treasury marketable notes included $93,738 million of inflation-indexed notes and Treasury marketable bonds included $45,132 million of inflation-indexed bonds. As of September 30, 2001, Treasury marketable notes included $95,147 million of inflation-indexed notes and Treasury marketable bonds included $39,744 million of inflation-indexed bonds.

As of September 30, 2002, nonmarketable securities primarily consisted of $193,357 million in U.S. Savings Securities, $144,286 million in securities issued to State and Local Governments, $12,519 million in Foreign Series Securities, and $29,995 million in Domestic Series Securities. As of September 30, 2001, nonmarketable securities primarily consisted of $186,509 million in U.S. Savings Securities, $146,364 million in securities issued to State and Local Governments, $18,269 million in Foreign Series Securities, and $29,995 million in Domestic Series Securities. 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, 2002 and 2001, respectively. Nonmarketable securities are issued with a term of on demand to more than 10 years.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt

For the Fiscal Years Ended September 30, 2002 and 2001

(Dollars in Millions)

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

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. The net increase in amounts borrowed from the fund during fiscal years 2002 and 2001 are included in the respective Borrowings from the Public amounts reported on the Schedules of Federal Debt.

Federal Debt Held by the Public includes federal debt held outside of the U. S. government by individuals, corporations, Federal Reserve Banks (FRB), state and local governments, and foreign governments and central banks. The FRB owned $603 billion and $558 billion of Federal Debt Held by the Public as of September 30, 2002 and 2001, respectively. These securities are held in the FRB System Open Market Account (SOMA) for the purpose of conducting monetary policy.

Fiscal year 2001 ended on Sunday, September 30, 2001. As a result, $33,316 million of marketable Treasury notes matured but not repaid are included in the balance of the total Federal Debt Held by the Public as of September 30, 2001. Settlement of these debt repayments occurred on Monday, October 1, 2001.

Note 3. Intragovernmental Debt Holdings

As of September 30, 2002 and 2001, Intragovernmental Debt Holdings are owed to the following:

		2002	2001
SSA:	Federal Old-Age and Survivors Insurance Trust Fund	$1,173,759	$1,034,113
OPM:	Civil Service Retirement and Disability Fund	558,713 *	527,608 *
HHS:	Federal Hospital Insurance Trust Fund	228,906	197,137
DOD:	Military Retirement Fund	162,396	156,978
SSA:	Federal Disability Insurance Trust Fund	155,286 *	135,842 *
DOL:	Unemployment Trust Fund	68,265	88,638
HHS:	Federal Supplementary Medical Insurance Trust Fund	38,804	41,978
FDIC:	The Bank Insurance Fund	30,542	30,677
OPM:	Employees' Life Insurance Fund	25,350	23,690
DOE:	Nuclear Waste Disposal Fund	23,421	21,060
RRB:	Railroad Retirement Account	23,383	24,983
HUD:	FHA – Liquidating Account	21,249	17,282
DOT:	Highway Trust Fund	18,840	24,115
DOL:	Pension Benefit Guaranty Corporation Fund	12,834	11,575
DOS:	Foreign Service Retirement & Disability Fund	11,734	11,192
VA:	National Service Life Insurance Fund	11,465	11,639
FDIC:	Savings Association Insurance Fund (SAIF)	11,153	10,654
DOT:	Airport & Airway Trust Fund	10,997	13,660
Treasury:	Exchange Stabilization Fund	9,717	10,014
Other Programs and Funds		63,242	60,318
Total Intragovernmental Debt Holdings		$2,660,056	$2,453,153

* These amounts include marketable Treasury securities as well as GAS securities as follows:

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt

For the Fiscal Years Ended September 30, 2002 and 2001

(Dollars in Millions)

Note 3. Intragovernmental Debt Holdings (continued)

	GAS Securities	Marketable Treasury Securities	Total
As of September 30, 2002:			
Civil Service Retirement and Disability Fund	$558,433	$280	$558,713
Federal Disability Insurance Trust Fund	155,256	30	155,286
As of September 30, 2001:			
Civil Service Retirement and Disability Fund	$527,189	$419	$527,608
Federal Disability Insurance Trust Fund	135,802	40	135,842

Social Security Administration (SSA); Office of Personnel Management (OPM); Department of Health and Human Services (HHS); Department of Defense (DOD); Department of Labor (DOL); Federal Deposit Insurance Corporation (FDIC); Department of Energy (DOE); Railroad Retirement Board (RRB); Department of Housing and Urban Development (HUD); Department of Transportation (DOT); Department of State (DOS); Department of Veterans Affairs (VA); Department of the Treasury (Treasury).

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. The average interest rates for fiscal years 2002 and 2001 were 6.0 percent and 6.4 percent, respectively. The average interest rate represents the original issue weighted effective yield on securities outstanding as of September 30, 2002 and 2001, respectively. GAS securities are issued with a term of on demand to 30 years.

Fiscal year 2001 ended on Sunday, September 30, 2001. As a result, $1,457 million of GAS securities matured but not repaid are included in the balance of the Intragovernmental Debt Holdings as of September 30, 2001. Settlement of these debt repayments occurred on Monday, October 1, 2001.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2002 and 2001
(Dollars in Millions)

Note 4. Interest Expense

Interest expense on Federal Debt Managed by BPD for fiscal years 2002 and 2001 consisted of the following:

	2002	2001
Federal Debt Held by the Public		
Accrued Interest	$152,038	$171,034
Net Amortization of Premiums and Discounts	19,553 *	35,934 *
Total Interest Expense on Federal Debt Held by the Public	171,591	206,968
Intragovernmental Debt Holdings		
Accrued Interest	161,627	153,072
Net Amortization of Premiums and Discounts	1,347	2,784
Total Interest Expense on Intragovernmental Debt Holdings	162,974	155,856
Total Interest Expense on Federal Debt Managed by BPD	$334,565	$362,824

*Amount shown here differs from the net amortization amount on the Schedules of Federal Debt as of September 30, 2002 and September 30, 2001 due to $43 million and $110 million, respectively, of net unamortized premiums and discounts written off relating to the marketable securities bought back prior to maturity through competitive redemption processes. (See note 6 for additional information on debt buybacks.)

Note 5. Fund Balance With Treasury

	As of September 30, 2002	As of September 30, 2001
Appropriated Funds Obligated	$168	$168

The Fund Balance with Treasury, a non-entity, intragovernmental account, is not included on the Schedules of Federal Debt and is presented for informational purposes.

Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2002 and 2001
(Dollars in Millions)

Note 6. Debt Buybacks

Debt buybacks are competitive redemption processes by which Treasury accepts offers to redeem particular marketable Treasury securities prior to their maturity dates. Once the securities have been redeemed from investors, they are removed from the total Treasury securities outstanding. On January 19, 2000, the Department of the 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. This authority to buy back securities enables Treasury to better manage financing needs, promote more efficient capital markets, and may lower financing costs for taxpayers. The first of these "buybacks" occurred on March 9, 2000. The premium paid represents the amount of money paid above par value to buy back securities. During fiscal years 2002 and 2001, there were 9 and 23 buyback operations, respectively, which involved the following:

	2002	2001
Total Amount Paid for Debt Buybacks, excluding Accrued Interest	$16,278	$44,357
Principal Amount of Debt Buybacks	12,521	33,752
Premium Paid on Debt Buybacks	$3,757	$10,605
Write Off of Net Unamortized Discounts on Debt Buybacks	43	110
Loss on Debt Buybacks	$3,800	$10,715

Comments from the Bureau of the Public Debt

DEPARTMENT OF THE TREASURY
BUREAU OF THE PUBLIC DEBT
WASHINGTON, DC 20239-0001

October 29, 2002

Mr. Gary T. Engel
Director
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Engel:

This letter is our response to your audit of the Schedules of Federal Debt Managed by the Bureau of the Public Debt for the fiscal years ended September 30, 2002, and 2001. We agree with your audit report's conclusions.

I would like to thank you and your staff for conducting a thorough audit of these schedules. We appreciate the dedication and commitment of your audit team. Even with the added challenge of complying with our Secretary's goal of publishing audited departmental financial statements by November 15, 2002, the overall audit process still continues to grow less arduous and more streamlined each year. Without the significant amount of coordination and planning between our offices that began in April, the burden of condensing our audit completion timeline by three and one-half months would have been overwhelming.

As always, we look forward to continuing this productive and successful relationship.

Sincerely,

Van Zeck
Commissioner

www.publicdebt.treas.gov

GAO Contact and Staff Acknowledgments

GAO Contact

Louise DiBenedetto, (202) 512-6921

Acknowledgments

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