United States Government Accountability Office

GAO

Report to the Secretary of the Treasury

November 2007

FINANCIAL AUDIT

Bureau of the Public Debt's Fiscal Years 2007 and 2006 Schedules of Federal Debt

GAO-08-168

GAO Accountability•Integrity•Reliability

Highlights

Highlights of GAO-08-168, a report to the Secretary of the Treasury

November 2007

FINANCIAL AUDIT

Bureau of the Public Debt's Fiscal Years 2007 and 2006 Schedules of Federal Debt

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 a significant selected provision of law 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.

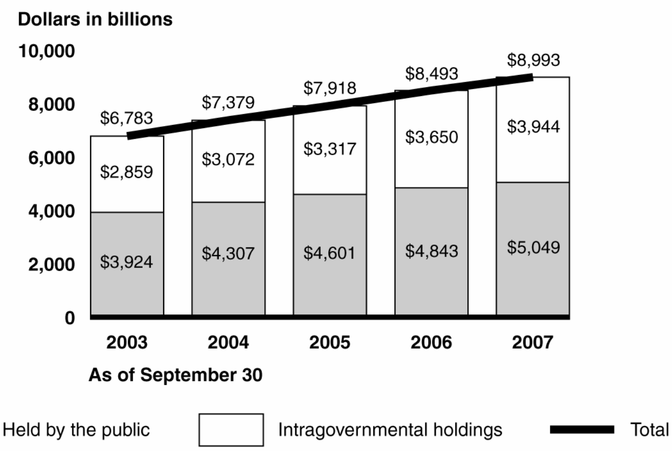
For a fuller understanding of GAO's opinion on BPD's fiscal years 2007 and 2006 Schedules of Federal Debt, readers should refer to the complete audit report, available by clicking on GAO-08-168, which includes information on audit objectives, scope and methodology. For more information, contact Gary T. Engel at (202) 512-3406 or engelg@gao.gov.

What GAO Found

In GAO's opinion, BPD's Schedules of Federal Debt for fiscal years 2007 and 2006 were fairly presented in all material respects and BPD maintained effective internal control relevant to the Schedule of Federal Debt as of September 30, 2007. GAO also found no instances of noncompliance in fiscal year 2007 with the statutory debt limit.

As of September 30, 2007 and 2006, federal debt managed by BPD totaled about $8,993 billion and $8,493 billion, respectively. As shown in figure 1 below, total federal debt increased over each of the last 4 fiscal years.

Figure 1 – Total Gross Federal Debt Outstanding



Source: BPD.

Total federal spending has exceeded total federal revenues which have resulted in increases in debt held by the public. Further, certain trust funds (e.g., Social Security) continue to run cash surpluses, resulting in increased intragovernmental debt holdings since the federal government spends these surpluses on other operating costs and replaces them with federal debt instruments. These debt holdings are backed by the full faith and credit of the U.S. government and represent a priority call on future budgetary resources. As a result, total gross federal debt has increased about 33 percent between the end of fiscal years 2003 and 2007. On September 29, 2007, legislation was enacted to raise the statutory debt limit by $850 billion to $9,815 billion. This was the third occurrence since the end of fiscal year 2003 that the statutory debt limit had to be raised to avoid breaching the statutory debt limit. During that time, the debt limit has increased by over $2.4 trillion, or about 33 percent, from $7,384 billion on September 30, 2003, to the current limit of $9,815 billion.

Contents

Abbreviations

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

November 7, 2007

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 (BPD) for the fiscal years ended September 30, 2007 and 2006. 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.[1]

The auditor's report contains our (1) opinion on the Schedules of Federal Debt for the fiscal years ended September 30, 2007 and 2006, (2) opinion on the effectiveness of relevant internal control as of September 30, 2007, (3) conclusion on compliance in fiscal year 2007 with a selected provision of law 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, 2007 and 2006, federal debt managed by the bureau totaled about $8,993 billion and $8,493 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) $5,049 billion as of September 30, 2007, and $4,843 billion as of September 30, 2006, of debt held by the public and about (2) $3,944 billion as of September 30, 2007, and $3,650 billion as of September 30, 2006, 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 total prior federal spending in excess of 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 federal government borrows

[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.

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 federal government uses the trust funds' invested cash surpluses to assist in funding other federal government costs. The transactions relating to Treasury securities held by the federal government accounts net out on the federal government's consolidated financial statements because under current U.S. generally accepted accounting principles they essentially 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 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, Treasury usually borrows from the public to finance these redemptions. Such borrowings result in competition with the private sector and thus an effect on the economy.

We have audited the Schedule of Federal Debt since fiscal year 1997. Over this period, total federal debt has increased by 73 percent. During the last 4 fiscal years, managing the federal debt has continued to be a challenge as evidenced by the growth of total federal debt by $2,210 billion, or 33 percent, from $6,783 billion as of September 30, 2003, to $8,993 billion as of September 30, 2007. As a result of the increasing debt, again this past year, Congress enacted a bill to increase the debt limit to avoid breaching the statutory debt limit. On September 29, 2007, the President approved the bill to increase the statutory debt limit from $8,965 billion to $9,815 billion. This was the third occurrence since the end of fiscal year 2003 that a law has been enacted to raise the statutory debt limit, with the debt limit increasing over $2.4 trillion, or about 33 percent, from $7,384 billion on September 30, 2003, to $9,815 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 2007 *Treasury Bulletin*, Treasury estimates that the amount of Treasury securities held by foreign and international investors has increased $837 billion, from $1,383 as of June 30, 2003, to $2,220 billion as of June 30, 2007. As of June 30, 2007, this represents an estimated 45 percent of debt held by the public, up from about 36 percent as of June 30, 2003. The United States benefits from foreign purchases of Treasury securities because foreign and international 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 and international 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.

Another trend we have observed is the decline in annual budget deficits. As widely reported last month, the fiscal year 2007 budget deficit of $163 billion represents the third consecutive decline in budget deficits, down from last year's deficit of $248 billion. Certainly lower short-term deficits are better than higher short-term deficits. However, our nation's real challenge is not short-term deficits, rather it's the U.S. government's impending longer-term structural deficits and related debt burdens. Indeed, what we call the longer-term fiscal challenge is not in the distant future. The first of the baby boomers become eligible for early retirement under Social Security on January 1, 2008—only two months from now— and for Medicare benefits just 3 years later. The budget and economic implications of the baby boom generation's retirement have already become a factor in

Congressional Budget Office's 10-year baseline projections and will only intensify as the baby boomers age. 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] Simply put, our nation is on an imprudent and unsustainable long-term fiscal path that is getting worse with the passage of time. Absent significant changes on the spending and/or revenue sides of the budget, 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.

As discussed earlier, federal debt managed by the bureau totaled about $9 trillion at the end of fiscal year 2007. 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 total burden in present value dollars is estimated to be about $53 trillion.[3] Stated differently, the estimated current total burden for every American is nearly $175,000; and every day that burden becomes larger. 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 Committee on the Budget; the Subcommittee on Financial Services and General Government, Senate Committee on Appropriations; the

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

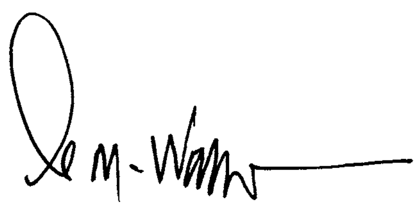
[3]The total burden is estimated based on the federal government's liabilities, commitments, and contingencies reported in the Financial Report of the U.S. Government for Fiscal Year 2006 adjusted for growth in debt held by the public during fiscal year 2007 and updated estimates of future social insurance obligations as reported in the 2007 Trustees reports.

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

Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Appropriations; the House Committee on Oversight and Government Reform; the House Committee on the Budget; the Subcommittee on Financial Services and General Government, House Committee on Appropriations; and the Subcommittee on Government Management, Organization, and Procurement, House Committee on Oversight and Government Reform. We are also sending copies of this report to the Commissioner of the Bureau of the Public Debt, the Acting 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 acknowledgements are provided in appendix II.

Sincerely yours,



David M. Walker
Comptroller General
of the United States

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, 2007 and 2006. 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 Managed by BPD for the fiscal years ended September 30, 2007 and 2006, we found

- 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, 2007; and

- no reportable noncompliance in fiscal year 2007 with a selected provision of law we tested.

The following sections discuss, in more detail, (1) these conclusions; (2) our conclusion on the Overview on Federal Debt Managed by the Bureau of the Public Debt; (3) our audit objectives, scope, and methodology; and (4) agency comments.

[1]31 U.S.C. § 331(e).

[2]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, 2007, 2006, and 2005 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, 2007 and 2006.

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, 2007, 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), the Federal Managers' Financial Integrity Act, and the Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control.*

We found matters involving information security controls that we do not consider to be significant deficiencies.[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 a Selected Provision of Law

Our tests for compliance in fiscal year 2007 with the statutory debt limit 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, 2007, was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

[3]A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions to prevent or detect misstatements on a timely basis.

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 or U.S. generally accepted accounting principles.

Objectives, Scope, and Methodology

Management is responsible for (1) preparing the Schedules of Federal Debt in conformity with U.S. generally accepted accounting principles; (2) 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 (3) 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, 2007, 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, 2007, 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, 2007, 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 (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the Schedule of Federal Debt and (2) 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 the entity and its operations, including its internal control relevant to the Schedule of Federal Debt as of September 30, 2007, 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, 2007;

- 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 2007 with the statutory debt limit (31 U.S.C. § 3101(b) (Supp IV 2005), as amended by Pub. L. No. 109-182, 120 Stat. 289 (2006), and Pub L. No. 110-91, 121 Stat. 988 (2007)).

We did not evaluate all internal controls relevant to operating objectives as broadly defined 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 a selected provision of law that has a direct and material effect on the Schedule of Federal Debt for the fiscal year ended September 30, 2007. 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.

David M. Walker
Comptroller General
of the United States

October 31, 2007

Overview, Schedules, and Notes

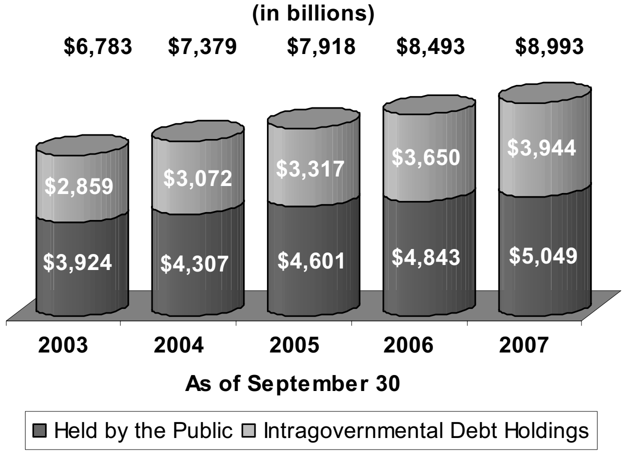
Overview on Federal Debt Managed by the Bureau of the Public Debt

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 (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, 2007 and 2006, outstanding gross federal debt managed by the bureau totaled $8,993 and $8,493 billion, respectively. The increase in gross federal debt of $500 billion during fiscal year 2007 was due to an increase in gross intragovernmental debt holdings of $294 billion and an increase in gross debt held by the public of $206 billion. As Figure 1 illustrates, both intragovernmental debt holdings and debt held by the public have steadily increased since fiscal year 2003. 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, 2007, gross debt held by the public totaled $5,049 billion and gross intragovernmental debt holdings totaled $3,944 billion.

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

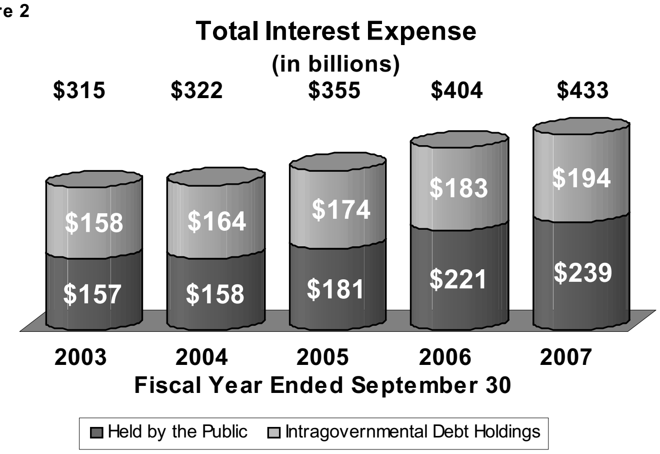


[1] Federal debt outstanding reported here differs from the amount reported in the Financial Report of the United States Government because of the securities not maintained or reported by the bureau and which are issued by the Federal Financing Bank and other federal government agencies.

Interest Expense

Interest expense incurred during fiscal year 2007 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 2007, interest expense incurred totaled $433 billion, interest expense on debt held by the public was $239 billion, and $194 billion was interest incurred for intragovernmental debt holdings. As Figure 2 illustrates, total interest expense has increased in fiscal years 2003 through 2007. Average interest rates on principal balances outstanding as of September 30, 2007 and 2006, are disclosed in the Notes to the Schedules of Federal Debt.

Figure 2

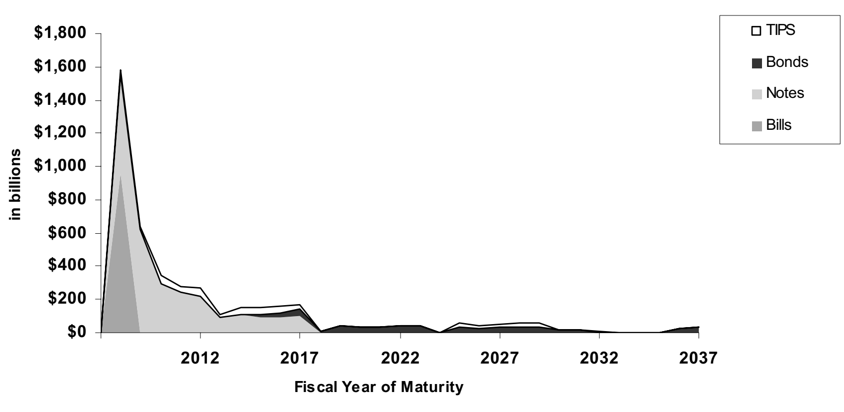


Debt Held by the Public

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, 2007 and 2006, gross debt held by the public totaled $5,049 billion and $4,843 billion, respectively (see Figure 1), an increase of $206 billion. The borrowings and repayments of debt held by the public increased from fiscal year 2006 to 2007. After Treasury took into account the increased issuances of State and Local Government Series securities, Treasury decided to finance the remaining current operations using more short-term securities.

As of September 30, 2007, $4,428 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, 2007, $2,838 billion or 64 percent will mature within the next 4 years (see Figure 3). As of September 30, 2007 and 2006, notes and TIPS held by the public maturing within the next 10 years totaled $2,767 billion and $2,709 billion, respectively, an increase of $58 billion.

Figure 3 **Maturity Dates[2] of Marketable Debt Held by the Public as of September 30, 2007**



[2] Callable securities mature between fiscal years 2013 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, 2007, nonmarketable securities totaled $621 billion, or 12 percent of debt held by the public. As of that date, nonmarketable securities primarily consisted of savings securities totaling $197 billion and special securities for state and local governments totaling $297 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.

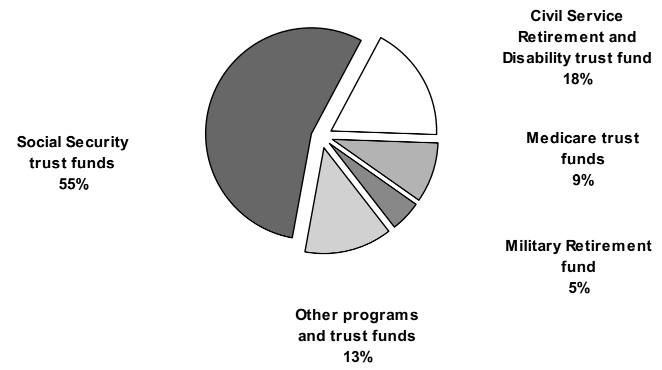
Intragovernmental Debt Holdings

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, 2007, such funds accounted for $3,419 billion, or 87 percent, of the $3,944 billion intragovernmental debt holdings balances (see Figure 4). As of September 30, 2007 and 2006, gross intragovernmental debt holdings totaled $3,944 billion and $3,650 billion, respectively (see Figure 1), an increase of $294 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, 2007



[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 2007

Statutory Debt Ceiling Raised

On May 17, 2007, a house bill was introduced and approved to increase the debt limit from $8,965 billion to $9,815 billion. The bill was then referred to the Senate Committee on Finance on May 21, 2007, where it gained approval on September 12, 2007. Projections determined that the United States would hit the statutory debt limit on October 1, 2007, and consequently, the full senate passed this measure to raise the debt limit by $850 billion on September 27, 2007. On September 29, 2007, Public Law 110-91 was enacted, which raised the statutory debt ceiling to $9,815 billion.

Thirty-Year Bond Issuance/Discontinuation of 3-Year Note

The thirty-year bond was re-introduced in February 2006 with semi-annual issuance planned. In August 2006, Treasury announced that the 30-year bond would be issued on a quarterly basis beginning in February 2007. The February issue was reopened in May 2007, followed by an original issue in August 2007 that will be reopened in November 2007. This quarterly issuance pattern has benefited the Separate Trading of Registered Interest and Principal of Securities (STRIPS) market by creating interest payments for February, May, August and November. Beginning in 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.

Additionally, Treasury's ongoing monitoring of the fiscal year's economic outlook has resulted in the discontinuance of the 3-year note. Discontinuance of the 3-year note will allow Treasury to ensure large liquid benchmark issuances, better balance its portfolio, and manage the fiscal outlook. The final scheduled auction of the 3-year note was held on May 7, 2007.

Discontinuance of Long-Term Securities in Legacy Treasury Direct

On January 18, 2007, a final amendment to the Uniform Offering Circular (UOC) was published in the Federal Register clarifying that the Treasury Department may announce certain marketable Treasury securities as not eligible for purchase or holding in Legacy Treasury Direct. Legacy Treasury Direct, which was implemented in 1986, will be phased out and replaced by the newer, online TreasuryDirect system. To assist with this phasing out, the offering of longer-term securities in Legacy Treasury Direct was discontinued. Since January 2007, 30-year bonds and 20-year TIPS are no longer available in Legacy Treasury Direct. This amendment also clarified that the announcement for each auction, in conjunction with the UOC, provides the terms and conditions for the sale and issuance of marketable Treasury bills, notes, bonds, and TIPS.

TreasuryDirect Security Changes

TreasuryDirect is an Internet-accessed system that enables investors to purchase the full range of Treasury securities and manage their holdings in a single account. Sensitive online transactions such as bank account changes and securities sales and transfers could become vulnerable to fraud. In July 2007, BPD initiated certified paper requests to process these sensitive transactions. This third-party investor identification helps mitigate risk and assure individual investors of the security of their Treasury Direct investments by providing additional verification and a written record of transaction requests.

Significant Events in FY 2007, cont.

Postal Retiree Health Benefits Fund

On December 20, 2006, the President signed H.R. 6407, which enacted Public Law 109-435, the "Postal Accountability and Enhancement Act." This Act created a new Government Account Series Trust Fund, the Postal Retiree Health Benefits Fund. This fund is administered by the Office of Personnel Management and receives transfers from the United States Postal Service (USPS). The initial transfer in the amount of $3 billion was received and invested in par value securities on April 6, 2007. Additional amounts of $17.1 billion and $5.4 billion were transferred and invested on June 30, 2007 and September 28, 2007, respectively. The fund is not expected to make payouts until 2017.

Daily Financial Statements

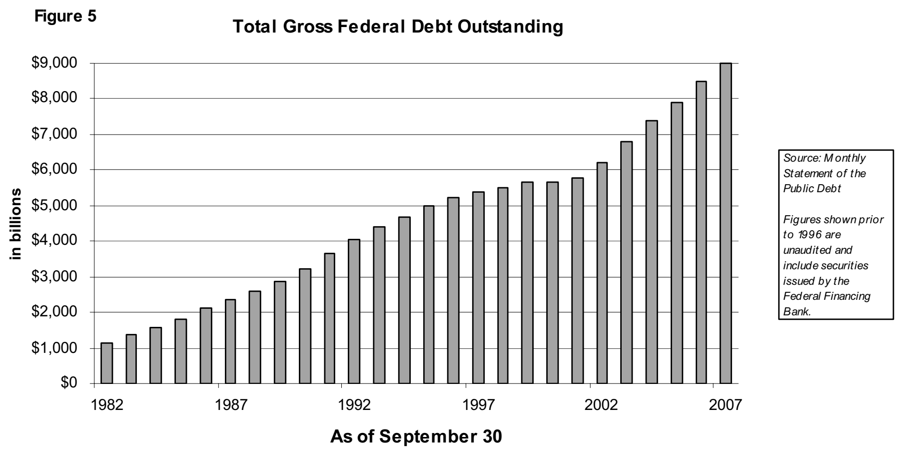
Beginning with the accounting date of June 1, 2007, BPD is publishing key daily debt-related financial data on our website, http://www.treasurydirect.gov/govt/reports/pd/feddebt/feddebt_daily.htm. Similar financial information is currently published monthly. During the past fiscal year, BPD strengthened internet communications with customers by redesigning the government section of the Treasurydirect.gov website. Additional on-line resources are now available and the overall functionality and accessibility features are greatly improved. The Schedules of Federal Debt daily reporting was implemented to support the Treasury strategic objective to "make accurate, timely financial information on U.S. Government programs readily available." The enhanced financial reporting is geared toward providing our customers more timely information and is one of BPD's strategic goals for FY 2007.

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 $1,142 billion as of September 30, 1982, to $8,993 billion as of September 30, 2007 (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 almost five fold between 1982 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, 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 $5,049 billion in 2007.

Figure 5

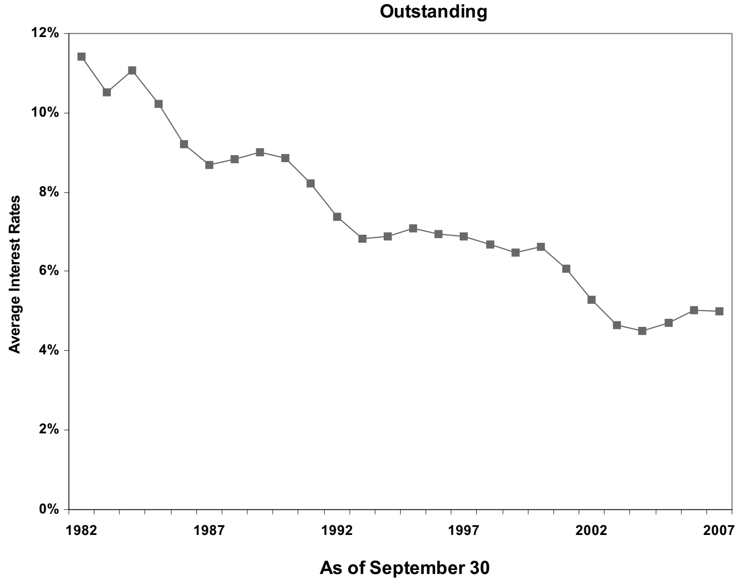


Historical Perspective, cont.

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 $1,085 billion, from $2,859 billion as of September 30, 2003, to $3,944 billion as of September 30, 2007. 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.

Figure 6 Average Interest Rates of Federal Debt Outstanding



Source:
Prior to fiscal year 2001: Monthly Statement of the Public Debt
Fiscal year 2001and after: Public Debt Online Average Interest Rates

Schedules of Federal Debt

Schedules of Federal Debt

Managed by the Bureau of the Public Debt
For the Fiscal Years Ended September 30, 2007 and 2006
(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, 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)**
Increases						
Borrowings from the Public	4,596,053		(48,776)			
Net Increase in Intragovernmental Debt Holdings				294,495		6,005
Accrued Interest (Note 4)		189,396			195,445	
Total Increases	**4,596,053**	**189,396**	**(48,776)**	**294,495**	**195,445**	**6,005**
Decreases						
Repayments of Debt Held by the Public	4,389,869					
Interest Paid		186,129			192,560	
Net Amortization (Note 4)			(49,500)			1,116
Total Decreases	**4,389,869**	**186,129**	**(49,500)**	**0**	**192,560**	**1,116**
Balance as of September 30, 2007	***$5,049,305***	***$44,386***	***($39,441)***	***$3,944,348***	***$48,611***	***$3,730***

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, 2007 and 2006

(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 2007 and 2006 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, 2007 and 2006

(Dollars in Millions)

Note 2. Federal Debt Held by the Public

As of September 30, 2007 and 2006, Federal Debt Held by the Public consisted of the following:

	2007		2006	
	Amount	Average Interest Rates	Amount	Average Interest Rates
Marketable:				
Treasury Bills	$954,607	4.6%	$908,474	5.0%
Treasury Notes	2,456,100	4.4%	2,445,307	4.2%
Treasury Bonds	560,922	7.4%	534,473	7.6%
TIPS	456,776	2.3%	395,550	2.3%
Total Marketable	$4,428,405		$4,283,804	
Nonmarketable	$620,900	4.9%	$559,317	5.0%
Total Federal Debt Held by the Public	$5,049,305		$4,843,121	

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, 2007 and 2006, 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, 2007 and 2006. 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, a widely used measure 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 $50,517 million and $43,927 million as of September 30, 2007 and 2006, 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 $775 billion and $765 billion of Federal Debt Held by the Public as of September 30, 2007 and 2006, 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, 2007 and 2006

(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, 2007 and 2006. Nonmarketable securities are issued with a term of on demand to more than 10 years.

As of September 30, 2007 and 2006, nonmarketable securities consisted of the following:

	2007	2006
Domestic Series	$29,995	$29,995
Foreign Series	2,986	2,986
R.E.A. Series	1	1
State and Local Government Series	296,513	238,835
United States Savings Securities	197,171	203,701
Government Account Series	88,153	78,129
Other	6,081	5,670
Total Nonmarketable	$620,900	$559,317

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 2007 and 2006 are included in the respective Borrowings from the Public amounts reported on the Schedules of Federal Debt.

Fiscal years-end September 30, 2007 and 2006, occurred on a Sunday and Saturday, respectively. As a result, $26,591 million and $31,656 million of marketable Treasury notes matured but not repaid is included in the balance of the total Federal Debt Held by the Public as of September 30, 2007 and 2006, respectively. Settlement of these debt repayments occurred on Monday, October 1, 2007, and 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, 2007 and 2006

(Dollars in Millions)

Note 3. Intragovernmental Debt Holdings

As of September 30, 2007 and 2006, Intragovernmental Debt Holdings are owed to the following:

		2007	2006
SSA:	Federal Old-Age and Survivors Insurance Trust Fund	$1,968,262	$1,793,129
OPM:	Civil Service Retirement and Disability Fund	687,665	675,936
HHS:	Federal Hospital Insurance Trust Fund	319,377	302,186
SSA:	Federal Disability Insurance Trust Fund	213,830	202,178
DOD:	Military Retirement Fund	190,232	181,810
DOD:	DOD Medicare-Eligible Retiree Health Care Fund	92,191	72,740
DOL:	Unemployment Trust Fund	74,923	66,213
FDIC:	The Deposit Insurance Fund	47,515	46,216
DOE:	Nuclear Waste Disposal Fund	39,435	36,482
HHS:	Federal Supplementary Medical Insurance Trust Fund	39,248	32,306
DOL:	Pension Benefit Guaranty Corporation	35,775	36,635
OPM:	Employees Life Insurance Fund	32,965	31,282
OPM:	Postal Service Retiree Health Benefits Fund	25,491	0
HUD:	FHA – Liquidating Account	22,405	22,030
Treasury:	Exchange Stabilization Fund	16,436	15,711
OPM:	Employees Health Benefits Fund	15,890	14,822
DOS:	Foreign Service Retirement and Disability Fund	14,378	13,876
DOT:	Highway Trust Fund	12,205	10,998
VA:	National Service Life Insurance Fund	9,752	10,189
Other Programs and Funds		86,373	85,114
Total Intragovernmental Debt Holdings		$3,944,348	$3,649,853

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).

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 2007 and 2006 were 5.1 and 5.2 percent, respectively. The average interest rate represents the original issue weighted effective yield on securities outstanding as of September 30, 2007 and 2006. 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, 2007 and 2006, the inflation-adjusted principal balance included inflation of $28,643 million and $19,576 million, respectively.

Fiscal years-ended September 30, 2007 and 2006, occurred on a Sunday and Saturday, respectively. As a result, $53 million and $360 million of GAS securities held by Federal Agencies matured but not repaid is included in the balance of the Intragovernmental Debt Holdings as of September 30, 2007 and 2006, respectively. Settlement of these debt repayments occurred on Monday, October 1, 2007 and 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, 2007 and 2006

(Dollars in Millions)

Note 4. Interest Expense

Interest expense on Federal Debt Managed by BPD for fiscal years 2007 and 2006 consisted of the following:

	2007	2006
Federal Debt Held by the Public		
Accrued Interest	$189,396	$177,593
Net Amortization of Premiums and Discounts	49,500	43,934
Total Interest Expense on Federal Debt Held by the Public	238,896	221,527
Intragovernmental Debt Holdings		
Accrued Interest	195,445	186,108
Net Amortization of Premiums and Discounts	(1,116)	(3,269)
Total Interest Expense on Intragovernmental Debt Holdings	194,329	182,839
Total Interest Expense on Federal Debt Managed by BPD	$433,225	$404,366

The valuation of TIPS is adjusted daily over the life of the security based on the Consumer Price Index for all Urban Consumers. This daily adjustment is an interest expense for the Bureau of the Public Debt. Accrued interest on Federal Debt Held by the Public includes inflation adjustments of $10,276 million and $14,512 million for fiscal years 2007 and 2006, respectively. Accrued interest on Intragovernmental Debt Holdings includes inflation adjustments of $378 million and $607 million for fiscal years 2007 and 2006, respectively.

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

For the Fiscal Years Ended September 30, 2007 and 2006

(Dollars in Millions)

Note 5. Fund Balance With Treasury

	As of September 30, 2007	As of September 30, 2006
Appropriated Funds Obligated	$156	$152

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
PARKERSBURG, WV 26106-1328

November 2, 2007

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, 2007 and 2006. We agree with your audit report's conclusions.

As we conclude the eleventh 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 Zeck
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; Dean D. Carpenter; Emily M. Clancy; Dennis L. Clarke; Chau L. Dinh; Lisa M. Galvan-Treviño; Vivian M. Gutierrez; Erik S. Huff; Bret R. Kressin; Nicole M. McGuire; and Jay R. McTigue made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "E-mail Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, jarmong@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548