

November 2006

FINANCIAL AUDIT

Bureau of the Public Debt's Fiscal Years 2006 and 2005 Schedules of Federal Debt



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-07-127](#), a report to the Secretary of the Treasury

Why GAO Did This Study

GAO is required to audit the consolidated financial statements of the U.S. government. Due to the significance of the federal debt held by the public to the governmentwide financial statements, GAO has also been auditing the Bureau of the Public Debt's (BPD) Schedules of Federal Debt annually. The audit of these schedules is done to determine whether, in all material respects, (1) the schedules are reliable and (2) BPD management maintained effective internal control relevant to the Schedule of Federal Debt. Further, we test compliance 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, referred to as 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 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-07-127.

For a fuller understanding of GAO's opinion on BPD's fiscal years 2006 and 2005 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 more information, contact Gary T. Engel at (202) 512-3406 or engelg@gao.gov.

FINANCIAL AUDIT

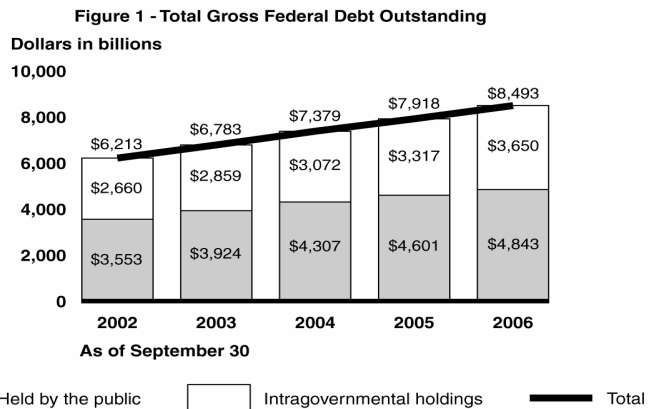
Bureau of the Public Debt's Fiscal Years 2006 and 2005 Schedules of Federal Debt

What GAO Found

In GAO's opinion, BPD's Schedules of Federal Debt for fiscal years 2006 and 2005 were fairly presented in all material respects and BPD maintained effective internal control relevant to the Schedule of Federal Debt as of September 30, 2006. GAO also found no instances of noncompliance in fiscal year 2006 with selected provisions of the statutory debt limit and debt issuance suspension period laws we tested.

As of September 30, 2006 and 2005, federal debt managed by BPD totaled about \$8,493 billion and \$7,918 billion, respectively. At the end of fiscal year 2006, debt held by the public as a percentage of the U.S. economy is estimated at 36.9 percent, compared to 34.1 percent at the end of fiscal year 2002. Further, certain trust funds (e.g., Social Security) continue to run surpluses, resulting in increased intragovernmental debt holdings. These debt holdings are backed by the full faith and credit of the U.S. government and represent a priority call on budgetary resources. As a result, total gross federal debt has increased 37 percent between the end of fiscal years 2002 and 2006. During fiscal year 2006, a debt issuance suspension period was invoked to avoid breaching the statutory debt limit. On March 20, 2006, legislation was enacted to raise the debt limit by \$781 billion to \$8,965 billion. This was the fourth occurrence since 2002 that the statutory debt limit had to be raised to avoid breaching the statutory debt limit. During that time, the debt limit has increased more than \$3 trillion, from \$5,950 billion in 2002 to the current limit of \$8,965 billion.

As shown in figure 1 below, total federal debt increased over each of the last 4 fiscal years. Debt held by the public increased during this 4-year period primarily as a result of annual unified budget deficits. Intragovernmental debt holdings steadily increased during this 4-year period primarily due to excess receipts over disbursements in federal trust funds (e.g., Social Security).



Source: BPD.

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Abbreviations

BPD	Bureau of the Public Debt
GDP	gross domestic product
OMB	Office of Management and Budget

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United States Government Accountability Office
Washington, D.C. 20548

November 7, 2006

The Honorable Henry M. Paulson, Jr.
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, 2006 and 2005. 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, 2006 and 2005, (2) opinion on the effectiveness of relevant internal control as of September 30, 2006, (3) conclusion on the bureau's compliance in fiscal year 2006 with selected provisions of laws we tested, and (4) conclusion on the consistency between information in the Schedules of Federal Debt and the accompanying Overview on Federal Debt Managed by the Bureau of the Public Debt.

As of September 30, 2006 and 2005, federal debt managed by the bureau totaled about \$8,493 billion and \$7,918 billion, respectively, for moneys borrowed to fund the federal government's operations. As shown on the Schedules of Federal Debt, these balances consisted of approximately (1) \$4,843 billion as of September 30, 2006, and \$4,601 billion as of September 30, 2005, of debt held by the public and about (2) \$3,650 billion as of September 30, 2006, and \$3,317 billion as of September 30, 2005, 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 federal revenues. It best represents the cumulative effect of past federal borrowing on today's economy and the

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

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

Intragovernmental debt holdings represent balances of Treasury securities held by federal government accounts, primarily federal trust funds (e.g., Social Security), 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. The transactions relating to the use of the federal government accounts' surpluses net out on the federal government's consolidated financial statements because, in effect, they represent loans from one part of the federal government to another. These securities are nonmarketable; however, they represent a priority call on future budgetary resources.

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 that would otherwise be 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 federal 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 federal government accounts by the Treasury are entirely offset by the income received by such accounts. 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. Specifically, 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.

Over the past decade that we have audited the Schedule of Federal Debt, managing the federal debt has been a challenge as evidenced by the growth of total federal debt by \$3,283 billion, or 63 percent, during this period, from \$5,210 billion as of October 1, 1996, to \$8,493 billion as of September

30, 2006. As a result of the increasing debt, again this past year, Congress had to enact legislation to increase the debt limit to avoid breaching the statutory debt limit. On March 20, 2006, Congress increased the statutory debt limit from \$8,184 billion to \$8,965 billion. This was the fourth occurrence since 2002 that Congress has raised the statutory debt limit, with the debt limit increasing over \$3 trillion, from \$5,950 billion to \$8,965 billion, over that period.

Over the last several years, we have noted a trend in the amount of Treasury securities held by foreign and international investors. According to amounts reported in the September 2006 *Treasury Bulletin*, Treasury estimates that the amount of Treasury securities held by foreign and international investors has increased \$957 billion, from \$1,135 billion as of June 30, 2002, to \$2,092 billion as of June 30, 2006. As of June 30, 2006, this represents an estimated 44 percent of debt held by the public, up from about 33 percent as of June 30, 2002. The United States benefits from foreign purchases of Treasury securities because foreign investors fill part of the U.S. government's borrowing needs. However, to service this foreign-held debt, the U.S. government must send interest payments abroad, which adds to the incomes of residents of other countries rather than to the incomes of U.S. residents. In addition, this increasing reliance on foreign investors to finance the deficits of the U.S. government presents potential risk to the U.S. economy, especially since the U.S. gross national saving rate is low by U.S. historical standards.

The challenge of managing the federal debt is not likely to diminish any time soon. At the end of fiscal year 2006, debt held by the public as a share of gross domestic product (GDP) is estimated at 36.9 percent, down from 37.5 percent last year but well above the 34.1 percent at the end of fiscal year 2002. In addition, gross federal debt has increased 37 percent during the same period, from \$6,213 billion, as of September 30, 2002, to \$8,493 billion, as of September 30, 2006. This increase represents an additional burden on future generations and the future economy. Further, interest expense on debt held by the public continued to grow rapidly, rising about 22 percent above the fiscal year 2005 level. As federal debt is expected to continue rising in both the near and long term, the amount the government pays to finance that debt will grow as well and place increasing pressure on the federal budget.

The pending retirement of the Baby Boom generation and rising health care costs will soon place unprecedented and long-lasting stress on the federal budget, raising debt held by the public to unprecedented levels as a share

of GDP. GAO's long-range fiscal policy simulations show that the nation's current fiscal condition is but a prelude to a much more daunting long-term fiscal challenge.² Absent significant changes on the spending or revenue sides of the budget, or both, these long-term deficits will encumber a growing share of federal resources and test the capacity of current and future generations to afford both today's and tomorrow's commitments. Continuing on this unsustainable path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security.

As discussed earlier, federal debt managed by the bureau totaled about \$8.5 trillion at the end of fiscal year 2006. However, that number excludes many items, including the gap between scheduled and funded Social Security and Medicare benefits, veterans' health care, and a range of other commitments and contingencies that the federal government has pledged to support. If these items are factored in, the present value of the total burden is estimated to be about \$50 trillion.³ Stated differently, the estimated current total burden for every American is more than \$160,000—and every day that burden becomes larger.

Addressing the nation's long-term fiscal imbalance constitutes a major transformational challenge that may take a generation or more to resolve. Given the size of the projected imbalance, the U.S. government will not be able to grow its way out of this problem—tough choices will be required. Our report, *21st Century Challenges: Reexamining the Base of the Federal Government*, is intended to support Congress in identifying issues and options that could help address these fiscal pressures.⁴

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Appropriations; the Senate Committee on Homeland Security and Governmental Affairs; the Senate

²See GAO, *Our Nation's Fiscal Outlook: The Federal Government's Long-Term Budget Imbalance*, <http://www.gao.gov/special.pubs/longterm>.

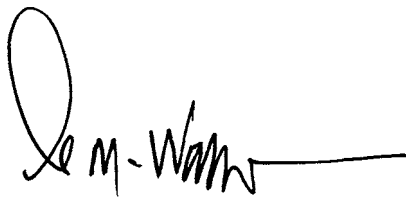
³The total burden is estimated based on the federal government's liabilities, commitments, and contingencies reported in the Financial Report of the U.S. Government for Fiscal Year 2005 adjusted for growth in debt held by the public during fiscal year 2006 and updated estimates of future social insurance obligations as reported in the 2006 Trustees reports.

⁴GAO, *21st Century Challenges: Reexamining the Base of the Federal Government*, GAO-05-325SP (Washington, D.C.: February 2005).

Committee on the Budget; the Subcommittee on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies, Senate Committee on Appropriations; the Subcommittee on Federal Financial Management, Government Information, and International Security, the Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Appropriations; the House Committee on Government Reform; the House Committee on the Budget; the Subcommittee on Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia, House Committee on Appropriations; and the Subcommittee on Government Management, Finance, and Accountability, 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 or engelg@gao.gov. Staff acknowledgments are provided in appendix II.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D. M. Walker", with a horizontal line extending to the right from the end of the signature.

David M. Walker
Comptroller General
of the United States

**United States Government Accountability Office
Washington, D.C. 20548**

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,¹ we have 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.

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, 2006 and 2005. 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.²

In our audits of the Schedules of Federal Debt for the fiscal years ended September 30, 2006 and 2005, 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 relevant to the Schedule of Federal Debt as of September 30, 2006; and
- no reportable noncompliance in fiscal year 2006 with selected provisions of 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.

¹31 U.S.C. § 331(e).

²Intragovernmental 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, 2006, 2005, and 2004, 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, 2006 and 2005.

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, 2006, that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the Schedule of Federal Debt 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, revised December 21, 2004, *Management's Responsibility for Internal Control*.

We found matters involving information security controls that we consider not to be reportable conditions.³ 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 for compliance in fiscal year 2006 with selected provisions of laws disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or applicable OMB audit guidance. However, the objective of our audit of the Schedule of Federal Debt for the fiscal year ended September 30, 2006, was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

³Reportable 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 relevant internal control as of September 30, 2006, 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, 2006, 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, 2006, 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, 2006, 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 relevant to the Schedule of Federal Debt as of September 30, 2006;
- 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 2006 with the (1) statutory debt limit (31 U.S.C. § 3101(b), as amended by Pub. L. No. 107-199, § 1, 116 Stat. 734 (2002), Pub. L. No. 108-24, 117 Stat. 710 (2003), Pub. L. No. 108-415, § 1, 118 Stat. 2337 (2004), and Pub. L. No. 109-182, 120 Stat. 289 (2006)); (2) suspension and early redemption of investments from the Civil Service Retirement and Disability Trust Fund (5 U.S.C. § 8348(j)(k)); and (3) 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

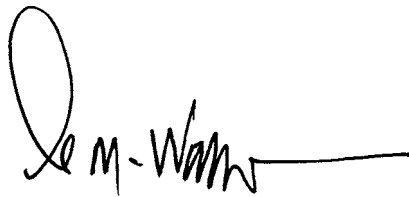
caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We did not test compliance with all laws and regulations applicable to BPD. We limited our tests of compliance to selected provisions of laws that have a direct and material effect on the Schedule of Federal Debt for the fiscal year ended September 30, 2006. 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 conclusions in our report. The comments are reprinted in appendix I.

A handwritten signature in black ink, appearing to read "D. M. Walker", with a horizontal line extending to the right from the end of the signature.

David M. Walker
Comptroller General
of the United States

October 25, 2006

Overview, Schedules, and Notes

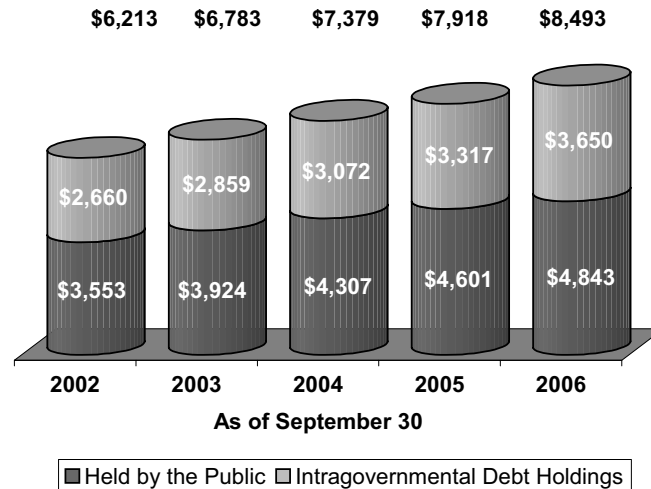
Overview on Federal Debt Managed by the Bureau of the Public Debt

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

Gross Federal Debt Outstanding¹

Federal debt managed by the Bureau of the Public Debt (BPD) 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, 2006 and 2005, outstanding gross federal debt managed by the bureau totaled \$8,493 and \$7,918 billion, respectively. The increase in gross federal debt of \$575 billion during fiscal year 2006 was due to an increase in gross intragovernmental debt holdings of \$333 billion and an increase in gross debt held by the public of \$242 billion. As Figure 1 illustrates, both intragovernmental debt holdings and debt held by the public have steadily increased since fiscal year 2002. The primary reason for the increases in intragovernmental debt holdings is the annual surpluses in the Federal Old-Age and Survivors Insurance Trust Fund, Civil Service Retirement and Disability Fund, Federal Hospital Insurance Trust Fund, Federal Disability Insurance Trust Fund, and Military Retirement Fund. The increases in debt held by the public are due primarily to total federal spending exceeding total federal revenues. As of September 30, 2006, gross debt held by the public totaled \$4,843 billion and gross intragovernmental debt holdings totaled \$3,650 billion.

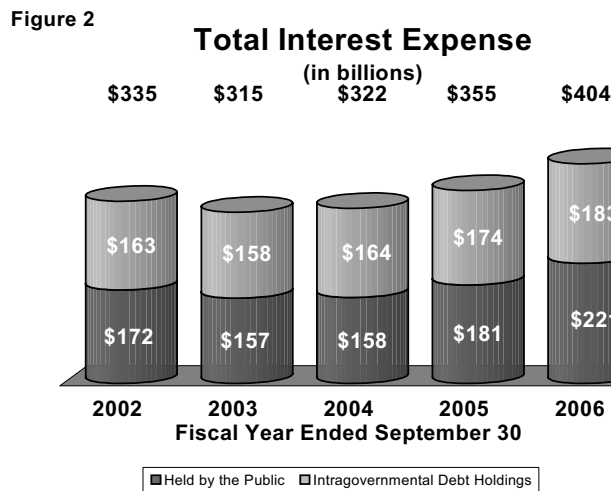
Figure 1 **Total Gross Federal Debt Outstanding**
(in billions)



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 2006 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 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 2006, interest expense incurred totaled \$404 billion, interest expense on debt held by the public was \$221 billion, and \$183 billion was interest incurred for intragovernmental debt holdings. As Figure 2 illustrates, total interest expense decreased from fiscal year 2002 to 2003, but increased in fiscal years 2004 through 2006. Average interest rates on principal balances outstanding as of September 30, 2006 and 2005 are disclosed in the Notes to the Schedules of Federal Debt.

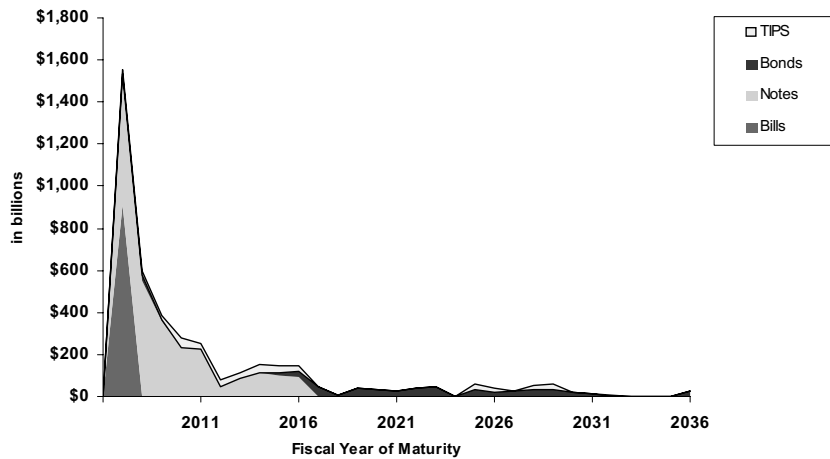


Debt Held by the Public

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, 2006, and 2005, gross debt held by the public totaled \$4,843 billion and \$4,601 billion, respectively (see Figure 1), an increase of \$242 billion. The borrowings and repayments of debt held by the public decreased from fiscal year 2005 to 2006 primarily due to Treasury's decision to finance current operations using more long-term securities.

As of September 30, 2006, \$4,284 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, Treasury notes, Treasury bonds, and Treasury Inflation-Protected Securities (TIPS) 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, 2006, \$2,813 billion or 66 percent will mature within the next 4 years (see Figure 3). As of September 30, 2006 and 2005, notes and TIPS held by the public maturing within the next 10 years totaled \$2,709 billion and \$2,558 billion, respectively, an increase of \$151 billion.

Figure 3 Maturity Dates² of Marketable Debt Held by the Public as of September 30, 2006



² Callable securities mature between fiscal years 2012 and 2015, but are reported by their call date.

Debt Held by the Public, cont.

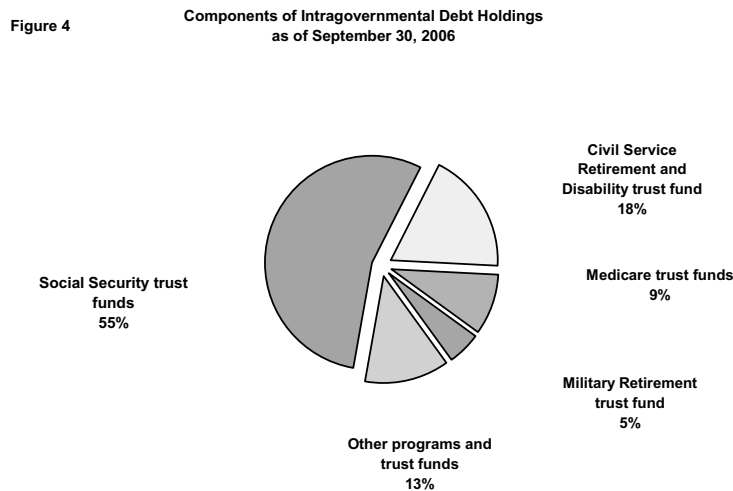
The government also issues to the public, state and local governments, and foreign governments and central banks nonmarketable securities, which cannot be resold, and have maturity dates from on demand to more than 10 years. As of September 30, 2006, nonmarketable securities totaled \$559 billion, or 12 percent of debt held by the public. As of that date, nonmarketable securities primarily consisted of savings securities totaling \$204 billion and special securities for state and local governments totaling \$239 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 and collect payment 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 sell, print, and deliver savings bonds; redeem savings bonds; and handle the related transfers of cash.

Intragovernmental Debt Holdings

Intragovernmental debt holdings represent balances of Treasury securities held by over 230 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, 2006, such funds accounted for \$3,188 billion, or 87 percent, of the \$3,650 billion intragovernmental debt holdings balances (see Figure 4). As of September 30, 2006 and 2005, gross intragovernmental debt holdings totaled \$3,650 billion and \$3,317 billion, respectively (see Figure 1), an increase of \$333 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.



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 2006

Statutory Debt Ceiling Raised

From February 16 to March 20, 2006, Treasury faced a period that required it to depart from its normal debt management procedures and to invoke legal authorities to avoid breaching the statutory debt limit. During this period, actions taken by Treasury included suspending investment of receipts of the Government Securities Investment Fund (G-Fund) of the federal employees Thrift Savings Plan, the Exchange Stabilization Fund (ESF), and the Civil Service Retirement and Disability Fund (Civil Service Fund); redeeming Civil Service Fund securities early; and suspending the sales of State and Local Government Series securities. On March 20, 2006, Public Law 109-182 was enacted, which raised the statutory debt ceiling by \$781 billion to \$8,965 billion. Subsequently, Treasury restored all losses to the G-Fund and Civil Service Fund in accordance with legal authorities provided to the Secretary of the Treasury.

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Beginning with the October 3, 2005 auction of 13- and 26-week Treasury bills, individuals with TreasuryDirect online accounts were able to purchase marketable Treasury securities (bills, notes, bonds, and TIPS) on a non-competitive basis in TreasuryDirect. With the addition of marketable securities to TreasuryDirect, investors are able to hold the full range of Treasury retail securities in a single account, providing 24/7 convenience for tracking and managing all Treasury consumer securities.

Risk Management

In September 2005, BPD defined a comprehensive approach to risk management in TreasuryDirect and established a Risk Management Group (RMG) to identify and monitor patterns of behavior, establish precedents and procedures, and network with private and public sector industry groups. In FY 2006, the RMG reviewed TreasuryDirect reports for unusual activity, watched blogs for TreasuryDirect references and news reports for scams and alerts, and participated in interagency identity theft workgroups.

Thirty-Year Bond

The re-introduction of the regular semi-annual auctions of the thirty-year bond began with the auction on February 9, 2006, followed by a reopening of the thirty-year bond, which was issued on August 15, 2006. Also, during February 2006, the auction and issuance of the monthly 5-year note was shifted to month end to accommodate the re-introduction of the 30-year bond. Beginning in February 2007, Treasury will issue 30-year bonds on a quarterly basis. A quarterly issuance pattern will benefit the Separate Trading of Registered Interest and Principal of Securities (STRIPS) market by creating interest payments for February, May, August and November.

Last Bearer Bond Called

In July 2006, Treasury called 30-year bonds issued in November 1981 for redemption on November 15, 2006. The call of this high-interest rate bond marks the end of the bearer program that began in March 1859, when Congress authorized the issuance of bearer instruments.

Significant Events in FY 2006, cont.

Trust Fund – FDIC Merger

Prior to June 1, 2006, the Federal Deposit Insurance Corporation (FDIC) maintained three investment funds in the Federal Investments Program. Two of the larger funds, however, were affected by Public Law 109-173 that merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the Deposit Insurance Fund (DIF). On June 1, 2006, the combined balances of BIF and SAIF of \$45.7 billion were transferred to the new fund. Since June 1, 2006, all new investment activity has taken place in the DIF.

Treasury Hunt®

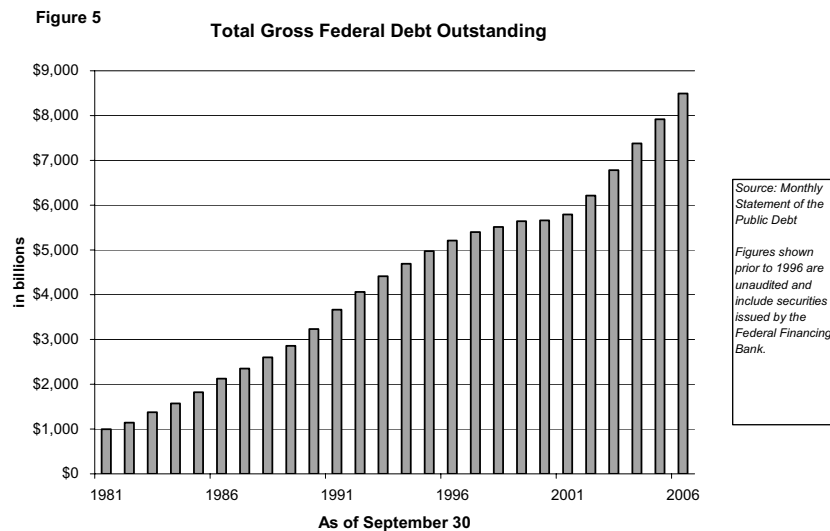
Treasury Hunt® is an online application that helps the public identify bonds they may hold that have stopped earning interest. There are nearly 13 million savings bond records with taxpayer identification numbers (TINs) now available for searching in the Treasury Hunt database. This represents over 2.8 million unique TINs. In FY 2006, customers searched the system 840,000 times, with 17,000 possible Series E matured, unredeemed debt matches. In addition, BPD re-mailed 685 bonds, replaced 302 bonds, and released about \$3,000 in interest payments.

Gulf Coast Recovery Bonds

To encourage support for ongoing recovery efforts in areas devastated by last year's hurricanes, Treasury has designated paper Series I Savings Bonds bought through financial institutions from March 29, 2006 through September 30, 2007 as Gulf Coast Recovery Bonds. The bonds contain the special inscription, "Gulf Coast Recovery Bond." The Gulf Opportunity Zone Act of 2005 contained a provision that encouraged Treasury to make this designation. As of September 30, 2006, BPD had issued 930,000 Gulf Coast Recovery Bonds worth \$775 million.

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 and accounting mechanism for certain federal government accounts' excess receipts, primarily trust funds. Total gross federal debt outstanding has dramatically increased over the past 25 years from \$998 billion as of September 30, 1981 to \$8,493 billion as of September 30, 2006 (see Figure 5). Large budget deficits emerged during the 1980's due to tax policy decisions and increased outlays for defense and domestic programs. 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 more than five fold between 1981 and 1997.

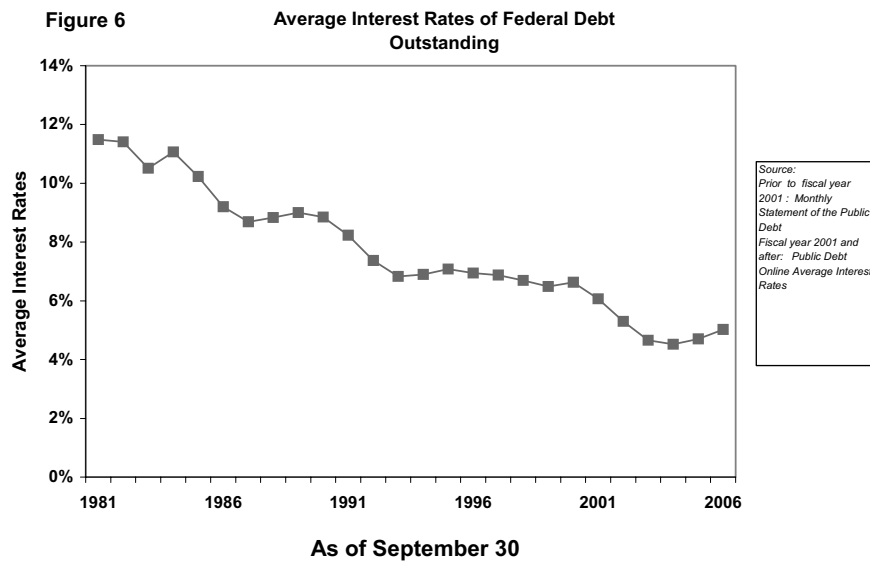


By fiscal year 1998, federal debt held by the public was beginning to decline. In fiscal years 1998 through 2001, the amount of debt held by the public fell by \$476 billion, from \$3,815 billion to \$3,339 billion. However, not withstanding the strong rebound of the economy from the 2001 recession, higher Federal outlays and tax policy decisions have resulted in an increase in debt held by the public from \$3,339 billion in 2001 to \$4,843 billion in 2006.

Historical Perspective, cont.

Even in those years where debt held by the public declined, total federal debt increased because of increases in intragovernmental debt holdings. Over the past 4 fiscal years, intragovernmental debt holdings increased by \$990 billion, from \$2,660 billion as of September 30, 2002, to \$3,650 billion as of September 30, 2006. 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.

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 securities outstanding at the end of the fiscal year.



Schedules of Federal Debt

Schedules of Federal Debt

Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005
(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, 2004	4,307,345	32,735	(34,778)	3,071,708	42,263	(589)
Increases						
Borrowings from the Public	4,638,118		(27,521)			
Net Increase in Intragovernmental Debt Holdings				245,763		17,143
Accrued Interest (Note 4)		154,398			175,564	
Total Increases	4,638,118	154,398	(27,521)	245,763	175,564	17,143
Decreases						
Repayments of Debt Held by the Public	4,344,224					
Interest Paid		152,172			174,577	
Net Amortization (Note 4)			(26,768)			1,814
Total Decreases	4,344,224	152,172	(26,768)	0	174,577	1,814
Balance as of September 30, 2005	4,601,239	34,961	(35,531)	3,317,471	43,250	14,740
Increases						
Borrowings from the Public	4,534,335		(48,568)			
Net Increase in Intragovernmental Debt Holdings				332,382		(12,630)
Accrued Interest (Note 4)		177,593			186,108	
Total Increases	4,534,335	177,593	(48,568)	332,382	186,108	(12,630)
Decreases						
Repayments of Debt Held by the Public	4,292,453					
Interest Paid		171,435			183,632	
Net Amortization (Note 4)			(43,934)			3,269
Total Decreases	4,292,453	171,435	(43,934)	0	183,632	3,269
Balance as of September 30, 2006	\$4,843,121	\$41,119	(\$40,165)	\$3,649,853	\$45,726	(\$1,159)

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, 2006 and 2005

(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 2006 and 2005 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 and the redemption of Treasury securities.

Reporting Entity

The Constitution empowers the Congress to borrow money on the credit of the United States. 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.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 all long term securities and the straight line method for short term securities. The Department of the 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 Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005*

(Dollars in Millions)

Note 2. Federal Debt Held by the Public

As of September 30, 2006 and 2005, Federal Debt Held by the Public consisted of the following:

	2006		2005	
	Amount	Average Interest Rates	Amount	Average Interest Rates
Marketable:				
Treasury Bills	\$908,474	5.0%	\$910,323	3.4%
Treasury Notes	2,445,307	4.2%	2,328,212	3.7%
Treasury Bonds	534,473	7.6%	520,507	7.9%
TIPS	395,550	2.3%	307,011	2.4%
Total Marketable	<u>\$4,283,804</u>		<u>\$4,066,053</u>	
Nonmarketable	\$559,317	5.0%	\$535,186	4.9%
Total Federal Debt Held by the Public	<u>\$4,843,121</u>		<u>\$4,601,239</u>	

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, 2006 and 2005, 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, 2006 and 2005. Treasury notes are issued with a term of 2 – 10 years and Treasury bonds are issued with a term of more than 10 years.

Treasury also issues TIPS that have interest and redemption payments, which are tied to the Consumer Price Index, the leading measurement of inflation. TIPS are issued with a term of 5 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 TIPS Federal Debt Held by the Public inflation-adjusted principal balance includes inflation of \$43,927 million and \$29,001 million as of September 30, 2006 and 2005, respectively.

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 \$765 billion and \$733 billion of Federal Debt Held by the Public as of September 30, 2006 and 2005, respectively. These securities are held in the FRB System Open Market Account (SOMA) for the purpose of conducting monetary policy.

*Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005*

(Dollars in Millions)

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

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, 2006 and 2005. Nonmarketable securities are issued with a term of on demand to more than 10 years.

As of September 30, 2006 and 2005, nonmarketable securities consisted of the following:

	2006	2005
Domestic Series	\$29,995	\$29,995
Foreign Series	2,986	3,086
R.E.A. Series	1	1
State and Local Government Series	238,835	225,283
United States Savings Securities	203,701	203,690
Government Account Series	78,129	67,961
Other	5,670	5,170
Total Nonmarketable	<u>\$559,317</u>	<u>\$535,186</u>

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 2006 and 2005 are included in the respective Borrowings from the Public amounts reported on the Schedules of Federal Debt.

Fiscal year-end September 30, 2006, occurred on a Saturday. As a result \$31,656 million of marketable Treasury notes matured but not repaid is included in the balance of the total debt held by the public as of September 30, 2006. Settlement of this debt repayment occurred on Monday, October 2, 2006.

*Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005*

(Dollars in Millions)

Note 3. Intragovernmental Debt Holdings

As of September 30, 2006 and 2005, Intragovernmental Debt Holdings are owed to the following:

	<u>2006</u>	<u>2005</u>
SSA: Federal Old-Age and Survivors Insurance Trust Fund	\$1,793,129	\$1,616,159
OPM: Civil Service Retirement and Disability Fund	675,936	646,749
HHS: Federal Hospital Insurance Trust Fund	302,186	277,268
SSA: Federal Disability Insurance Trust Fund	202,178	193,263
DOD: Military Retirement Fund	181,810	177,282
DOD: DOD Medicare-Eligible Retiree Health Care Fund	72,740	52,873
DOL: Unemployment Trust Fund	66,213	54,806
FDIC: The Deposit Insurance Fund	46,216	45,058 *
DOL: Pension Benefit Guaranty Corporation	36,635	12,997
DOE: Nuclear Waste Disposal Fund	36,482	33,549
HHS: Federal Supplementary Medical Insurance Trust Fund	32,306	17,204
OPM: Employees Life Insurance Fund	31,282	29,485
HUD: FHA – Liquidating Account	22,030	22,642
Treasury: Exchange Stabilization Fund	15,711	15,238
OPM: Employees Health Benefits Fund	14,822	12,531
DOS: Foreign Service Retirement and Disability Fund	13,876	13,359
DOT: Highway Trust Fund	10,998	8,271
VA: National Service Life Insurance Fund	10,189	10,597
DOT: Airport and Airway Trust Fund	7,893	10,047
Other Programs and Funds	77,221	68,093
Total Intragovernmental Debt Holdings	<u>\$3,649,853</u>	<u>\$3,317,471</u>

* On June 1, 2006, the Federal Deposit Insurance Corporation (FDIC) merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into the Deposit Insurance Fund (DIF).

FDIC's Holdings as of September 30, 2005:	<u>GAS Securities</u>
The Bank Insurance Fund	\$32,733
The Savings Association Insurance Fund	<u>12,325</u>
Total	<u>\$45,058</u>

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); Department of Housing and Urban Development (HUD); Department of the Treasury (Treasury); Department of State (DOS); Department of Transportation (DOT); Department of Veterans Affairs (VA).

*Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005*

(Dollars in Millions)

Note 3. Intragovernmental Debt Holdings (continued)

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 both fiscal years 2006 and 2005 were 5.2 percent. The average interest rate represents the original issue weighted effective yield on securities outstanding as of September 30, 2006 and 2005. GAS securities are issued with a term of on demand to 30 years. GAS securities include TIPS, which are reported at an inflation-adjusted principal balance using the Consumer Price Index. As of September 30, 2006 and 2005 the inflation-adjusted principal balance included inflation of \$19,576 million and \$8,268 million, respectively.

Fiscal year-end September 30, 2006, occurred on a Saturday. As a result \$360 million of GAS securities held by Federal Agencies matured but not repaid is included in the balance of the Intragovernmental Holdings as of September 30, 2006. Settlement of this debt repayment occurred on Monday, October 2, 2006.

Note 4. Interest Expense

Interest expense on Federal Debt Managed by BPD for fiscal years 2006 and 2005 consisted of the following:

	<u>2006</u>	<u>2005</u>
Federal Debt Held by the Public		
Accrued Interest	\$177,593	\$154,398
Net Amortization of Premiums and Discounts	43,934	26,768
Total Interest Expense on Federal Debt Held by the Public	<u>221,527</u>	<u>181,166</u>
Intragovernmental Debt Holdings		
Accrued Interest	186,108	175,564
Net Amortization of Premiums and Discounts	(3,269)	(1,814)
Total Interest Expense on Intragovernmental Debt Holdings	<u>182,839</u>	<u>173,750</u>
Total Interest Expense on Federal Debt Managed by BPD	<u>\$404,366</u>	<u>\$354,916</u>

The principal for 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 the Bureau of the Public Debt. Accrued interest on Federal Debt Held by the Public includes inflation adjustments of \$14,512 million and \$8,582 million for fiscal years 2006 and 2005, respectively. Accrued interest on Intragovernmental Debt Holdings includes inflation adjustments of \$607 million and \$419 million for fiscal years 2006 and 2005, respectively.

*Notes to the Schedules of Federal Debt Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2006 and 2005*

(Dollars in Millions)

Note 5. Fund Balance With Treasury

	As of <u>September 30, 2006</u>	As of <u>September 30, 2005</u>
Appropriated Funds Obligated	\$152	\$142

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.

Comments from the Bureau of the Public Debt



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

November 3, 2006

Mr. Gary T. Engel
Director
U.S. Government Accountability 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, 2006, and 2005. We agree with your audit report's conclusions.

As we conclude the tenth consecutive year of our professional relationship, we appreciate the experience and professional attitude of your audit team. As your audit team expands, their ability to grasp the complexities surrounding the schedule greatly enhances the audit process. We would like to thank you and your staff for conducting an efficient and thorough audit of these schedules with increasingly stringent audit requirements. The usability of these reports continues to develop through combined efforts, and we look forward to continuing this productive and successful relationship.

Sincerely,

Van Zeek
Commissioner

www.treasurydirect.gov

GAO Contact and Staff Acknowledgments

GAO Contact

Gary Engel, (202) 512-3406

Acknowledgments

In addition to the individual named above, Dawn B. Simpson, Assistant Director; Cara L. Bauer; Theresa M. Bowman; Erik A. Braun; Dean D. Carpenter; Dennis L. Clarke; Chau L. Dinh; Jennifer L. Henderson; Erik S. Huff; Brent J. LaPointe; Nicole M. McGuire; Jay McTigue; Timothy J. Murray; and Danietta S. Williams made key contributions to this report.

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