MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The Fiscal Year (FY) *2017 Financial Report of the United States Government (Financial Report)* provides the President, Congress, and the American people with a comprehensive view of the federal government's financial position and condition, and discusses important financial issues and significant conditions that may affect future operations, including the need to achieve fiscal sustainability over the medium and long term.

Pursuant to 31 U.S.C. § 331(e)(1), the Department of the Treasury (Treasury), in cooperation with the Office of Management and Budget (OMB), must submit an audited (by the Government Accountability Office or GAO) financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States Government[1] to the President and Congress no later than six months after the September 30 fiscal year-end.

The *Financial Report* is prepared from the audited financial statements of specifically designated federal agencies, (see organizational chart on the next page and Appendix A). As it has for the past twenty years, GAO issued a disclaimer of opinion on the accrual-based, consolidated financial statements for the fiscal years ended September 30, 2017 and 2016. GAO also issued a disclaimer of opinion on the sustainability financial statements, which consist of the 2017 and 2016 Statements of Long-Term Fiscal Projections (SLTFP); the 2017, 2016, 2015, 2014, and 2013 Statements of Social Insurance (SOSI); and the 2017 and 2016 Statements of Changes in Social Insurance Amounts (SCSIA). A disclaimer of opinion indicates that sufficient information was not available for the auditors to determine whether the reported financial statements were fairly presented in accordance with Generally Accepted Accounting Principles (GAAP). In FY 2017, 33[2] of the 39 most significant agencies earned unmodified opinions on their financial statement audits.

The FY 2017 *Financial Report* consists of:

- Management's Discussion and Analysis (MD&A), which provides management's perspectives on and analysis of information presented in the *Financial Report*, such as financial and performance trends;
- Principal financial statements and the related notes to the financial statements;
- Required Supplementary Information (RSI), Required Supplementary Stewardship Information (RSSI), and Other Information; and
- GAO's audit report.

This *Financial Report* addresses the Government's financial activity and results as of September 30, 2017. Note 25, *Subsequent Events* discusses events that occurred after the end of the fiscal year which may affect the Government's financial position and condition.

In addition, the Executive Summary to this *Financial Report* provides a quick reference to the key issues in the *Financial Report* and an overview of the Government's financial position and condition.

Mission & Organization

The Government's fundamental mission is derived from the Constitution: ***"…to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare and secure the blessings of liberty to ourselves and our posterity."*** The Government's functions have evolved over time to include health care, income security, veterans benefits and services, housing and transportation, security, and education. Exhibit 1 provides an overview of how the U.S. Government (Government) is organized.

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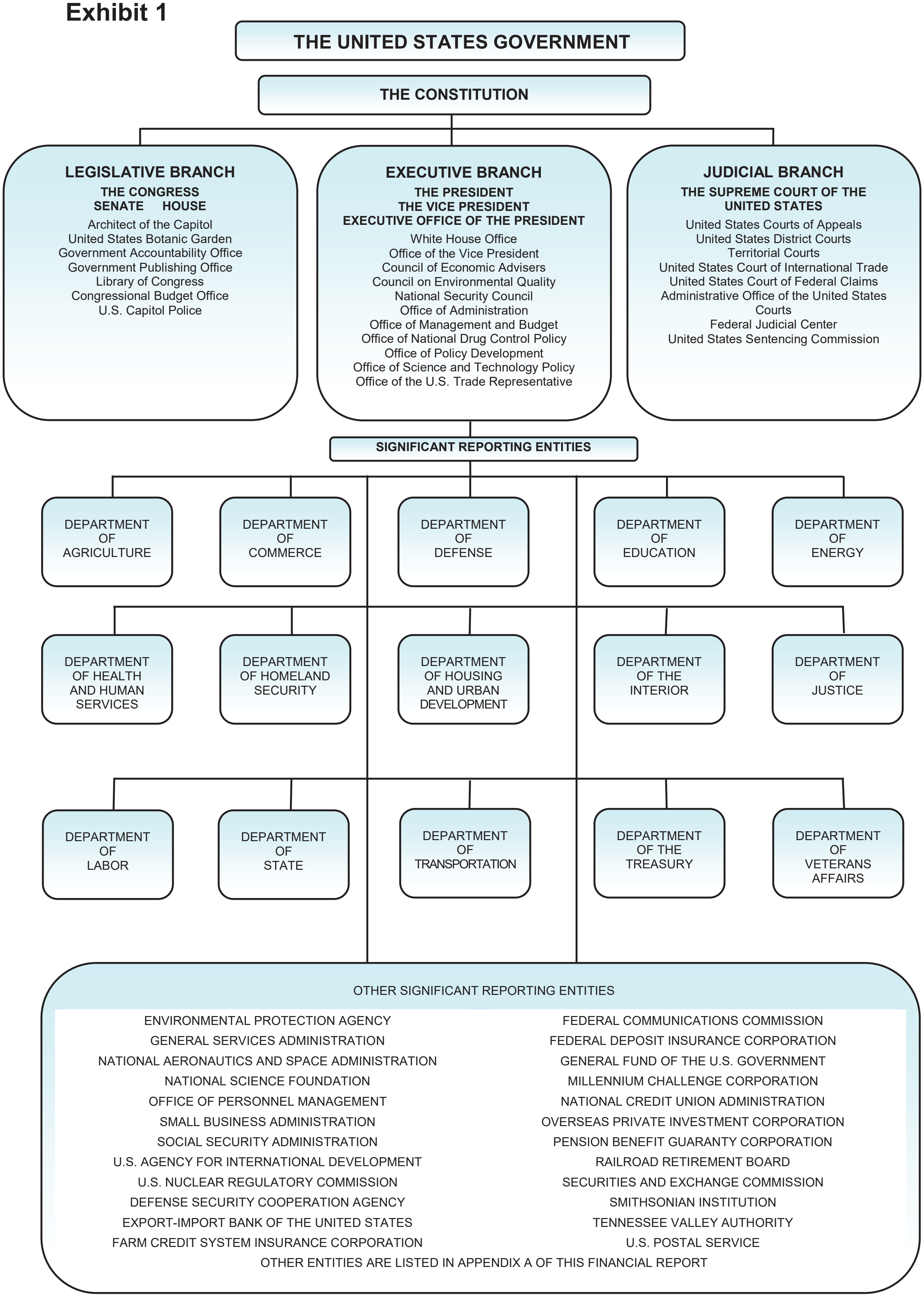
[1] The *Government Management Reform Act* of 1994 has required such reporting, covering the executive branch of the Government, beginning with financial statements prepared for FY 1997. Treasury and OMB included the legislative and judicial branches in the consolidated financial statements as well.

[2] The 33 agencies include: (1) the Department of Health and Human Services, which received disclaimers of opinion on its 2017, 2016, 2015, 2014, and 2013 SOSI and on its 2017 and 2016 SCSIA; (2) the Department of Labor, which received disclaimers of opinion on its 2017 SCSIA and 2016 SOSI and SCSIA; and (3) the Department of Agriculture (USDA), which received an unmodified opinion only on its balance sheet (other statements were not audited). The Department of Energy (DOE) expects to issue its audited Agency Financial Report (AFR) after the release of this *Financial Report*.

Exhibit 1


THE UNITED STATES GOVERNMENT
THE CONSTITUTION
LEGISLATIVE BRANCH
THE CONGRESS
SENATE HOUSE
Architect of the Capitol
United States Botanic Garden
Government Accountability Office
Government Publishing Office
Library of Congress
Congressional Budget Office
U.S. Capitol Police
EXECUTIVE BRANCH
THE PRESIDENT
THE VICE PRESIDENT
EXECUTIVE OFFICE OF THE PRESIDENT
White House Office
Office of the Vice President
Council of Economic Advisers
Council on Environmental Quality
National Security Council
Office of Administration
Office of Management and Budget
Office of National Drug Control Policy
Office of Policy Development
Office of Science and Technology Policy
Office of the U.S. Trade Representative
JUDICIAL BRANCH
THE SUPREME COURT OF THE UNITED STATES
United States Courts of Appeals
United States District Courts
Territorial Courts
United States Court of International Trade
United States Court of Federal Claims
Administrative Office of the United States Courts
Federal Judicial Center
United States Sentencing Commission
SIGNIFICANT REPORTING ENTITIES
DEPARTMENT OF AGRICULTURE
DEPARTMENT OF COMMERCE
DEPARTMENT OF DEFENSE
DEPARTMENT OF EDUCATION
DEPARTMENT OF ENERGY
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF HOMELAND SECURITY
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
DEPARTMENT OF THE INTERIOR
DEPARTMENT OF JUSTICE
DEPARTMENT OF LABOR
DEPARTMENT OF STATE
DEPARTMENT OF TRANSPORTATION
DEPARTMENT OF THE TREASURY
DEPARTMENT OF VETERANS AFFAIRS
OTHER SIGNIFICANT REPORTING ENTITIES
ENVIRONMENTAL PROTECTION AGENCY
GENERAL SERVICES ADMINISTRATION
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
NATIONAL SCIENCE FOUNDATION
OFFICE OF PERSONNEL MANAGEMENT
SMALL BUSINESS ADMINISTRATION
SOCIAL SECURITY ADMINISTRATION
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
U.S. NUCLEAR REGULATORY COMMISSION
DEFENSE SECURITY COOPERATION AGENCY
EXPORT-IMPORT BANK OF THE UNITED STATES
FARM CREDIT SYSTEM INSURANCE CORPORATION
FEDERAL COMMUNICATIONS COMMISSION
FEDERAL DEPOSIT INSURANCE CORPORATION
GENERAL FUND OF THE U.S. GOVERNMENT
MILLENNIUM CHALLENGE CORPORATION
NATIONAL CREDIT UNION ADMINISTRATION
OVERSEAS PRIVATE INVESTMENT CORPORATION
PENSION BENEFIT GUARANTY CORPORATION
RAILROAD RETIREMENT BOARD
SECURITIES AND EXCHANGE COMMISSION
SMITHSONIAN INSTITUTION
TENNESSEE VALLEY AUTHORITY
U.S. POSTAL SERVICE
OTHER ENTITIES ARE LISTED IN APPENDIX A OF THIS FINANCIAL REPORT

The Government's Financial Position and Condition

This *Financial Report* discusses the Government's financial position at the end of the fiscal year, explains how and why the financial position changed during the year, and discusses the Government's financial condition and how it may change in the future.

Table 1
The Federal Government's Financial Position and Condition

		2017		2016*	Increase / (Decrease) $	%
FINANCIAL MEASURES (Dollars in Billions)						
Gross Cost	**$**	**(4,609.3)**	**$**	**(4,515.7)**	**$ 93.6**	**2.1%**
Less: Earned Revenue	$	431.9	$	383.9	$ 48.0	12.5%
Gain/(Loss) from Changes in Assumptions	$	(356.5)	$	(273.3)	$ 83.2	30.4%
Net Cost	**$**	**(4,533.9)**	**$**	**(4,405.1)**	**$ 128.8**	**2.9%**
Less: Tax and Other Revenues	$	3,374.6	$	3,345.3	$ 29.3	0.9%
Unmatched Transactions & Balances	$	2.6	$	8.1	$ (5.5)	(67.9%)
Net Operating Cost	**$**	**(1,156.7)**	**$**	**(1,051.7)**	**$ 105.0**	**10.0%**
Budget Deficit	**$**	**(665.7)**	**$**	**(587.4)**	**$ 78.3**	**13.3%**
Assets:						
Cash & Other Monetary Assets	$	271.2	$	467.9	$ (196.7)	(42.0%)
Loans Receivable, Net	$	1,348.5	$	1,277.6	$ 70.9	5.5%
Inventories & Related Property, Net	$	326.7	$	314.3	$ 12.4	3.9%
Property, Plant & Equipment, Net	$	1,034.5	$	979.5	$ 55.0	5.6%
Other	$	499.8	$	495.5	$ 4.3	0.9%
Total Assets	**$**	**3,480.7**	**$**	**3,534.8**	**$ (54.1)**	**(1.5%)**
Liabilities:						
Federal Debt Held by the Public & Accrued Interest	$	(14,724.1)	$	(14,221.1)	$ 503.0	3.5%
Federal Employee & Veterans Benefits	$	(7,700.1)	$	(7,209.4)	$ 490.7	6.8%
Other	$	(1,472.7)	$	(1,401.1)	$ 71.6	5.1%
Total Liabilities	**$**	**(23,896.9)**	**$**	**(22,831.6)**	**$ 1,065.3**	**4.7%**
Net Position (Assets minus Liabilities)	**$**	**(20,416.2)**	**$**	**(19,296.8)**	**$ 1,119.4**	**5.8%**
SUSTAINABILITY MEASURES (Dollars in Trillions)						
Social Insurance Net Expenditures:						
Social Security (OASDI)	$	(15.4)	$	(14.1)	$ 1.3	9.2%
Medicare (Parts A, B, & D)	$	(33.5)	$	(32.5)	$ 1.0	3.1%
Other	$	(0.1)	$	(0.1)	$ 0.0	0.0%
Total Social Insurance Net Expenditures	**$**	**(49.0)**	**$**	**(46.7)**	**$ 2.3**	**4.9%**
Total Federal Non-Interest Net Expenditures	**$**	**(16.2)**	**$**	**(10.6)**	**$ 5.6**	**52.8%**
75-Year Fiscal Gap (Percent of Gross Domestic Product)		**(2.0%)**		**(1.6%)**	**0.4%**	**25.0%**

*Restated (See Financial Statement Note 1.V)

Table 1 on the previous page and the following summarize the federal government's financial position:

- The Government's gross costs of $4.6 trillion, less $431.9 billion in revenues earned for goods and services provided to the public (e.g., Medicare premiums, national park entry fees, and postal service fees), plus $356.5 billion in net losses from changes in assumptions (e.g., interest rates, inflation, disability claims rates) yields the Government's net cost of $4.5 trillion, an increase of $128.8 billion or 2.9 percent over FY 2016.
- Deducting $3.4 trillion in tax and other revenues, with some adjustment for unmatched transactions and balances, results in a "bottom line" net operating cost of $1.2 trillion for FY 2017, (an increase of $105.0 billion or 10.0 percent) over FY 2016.
- Comparing total 2017 Government assets of $3.5 trillion to total liabilities of $23.9 trillion (comprised mostly of $14.7 trillion in federal debt held by the public and accrued interest payable[3], and $7.7 trillion of federal employee and veterans benefits payable) yields a negative net position of $20.4 trillion.
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2017, debt held by the public, excluding accrued interest, was $14.7 trillion. This amount, plus intragovernmental debt ($5.6 trillion) equals gross federal debt, which, with some adjustments, is subject to the statutory debt limit. As of September 30, 2017, the Government's total debt subject to the debt limit was $20.2 trillion. The statutory debt limit was most recently suspended through December 8, 2017. See Note 25, Subsequent Events, for developments since the end of the fiscal year.

This *Financial Report* also contains information about projected impacts on the Government's future financial condition. Under federal accounting rules, social insurance amounts as reported in both the SLTFP and in the SOSI are not considered liabilities of the Government. From Table 1:

- The SLTFP shows that the present value (PV)[4] of total non-interest spending, including Social Security, Medicare, Medicaid, defense, and education, etc.), over the next 75 years, under current policy, is projected to exceed the PV of total receipts by $16.2 trillion (total federal non-interest net expenditures from Table 1).
- The SOSI shows that the PV of the Government's expenditures for Social Security and Medicare Parts A, B and D, and other social insurance programs over 75 years is projected to exceed social insurance revenues[5] by about $49.0 trillion, a $2.3 trillion increase over 2016 social insurance projections.
- The two sustainability measures in Table 1 differ primarily because total non-interest net expenditures from the SLTFP include the effects of general revenues and non-social insurance spending, neither of which is included in the SOSI.

The Government's current financial position and long-term financial condition can be evaluated both in dollar terms and in relation to the economy as a whole. Gross Domestic Product (GDP) is a measure of the size of the nation's economy in terms of the total value of all final goods and services that are produced in a year. Considering financial results relative to GDP is a useful indicator of the economy's capacity to sustain the Government's many programs. For example:

- The budget deficit (i.e., including the consolidated receipts and outlays from federal funds and the Social Security Trust Fund) increased from $587.4 billion in FY 2016 to $665.7 billion in FY 2017. The deficit-to-GDP ratio in 2017 was 3.5 percent, compared to 3.2 percent in FY 2016 and the 3.1 percent average over the past 40 years.[6]
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2017, the $14.7 trillion in debt held by the public, excluding accrued interest, equates to approximately 76 percent of GDP.
- The 2017 SOSI projection of $49.0 trillion net PV excess of expenditures over receipts over 75 years represents about 4.0 percent of the PV of GDP over 75 years. The excess of total projected non-interest spending over receipts of $16.2 trillion from the SLTFP represents 1.2 percent of GDP over 75 years. As discussed in this *Financial Report*, these projections can, in turn, have a significant impact on projected debt as a percent of GDP.
- To prevent the debt-to-GDP ratio from rising over the next 75 years, a combination of non-interest spending reductions and receipts increases that amounts to 2.0 percent of GDP on average is needed (1.6 percent of GDP on average in the 2016 projections). The fiscal gap represents 10.0 percent of 75-year present value receipts and 9.4 percent of 75-year present value non-interest spending.

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[3] On the Government's balance sheet, debt held by the public and accrued interest payable consists of Treasury securities, net of unamortized discounts and premiums, and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the federal government.

[4] Present values recognize that a dollar paid or collected in the future is worth less than a dollar today because a dollar today could be invested and earn interest. To calculate a present value, future amounts are thus reduced using an assumed interest rate, and those reduced amounts are summed.

[5] Social Security is funded by the payroll taxes and revenue from taxation of benefits. Medicare Part A is funded by the payroll taxes, revenue from taxation of benefits, and premiums that support those programs. Medicare Parts B and D are primarily financed by general revenues and premiums. By accounting convention, general revenues transferred to Medicare Parts B and D are eliminated in consolidation at the governmentwide level and, as such, are not included in the SOSI.

[6] Final Monthly Treasury Statement (as of September 30, 2017 and 2016), Joint Statement of Treasury Secretary Steven T. Mnuchin and OMB Director Mick Mulvaney on Budget Results for Fiscal Year 2017

Fiscal Year 2017 Financial Statement Audit Results

For FY 2017, GAO issued a disclaimer of audit opinion on the accrual-based, governmentwide financial statements, as it has for the past twenty years, due to certain material weaknesses in internal control over financial reporting and other limitations on the scope of its work. In addition, GAO issued a disclaimer of opinion on the sustainability financial statements due to significant uncertainties primarily related to the achievement of projected reductions in Medicare cost growth and certain other limitations. GAO's audit report on page 218 of this *Financial Report*, discusses GAO's findings.

21 of the 24 agencies required to issue audited financial statements under the *Chief Financial Officers* (CFO) *Act* received unmodified audit opinions, as did 12 of 15 additional significant reporting agencies (see Table 10 and Appendix A).[7]

The Governmentwide Reporting Entity

This *Financial Report* includes the financial status and activities of the executive, legislative, and judicial branches of the federal government, even though the legislative and judicial branches are not required by law to submit financial statement information to Treasury. Appendix A includes a list of the agencies and entities contributing to this *Financial Report*.[8]

A number of entities are not consolidated due to the nature of their operations, including the Federal Reserve System (considered to be an independent central bank under the general oversight of Congress), all fiduciary funds, and Government-Sponsored Enterprises (GSEs), including the Federal Home Loan Banks, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). Following U.S. GAAP for federal entities, the Government has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which Treasury holds either a direct, indirect, or beneficial majority equity investment. Under Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, these entities meet the criteria of paragraph 50 and do not appear in the Federal Budget section "Federal Programs by Agency and Account." As such, these entities are not consolidated into the financial reports of the Government. However, the values of the investments in and any related liabilities to such entities are presented on the balance sheet.

The following pages contain a more detailed discussion of the Government's financial results for FY 2017, the budget, the economy, the debt, and a long-term perspective about fiscal sustainability, including the Government's ability to meet its social insurance benefits obligations. The information in this *Financial Report*, when combined with the Budget of the U.S. Government, collectively presents information on the Government's financial position and condition.

Accounting Differences Between The Budget and the Financial Report

Each year, the Administration issues two reports that detail the Government's financial results: the *Budget of the U.S. Government (Budget)*, and this *Financial Report*. The exhibit on the following page provides the key characteristics and differences between the two documents.

Treasury generally prepares the financial statements in this *Financial Report* on an accrual basis of accounting as prescribed by U.S. GAAP for federal entities.[9] These principles are tailored to the Government's unique characteristics and circumstances. For example, agencies prepare a uniquely structured "Statement of Net Cost," which is intended to present net Government resources used in its operations. Also, unique to Government is the preparation of separate statements to reconcile differences and articulate the relationship between the budget and financial accounting results.

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[7] The 21 agencies include: (1) the Department of Health and Human Services, which received disclaimers of opinions on its 2017, 2016, 2015, 2014, and 2013, SOSI and its 2017 and 2016 SCSIA; and (2) the Department of Labor, which received a disclaimer of opinion on its 2017 SCSIA and 2016 SOSI and SCSIA. This also includes the Department of the Agriculture which received an unmodified audit opinion on its Balance Sheet as of September 30, 2017, but its other financial statements were not audited. The Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC) are among the 39 significant entities. These entities operate on a calendar year basis (December 31 year-end). Statistic reflects 2016 audit results for these organizations. In addition, neither the Defense Security Cooperation Agency (DSCA) nor the General Fund of the U.S. Government was subject to audit for FY 2017.

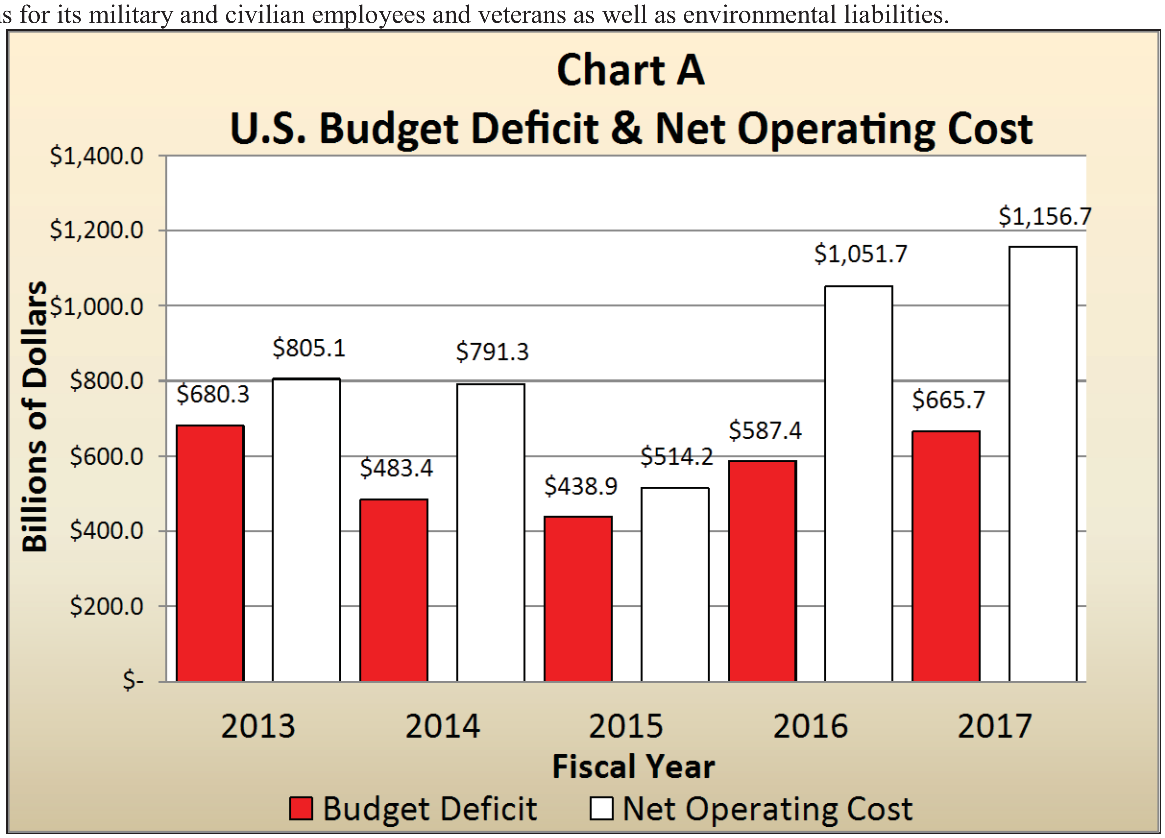
[8] Since programs are not administered at the governmentwide level, performance goals and measures for the federal government, as a whole, are not reported here. The outcomes and results of those programs are addressed at the individual agency level and can be found in each agency's financial report. Go to www.performance.gov for more information about Government performance.

[9] Under U.S. GAAP, most U.S. Government revenues are recognized on a 'modified cash' basis, or when they become measurable. The Statement of Social Insurance presents the present value of the estimated future revenues and expenditures for scheduled benefits over the next 75 years for the Social Security, Medicare, Railroad Retirement programs; and 25 years for the Black Lung program. The Statement of Long-Term Fiscal Projections presents the present value of the projected future receipts and non-interest spending for the federal government.

Budget of the U.S. Government	Financial Report of the U.S. Government
Prepared primarily on a "*cash basis*" • Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them. • Receipts ("cash in"), taxes and other collections recorded when received. • Outlays ("cash out"), largely recorded when payment is made.	Prepared on an "*accrual and modified cash basis*" • Agency-based and retrospective – prior and present resources used to implement initiatives. • Revenue: Tax revenue (more than 90 percent of total revenue) recognized on modified cash basis (see Financial Statement Note 1.B). Remainder recognized when earned, but not necessarily received. • Costs: recognized when incurred, but not necessarily paid.

Budget Deficit vs. Net Operating Cost

The budget deficit is measured as the excess of outlays, or payments made by the Government, over receipts, or cash received by the Government. Net operating cost, on an accrual basis, is the excess of costs (what the Government has incurred, but has not necessarily paid) over revenues (what the Government has collected and expects to collect, but has not necessarily received). As shown in Chart A, net operating cost typically exceeds the budget deficit due largely to the inclusion of cost accruals associated with increases in estimated liabilities for the Government's postemployment benefit programs for its military and civilian employees and veterans as well as environmental liabilities.



The Government's primarily cash-based[10] budget deficit increased by $78.3 billion (about 13.3 percent) from approximately $587.4 billion in FY 2016 to about $665.7 billion in FY 2017 due to lower growth in receipts compared to the increase in outlays in FY 2017. The $48.2 billion (1.5 percent) increase in receipts can be attributed to higher social insurance and retirement receipts and net individual income taxes, partially offset by lower deposits of earnings by the Federal Reserve. Outlays increased $126.5 billion (3.3 percent). Contributing to the increase over FY 2016 were higher outlays for Social Security, Medicare and Medicaid, and interest on the debt held by the public. In addition, revisions in estimates of credit subsidy for outstanding Federal loans and loan guarantees, primarily in the Departments of Education and Housing and Urban Development, as well as lower spectrum auction receipts and higher spending by the Federal Emergency Management

[10] Interest outlays on Treasury debt held by the public are recorded in the budget when interest accrues, not when the interest payment is made. For federal credit programs, outlays are recorded when loans are disbursed, in an amount representing the present value cost to the Government, (commonly referred to as credit subsidy cost. Credit subsidy cost excludes administrative costs.

Agency for hurricane relief and recovery contributed to the increase.[11] The Government's largely accrual-based net operating cost also increased, by $105.0 billion (10.0 percent) from $1.1 trillion to $1.2 trillion, over FY 2016. As explained below, net operating costs are affected by both changes in revenues and costs.

The ***Reconciliation of Net Operating Cost and Budget Deficit Statement*** is summarized in Table 2. Table 2 details the relationship between the Government's accrual-based net operating cost relates to the cash-based budget deficit. From Table 2, the $491.0 billion net difference between the Government's budget deficit and net operating cost for FY 2017, is mostly attributable to: (1) a $490.7 billion net increase in liabilities for Federal employee and veteran benefits payable (FEVBP); and (2) several offsetting items, including, but not limited to a net $55.0 billion increase in Property, Plant, and Equipment (PP&E) and a $17.9 billion increase in environmental and disposal liabilities. These and most of the other "Change in" amounts summarized in Table 2 affect net operating cost, but not the budget deficit. In particular, the $490.7 billion FEVBP change not only represents most (99.9 percent) of the difference between the budget deficit and net operating cost, but is also, as discussed in the following section, the most significant driver of the increase in the government's net operating cost for 2017.

Table 2: Net Operating Cost vs. Budget Deficit

Dollars in Billions	2017	2016*
Net Operating Cost	**$ (1,156.7)**	**$ (1,051.7)**
Change in:		
Federal Employee and Veteran Benefits Payable	$ 490.7	$ 437.0
Property, Plant, and Equipment, Net[1]	$ (55.0)	$ (54.2)
Environmental and Disposal Liabilities	$ 17.9	$ 35.0
Investments in Government-Sponsored Enterprises (GSEs)	$ 16.0	$ (2.3)
Insurance and Guarantee Program Liabilities	$ 15.5	$ 16.7
Other, Net	$ 5.9	$ 32.1
Subtotal - Net Difference:	$ 491.0	$ 464.3
Budget Deficit	**$ (665.7)**	**$ (587.4)**

*Restated (See Financial Statement Note 1.V)

1 Net effect of: capitalized fixed assets, depreciation expense, and asset disposals and revaluations

[11] 10/20/17 press release -- Joint Statement of Treasury Secretary Steven T. Mnuchin and OMB Director Mick Mulvaney on Budget Results for Fiscal Year 2017.

The Government's Net Position: "Where We Are"

The Government's financial position and condition have traditionally been expressed through the *Budget*, focusing on surpluses, deficits, and debt. However, this primarily cash-based discussion of the Government's net outlays (deficit) or net receipts (surplus) tells only part of the story. The Government's accrual-based net position, (the difference between its assets and liabilities), and its "bottom line" net operating cost (the difference between its revenues and costs) are also key financial indicators.

Costs and Revenues

The Government's ***Statement of Operations and Changes in Net Position***, much like a corporation's income statement, shows the Government's "bottom line" and its impact on net position (i.e., assets net of liabilities). To derive the Government's "bottom line" net operating cost, the ***Statement of Net Cost*** first shows how much it costs to operate the federal government, recognizing expenses when incurred, regardless of when payment is made (accrual basis). It shows the derivation of the Government's net cost or the net of: (1) gross costs, or the costs of goods produced and services rendered by the Government, (2) the earned revenues generated by those goods and services during the fiscal year, and (3) gains or losses from changes in actuarial assumptions used to estimate certain liabilities. This amount, in turn, is offset against the Government's taxes and other revenue reported in the ***Statement of Operations and Changes in Net Position*** to calculate the "bottom line" or net operating cost. [12]

Table 3: Gross Cost, Revenues, Net Cost, and Net Operating Cost

Dollars in Billions		2017		2016*	Increase / (Decrease) $	%
Gross Cost	**$**	**(4,609.3)**	**$**	**(4,515.7)**	**$ 93.6**	**2.1%**
Less: Earned Revenue	$	431.9	$	383.9	$ 48.0	12.5%
Gain/(Loss) from Changes in Assumptions	$	(356.5)	$	(273.3)	$ 83.2	30.4%
Net Cost	**$**	**(4,533.9)**	**$**	**(4,405.1)**	**$ 128.8**	**2.9%**
Less: Tax and Other Revenues	$	3,374.6	$	3,345.3	$ 29.3	0.9%
Unmatched Transactions and Balances	$	2.6	$	8.1	$ (5.5)	(67.9%)
Net Operating Cost	**$**	**(1,156.7)**	**$**	**(1,051.7)**	**$ 105.0**	**10.0%**

*Restated (See Financial Statement Note 1.V)

Table 3 shows that the Government's "bottom line" net operating cost increased by $105.0 billion (10.0 percent), from $1.1 trillion in FY 2016 to $1.2 trillion in FY 2017.[13] This increase is largely attributable to a $128.8 billion (2.9 percent) increase in agency net costs, which was offset slightly by a $29.3 billion (0.9 percent) increase in tax and other revenues over the past fiscal year as summarized in the following.

Gross Cost and Net Cost

The ***Statement of Net Cost***, starts with the Government's total gross costs of $4.6 trillion, subtracts revenues earned for goods and services provided (e.g., Medicare premiums, national park entry fees, and postal service fees), and adjusts the balance for gains or losses from changes in actuarial assumptions used to estimate certain liabilities, including federal employee and veterans benefits to derive its net cost of $4.5 trillion (See Chart B), a $128.8 billion (2.9 percent) increase over FY 2016.

Typically, the annual change in the Government's net cost is impacted by a variety of offsetting increases and decreases across agencies. For example, offsetting changes in net cost during FY 2017 included:

- Agencies administering federal employee and veterans benefits programs employ a complex series of assumptions, including but not limited to interest rates, beneficiary eligibility, life expectancy, and medical cost levels, to make actuarial projections of their long-term benefits liabilities. Changes in these assumptions can result in either losses (net cost increases) or gains (net cost decreases). Across the Government, net actuarial losses from these assumption changes amounted to $356.5 billion in FY 2017, an increase of $83.2 billion over FY 2016. The primary agencies that administer programs impacted by these assumptions – typically federal employee pension and benefit programs

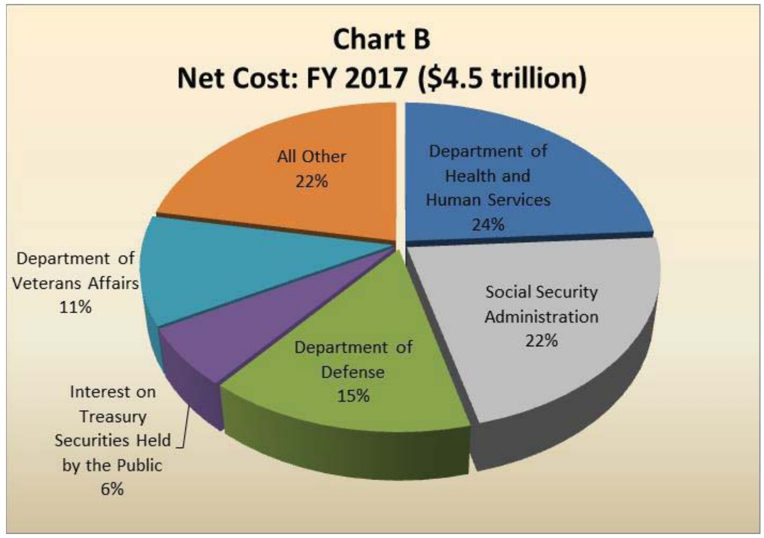
[12] As shown in Table 3, net operating cost includes an adjustment for unmatched transactions and balances, which represent unreconciled differences in intragovernmental activity and balances between Federal agencies. These amounts are described in greater detail in the Other Information section of this *Financial Report*.

[13] The Statement of Net Cost in this *Financial Report* reflects FY 2016 net cost restatements for the Pension Benefit Guaranty Corporation from $4.7 billion to $5.4 billion, (See Financial Statement Note 1.V).

– are the Office of Personnel Management (OPM), the Department of Veterans Affairs (VA), and the Department of Defense (DOD). These agencies recorded losses from changes in actuarial assumptions in the amounts of $102.5 billion, $229.7 billion, and $24.1 billion, respectively.

- These analyses and the resulting gains or losses can sometimes cause significant swings in total agency costs from year to year. For example, for FY 2017, changes in net cost at VA ($169.4 billion decrease), OPM ($178.5 billion increase), and DOD ($56.2 billion increase), were impacted by the corresponding changes in gains or losses from assumption changes at these agencies.

- Agencies that extend credit to the public in the form of loans, including student and housing loans, estimate and annually re-estimate the long-term costs of these programs employing multiple loan performance and economic assumptions. These estimates and reestimates can have varying effects on an agency’s net cost each year. For example, the $19.4 billion net cost decrease at the Department of Education and the $39.7 billion increase at the Department of Housing and Urban Development were both largely attributed to these “credit subsidy estimates and re-estimates.”[14];
- $11.8 billion and $17.0 billion net cost increases at the Department of Health and Human Services (HHS) and the Social Security Administration (SSA), respectively, primarily due to cost increases of the benefits programs that these agencies administer (HHS – Medicare and Medicaid programs, SSA – Old Age Survivors and Disability Insurance (OASDI) programs);
- A $23.3 billion cost increase in interest on debt held by the public due largely to an increase in the debt[15];
- $23.0 billion net cost decrease at the Department of Energy predominantly due to changes in estimated environmental remediation costs compared to FY 2016; and
- A $10.9 billion net cost increase at the Department of Homeland Security primarily to support response and recovery efforts related to the recent hurricanes.[16]



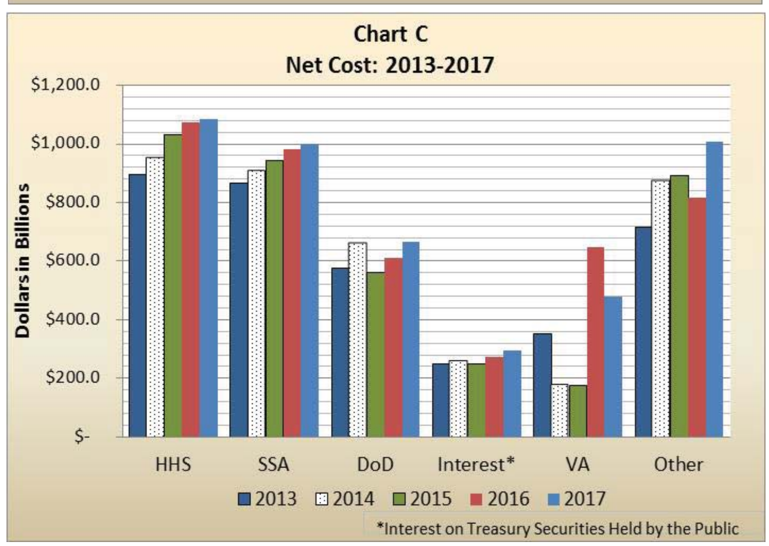
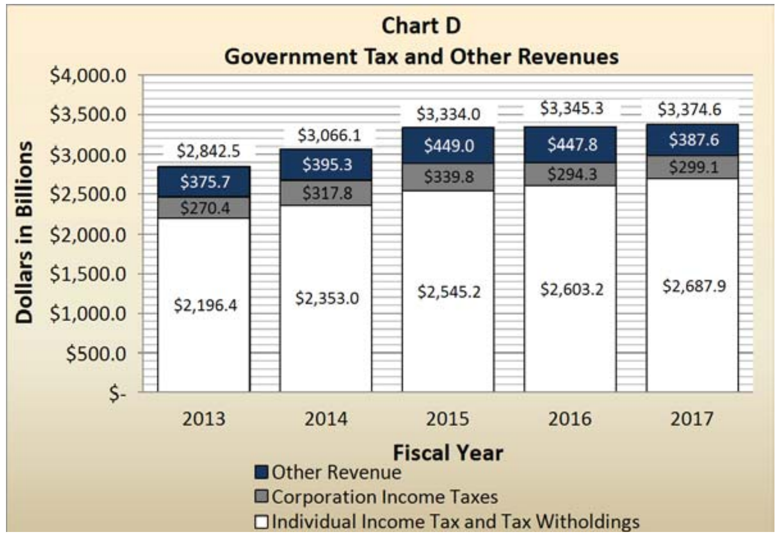


Chart B shows the composition of the Government’s net cost. In FY 2017, nearly three fourths of total net cost came from HHS, SSA, DOD, and VA. Chart C shows that these agencies have consistently incurred the largest agency shares of the Government’s total net cost in recent years. As indicated above, HHS and SSA net costs for FY 2017 ($1.1 trillion and $1.0 trillion, respectively) are attributable to major social insurance programs administered by these agencies. DOD net costs of $665.4 billion relate primarily to operations, readiness, and support; personnel; research; procurement; and retirement and health benefits. VA costs ($479.7 billion during FY 2017, nearly half of which was due to losses from changes in actuarial assumptions as referenced earlier) support health, education and other benefits programs for our Nation’s veterans. Chart B also shows that interest on debt held by the public contributed an additional 6 percent, and the other agencies included in the Government’s FY 2017 Statement of Net Cost accounted for a combined 22 percent of the Government’s total net cost for FY 2017.

[14] FY 2017 Department of Education Agency Financial Report, pp. 17-18; FY 2017 Department of Housing and Urban Development Agency Financial Report, pp. 20-23.
[15] FY 2017 Department of the Treasury Agency Financial Report, p. 28
[16] FY 2017 U.S. Department of Homeland Security Agency Financial Report, p. 27

Tax and Other Revenues

As noted earlier, tax and other revenues from the ***Statement of Operations and Changes in Net Position*** are deducted from total net cost to derive the Government's "bottom line" net operating cost. Chart D shows that total tax and other revenue did not change significantly, increasing slightly by $29.3 billion or 0.9 percent to $3.4 trillion for FY 2017. This increase is attributable mainly to an overall growth in individual income tax collections, partially offset by reduced estate and corporation income tax collections and deposit of earnings from the Federal Reserve System.[17] Earned revenues from Table 3 are not considered "taxes and other revenue" and, thus, are not shown in Chart D. Individual income tax and tax withholdings and corporation income taxes accounted for about 79.7 percent and 8.9 percent of total revenue, respectively in FY 2017; other revenues from Chart D include Federal Reserve earnings, excise taxes, unemployment taxes, and customs duties.



As previously shown in Table 3, the increase in net cost more than offset the slight increase in tax and other revenues, resulting in a slight increase in the government's net operating cost from $ 1.1 trillion for FY 2016 to $1.2 trillion for FY 2017.

Assets and Liabilities

The Government's net position at the end of the year is derived by netting the Government's assets against its liabilities, as presented in the ***Balance Sheet*** (summarized in Table 4). The balance sheet does not include the financial value of the Government's sovereign powers to tax, regulate commerce, or set monetary policy or value of nonoperational resources, such as national and natural resources, for which the Government is a steward. In addition, as is the case with the ***Statement of Operations and Changes in Net Position***, the ***Balance Sheet*** includes a separate presentation of the portion of net position related to funds from dedicated collections. Moreover, the Government's exposures are broader than the liabilities presented on the balance sheet. The Government's future social insurance exposures (e.g., Medicare and Social Security) as well as other fiscal projections, commitments and contingencies, are reported in separate statements and disclosures. This information is discussed later in this Management Discussion and Analysis (MD&A) section, the financial statements, and RSI sections of this *Financial Report*.

Table 4: Assets and Liabilities

Dollars in Billions	2017	2016*	Increase / (Decrease) $	Increase / (Decrease) %
Assets				
Cash & Other Monetary Assets	$ 271.2	$ 467.9	$ (196.7)	(42.0%)
Loans Receivable, Net	$ 1,348.5	$ 1,277.6	$ 70.9	5.5%
Inventories & Related Property, Net	$ 326.7	$ 314.3	$ 12.4	3.9%
Property, Plant & Equipment, Net	$ 1,034.5	$ 979.5	$ 55.0	5.6%
Other	$ 499.8	$ 495.5	$ 4.3	0.9%
Total Assets	**$ 3,480.7**	**$ 3,534.8**	**$ (54.1)**	**(1.5%)**
Less: Liabilities, comprised of:				
Federal Debt Held by the Public & Accrued Interest	$ (14,724.1)	$ (14,221.1)	$ 503.0	3.5%
Federal Employee & Veteran Benefits	$ (7,700.1)	$ (7,209.4)	$ 490.7	6.8%
Other	$ (1,472.7)	$ (1,401.1)	$ 71.6	5.1%
Total Liabilities	**$ (23,896.9)**	**$ (22,831.6)**	**$1,065.3**	**4.7%**
Net Position (Assets Minus Liabilities)	**$ (20,416.2)**	**$ (19,296.8)**	**$1,119.4**	**5.8%**

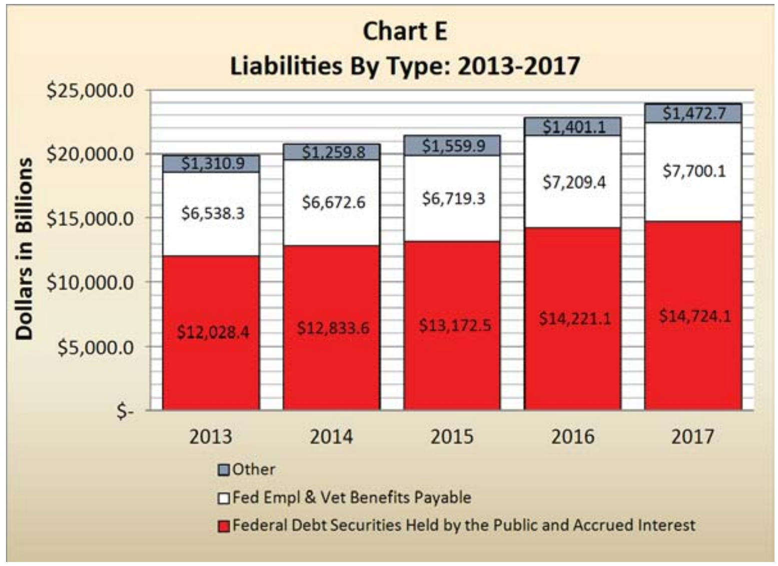
*Restated (See Financial Statement Note 1.V)

[17] FY 2017 Department of the Treasury Agency Financial Report, p. 29

Assets

As of September 30, 2017, the Government's $3.5 trillion in assets are comprised mostly of net loans receivable ($1.3 trillion) and net property, plant, and equipment ($1.0 trillion).[18] From Financial Statement Note 4, the Department of Education's (Education's) Federal Direct Student Loan Program accounted for $1.0 trillion (77.2 percent) of total net loans receivable. Education's direct student loan program receivables balances have grown by more than 170 percent since FY 2011 largely due to increased direct loan disbursements, attributable to the continued effect of 2010 legislation requiring a transition for new loans from guaranteed student loans to full direct lending by Education.[19]

Liabilities



As indicated in Table 4 and Chart E, of the Government's $23.9 trillion in total liabilities, the largest liability is federal debt securities held by the public and accrued interest, the balance of which increased by $503.0 billion (3.5 percent) to $14.7 trillion as of September 30, 2017.

The other major component of the Government's liabilities is federal employee and veteran benefits payable (i.e., the Government's pension and other benefit plans for its military and civilian employees), which increased $490.7 billion (6.8 percent) during FY 2017, to $7.7 trillion. This total amount is comprised of $2.5 trillion in benefits payable for the current and retired civilian workforce, and $5.2 trillion for the military and veterans. OPM administers the largest civilian pension plan, covering nearly 2.7 million current employees and 2.6 million annuitants and survivors. The military pension plan covers about 2.1 million current military personnel (including active service, reserve, and National Guard) and approximately 2.3 million retirees and survivors.

Federal Debt

The budget surplus or deficit is the difference between total federal spending and receipts (e.g., taxes) in a given year. The Government borrows from the public (increases federal debt levels) to finance deficits. During a budget surplus (i.e., when receipts exceed spending), the Government typically uses those excess funds to reduce the debt held by the public. ***The Statement of Changes in Cash Balance from Budget and Other Activities*** reports how the annual budget surplus or deficit relates to the federal government's borrowing and changes in cash and other monetary assets. It also explains how a budget surplus or deficit normally affects changes in debt balances.

The Government's publicly-held debt, or federal debt held by the public, and accrued interest (balance sheet liability) totaled $14.7 trillion as of September 30, 2017. It is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the federal government. As indicated above, budget surpluses have typically resulted in borrowing reductions, and budget deficits have conversely yielded borrowing increases. However, the Government's debt operations are generally much more complex. Each year, trillions of dollars of debt mature and new debt is issued to take its place. In FY 2017, new borrowings were $8.7 trillion, and repayments of maturing debt held by the public were $8.2 trillion, both increases from FY 2016).

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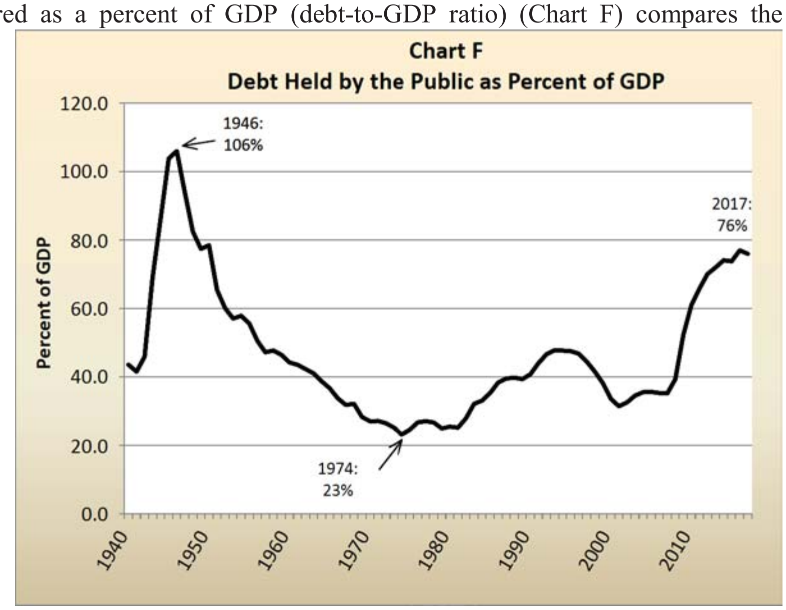
[18] For financial reporting purposes, other than multi-use heritage assets, stewardship assets are not recorded as part of Property, Plant, and Equipment. Stewardship assets are comprised of stewardship land and heritage assets. Stewardship land consists of public domain land (e.g., national parks, wildlife refuges). Heritage assets include national monuments and historical sites that among other characteristics are of historical, natural, cultural, educational, or artistic significance. See Note 24 – Stewardship Land and Heritage Assets.

[19] With the enactment of the SAFRA Act, which was included as part of the *Health Care and Education Reconciliation Act of 2010* (HCERA) (Pub. L. 111-152), no new loans were originated under the Federal Family Education Loan (FFEL) Program (guaranteed loan program) since July 1, 2010. See U.S. Department of Education FY 2017 Agency Financial Report p. 52.

In addition to debt held by the public, the Government has about $5.6 trillion in intragovernmental debt outstanding, which arises when one part of the Government borrows from another. It represents debt issued by the Treasury and held by Government accounts, including the Social Security ($2.9 trillion) and Medicare ($268.4 billion) trust funds. Intragovernmental debt is primarily held in Government trust funds in the form of special nonmarketable securities by various parts of the Government. Laws establishing Government trust funds generally require excess trust fund receipts (including interest earnings) over disbursements to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the Government trust funds, they are eliminated as part of the consolidation process for the governmentwide financial statements (see Note 11). When those securities are redeemed, e.g., to pay Social Security benefits, the Government will need to obtain the resources necessary to reimburse the trust funds. The sum of debt held by the public and intragovernmental debt equals gross federal debt, which (with some adjustments), is subject to a statutory ceiling (i.e., the debt limit). At the end of FY 2017, debt subject to the statutory limit (DSL) was $20.2 trillion (see sidebar). See Note 25, Subsequent Events for developments since the end of the fiscal year.

Prior to 1917, Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress and the President established a dollar ceiling for federal borrowing. With the Public Debt Act of 1941 (Public Law 77-7), Congress and the President set an overall limit of $65 billion on Treasury debt obligations that could be outstanding at any one time. Since then, Congress and the President have enacted a number of measures affecting the debt limit, including several in recent years. Congress and the President most recently suspended the debt limit from September 8, 2017 through December 8, 2017. It is important to note that increasing or suspending the debt limit does not increase spending or authorize new spending; rather, it permits the United States to continue to honor pre-existing commitments to its citizens, businesses, and investors domestically and around the world.

The federal debt held by the public measured as a percent of GDP (debt-to-GDP ratio) (Chart F) compares the country's debt to the size of its economy, making this measure sensitive to changes in both. Over time, the debt-to-GDP ratio has varied widely:



- For most of the nation's history, through the first half of the 20th century, the debt-to-GDP ratio has tended to increase during wartime and decline during peacetime.
- Chart F shows that wartime spending and borrowing pushed the debt-to-GDP ratio to an all-time high of 106 percent in 1946, soon after the end of World War II, but it decreased rapidly in the post-war years,
- The ratio grew rapidly from the mid-1970s until the early 1990s. Strong economic growth and fundamental fiscal decisions, including measures to reduce the federal deficit and implementation of binding "Pay As You Go" (PAYGO) rules (which require that new tax or spending laws not add to the deficit), generated a significant decline in the debt-to-GDP ratio, from a peak of 48 percent in 1993-1995, to 31 percent in 2001.
- During the first decade of the 21st century, PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 39 percent of GDP.
- PAYGO rules were reinstated in 2010, but the extraordinary demands of the last economic and fiscal crisis and the consequent actions taken by the federal government, combined with slower economic growth in the wake of the crisis, pushed the debt-to-GDP ratio up to 74 percent by the end of FY 2014.
- The debt was 76 percent of GDP at the end of FY 2017.[20]

[20] 10/20/2017 press release: Joint Statement of OMB Director, Mick Mulvaney and Treasury Secretary, Steven T. Mnuchin.

The Economy in Fiscal Year 2017

A review of the nation's key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. As summarized in Table 5, the economic expansion accelerated during FY 2017 and the economy continued to generate jobs, though at a slower pace. The unemployment rate trended lower, and by the end of the fiscal year, stood at its lowest level since February 2001.

Table 5: National Economic Indicators*

	FY 2017	FY 2016
Real GDP Growth	2.3%	1.5%
Residential Investment Growth	1.2%	2.6%
Average monthly payroll job change (thousands)	157	219
Unemployment rate (percent, end of period)	4.2%	4.9%
Consumer Price Index (CPI)	2.2%	1.5%
CPI, excluding food and energy	1.7%	2.2%

* Some FY2016 data may differ from the FY2016 Financial Report due to updates and revisions.

Real (i.e., inflation-adjusted) GDP expanded 2.3 percent during FY 2017, accelerating from the 1.5 percent advance recorded over the four quarters of FY 2016. The acceleration reflected a rebound in business fixed investment, particularly in the energy sector, a significant contribution from net exports, and a small contribution from inventory investment. Growth of consumer spending remained strong, growing 2.6 percent in FY 2017 compared with a rise of 2.8 percent in FY 2016. Recovery in the housing sector continued through the fiscal year, but at a slower pace, with residential fixed investment increasing by 1.2 percent, compared with an advance of 2.6 percent during FY 2016. Nonresidential fixed investment jumped 4.6 percent during FY 2017, reversing from a 0.7 percent decline during the previous fiscal year.

Labor market conditions improved further during FY 2017. The economy added 1.9 million nonfarm payroll jobs during the course of the fiscal year, compared with the 2.6 million jobs added during FY 2016. On a monthly basis, nonfarm payroll employment rose at an average rate of 157,000 jobs per month, somewhat less than the average monthly increase of 219,000 in FY 2016. The number of unemployed persons declined significantly to 6.8 million in September 2017, down from 7.9 million a year earlier. The unemployment rate declined 0.7 percentage point, from 4.9 percent in September 2016 to 4.2 percent in September 2017. At the end of FY 2017, the unemployment rate was 5.8 percentage points lower than the peak of 10.0 percent, reached in October 2009.

Headline inflation accelerated during FY 2017, as energy prices trended higher, but core inflation (the Consumer Price Index (CPI) excluding food and energy) slowed. CPI rose 2.2 percent during FY 2017, up from 1.5 percent during FY2016, and a flat reading in FY 2015. Underlying core inflation decelerated to 1.7 percent, compared with a reading of 2.2 percent during FY 2016.

Growth of real disposable (i.e., after-tax) personal income was stable during FY 2017, as a small pickup in growth of nominal disposable personal income was partially offset by faster inflation. The level of corporate profits grew 5.4 percent during FY 2017, after a decline of 1.6 percent during the previous fiscal year.

The Long-Term Fiscal Outlook: "Where We Are Headed"

An important purpose of the *Financial Report* is to help citizens understand current fiscal policy and the importance and magnitude of policy reforms necessary to make it sustainable. This *Financial Report* includes the ***Statements of Long-Term Fiscal Projections*** and a related Note Disclosure (Note 23). The Statements display the present value of 75-year projections of the federal government's receipts and non-interest spending[21] for FY 2017 and FY 2016. The projections and accompanying discussion do not reflect the *Tax Cuts and Jobs Act* (P.L. 115-97) enacted on December 22, 2017. Additional information about these projections may be found in Note 23 and the RSI section of this *Financial Report*; and additional information about the *Tax Cuts and Jobs Act* may be found in Note 25, *Subsequent Events*.

Fiscal Sustainability

A sustainable fiscal policy is one where the debt-to-GDP ratio is stable or declining over the long term. The projections discussed here show the impact on the ratio if current policy (i.e., current law, with certain adjustments, such as extension of expiring policies that are expected to continue)[22] is assumed to continue indefinitely. The projections are therefore neither forecasts nor predictions. As policy changes are enacted, actual financial outcomes will be different than those projected.

The projections in this *Financial Report* show that current policy is not sustainable. As discussed below, if current policy is left unchanged, the debt-to-GDP ratio is projected to fall about 4 percentage points by 2023 before commencing a steady rise to 297 percent in 2092 and is projected to rise continuously thereafter. Preventing the debt-to-GDP ratio from rising over the next 75 years is estimated to require some combination of spending reductions and revenue increases that amount to 2.0 percent of GDP over the period. While this estimate of the "75-year fiscal gap" is highly uncertain, it is nevertheless nearly certain that current fiscal policies cannot be sustained indefinitely.

Delaying action to reduce the gap increases the magnitude of spending and/or revenue changes necessary to stabilize the debt-to-GDP ratio. For example, reforms necessary to close the gap rises about 20 percent if reforms are delayed ten years, and about 50 percent larger if reform is delayed 20 years.

The estimates of the cost of policy delay assume policy does not affect GDP or other economic variables. Delaying fiscal adjustments for too long raises the risk that growing federal debt would increase interest rates, which would, in turn, reduce investment and ultimately economic growth.

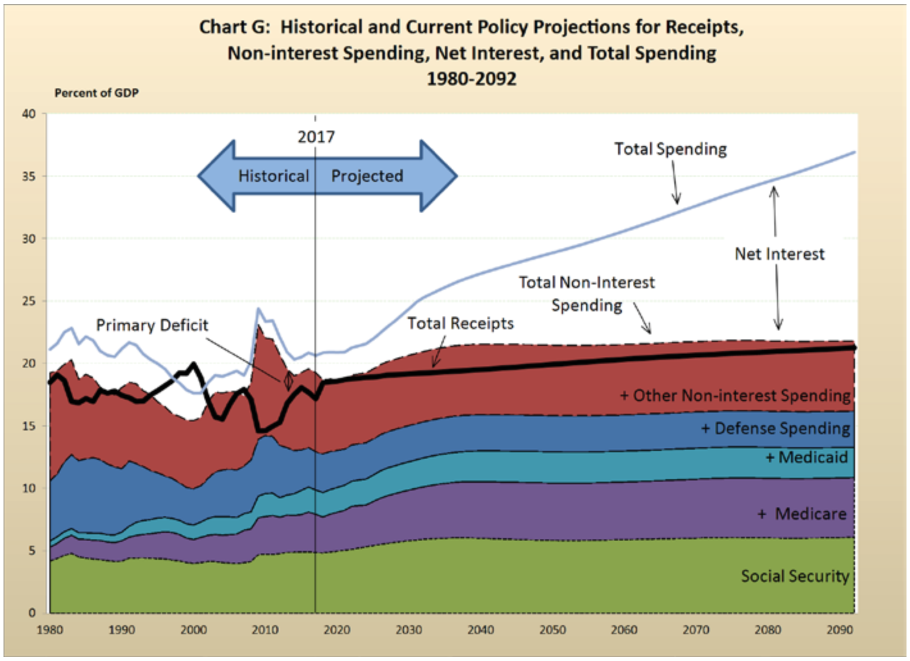
The Primary Deficit, Interest, and Debt

The primary deficit – the difference between non-interest spending and receipts – is the determinant of the debt-to-GDP ratio over which the Government has the greatest control (the other determinants include interest rates and growth in GDP). Chart G shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP. The primary deficit-to-GDP ratio spiked during 2009 through 2012 due to the 2008-09 financial crisis and the ensuing severe recession, as well as the increased spending and temporary tax reductions enacted to stimulate the economy and support recovery. These elevated primary deficits resulted in a sharp increase in the ratio of debt to GDP, which rose from 39 percent at the end of 2008 to 70 percent at the end of 2012. As an economic recovery took hold, the primary deficit ratio fell, averaging 1.9 percent of GDP over 2013 through 2017. This primary deficit ratio was still high enough that the debt increased further relative to GDP, ending 2017 at 76 percent. The primary deficit is projected to shrink further through 2021 as discretionary spending limits called for in the BCA continue and the economic recovery boosts tax receipts. After 2021, however, increased spending for Social Security and health programs due to the ongoing retirement of the baby boom generation and increases in the price of health care services is projected to result in increasing primary deficits that reach 1.1 percent of GDP in 2027. The primary deficit peaks at 2.1 percent of GDP in 2037 and 2038, gradually decreases beyond that point as aging of the population continues at a slower pace and reaches 0.6 percent of GDP in 2088 through 2091.

Primary deficit trends are heavily influenced by tax receipts. Receipts as a share of GDP were markedly depressed in 2009 through 2012 because of the recession and tax reductions enacted as part of the *American Recovery and Reinvestment Act of 2009* (ARRA) and the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*. The share has increased in subsequent years and was 17.2 percent in 2017, similar to its 30-year average due to continued economic growth and the higher tax rates enacted under the ATRA.

[21] For the purposes of the Statement of Long-Term Fiscal Projections and this analysis, spending is defined in terms of outlays. In the context of federal budgeting, spending can either refer to: (1) budget authority – the authority to commit the government to make a payment; (2) obligations – binding agreements that will result in either immediate or future payment; or (3) outlays, or actual payments made.

[22] Current policy in the projections is based on current law, but includes certain adjustments, such as extension of certain policies that expire under current law but are routinely extended or otherwise expected to continue (e.g., reauthorization of the Supplemental Nutrition Assistance Program).

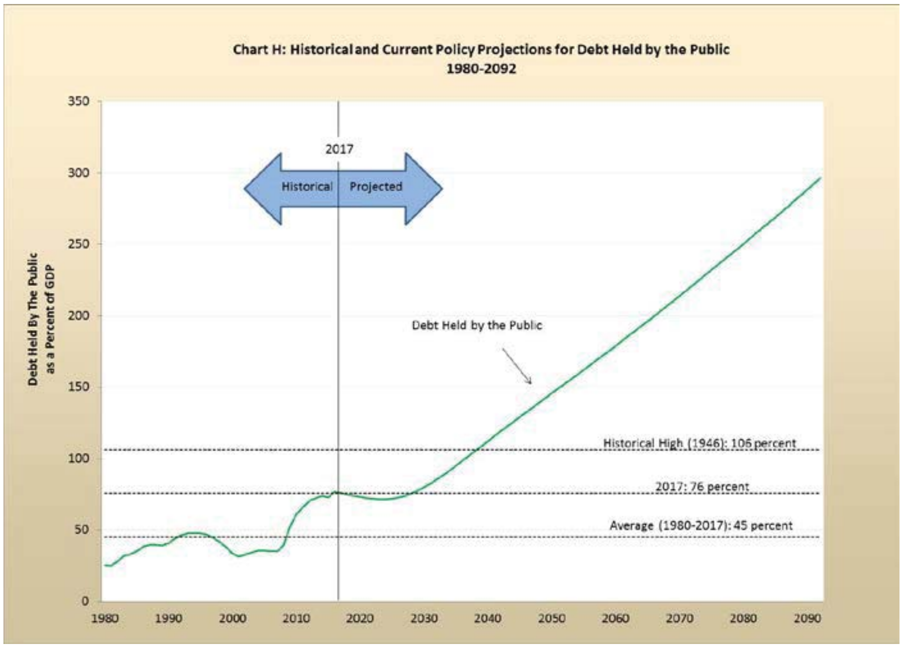


After 2020, receipts are projected to grow slightly more rapidly than GDP over the projection period as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets.

Non-interest spending as a share of GDP is projected to stay at or below its current level of about 19 percent until 2025, and to then rise gradually to 21.5 percent of GDP by 2037 and 21.8 percent of GDP in 2070 through 2092. Slight reductions in the non-interest spending share of GDP over the next few years are mostly due to caps on discretionary spending, which hold growth in discretionary spending below GDP growth. The subsequent increases are principally due to faster growth in Medicare, Medicaid, and Social Security spending (see Chart G). The aging of the baby boom generation over the next 25 years is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.1 percentage points, 1.5 percentage points, and 0.5 percentage points, respectively. After 2042, the Social Security spending share of GDP remains relatively stable, while the combined Medicare and Medicaid spending share of GDP continues to increase, albeit at a slower rate, due to projected increases in health care costs.

One of the most important assumptions underlying the projections is the future growth of health care costs. As discussed in Note 22, these future growth rates – both for health care costs in the economy generally and for Federal health care programs such as Medicare, Medicaid, and Affordable Care Act (ACA) exchange subsidies – are highly uncertain. In particular, enactment of the ACA in 2010 and the *Medicare Access and CHIP Reauthorization Act (MACRA)* in 2015 established cost controls for Medicare hospital and physician payments whose long-term effectiveness is still to be demonstrated. The Medicare spending projections in the long-term fiscal projections are based on the projections in the 2017 Medicare trustees' report, which assume the ACA and MACRA cost control measures will be effective in producing a substantial slowdown in Medicare cost growth. As discussed in Note 22, the Medicare projections are subject to much uncertainty about the ultimate effects of these provisions to reduce health care cost growth. For the long-term fiscal projections, that uncertainty also affects the projections for Medicaid and exchange subsidies, because the cost per beneficiary in these programs is assumed to grow at the same reduced rate as Medicare cost growth per beneficiary.

The primary deficit-to-GDP projections in Chart G, projections for interest rates, and GDP growth rates are the primary determinants for the debt-to-GDP ratio projections shown in Chart H. That ratio was 76 percent at the end of FY 2017 and under current policy is projected to be 74 percent in 2027, 136 percent in 2047, and 297 percent in 2092. The debt-to-GDP ratio rises continually despite primary deficits that flatten out because higher levels of debt lead to higher net interest expenditures, and higher net interest expenditures lead to higher debt.[23] The continuous rise of the debt-to-GDP ratio after 2023 indicates that current policy is unsustainable.



These debt-to-GDP projections are generally higher than the corresponding projections in both the FY 2016 and FY 2015 *Financial Reports*. For example, the debt-to-GDP projection for 2090 (the final projection year for the 2015 report) is 289 percent in this year's *Financial Report*, 249 percent in the FY 2016 *Financial Report*, and 223 percent in the FY 2015 *Financial Report*.[24]

Subsequent to the close of the reporting period, and after the preparation of these long-term fiscal projections, Congress passed and the President signed the *Tax Cuts and Jobs Act* (Public Law 114-411) which enacts comprehensive reforms to the individual and corporation income tax code. See Note 25, Subsequent Events, for more information.

The Fiscal Gap and the Cost of Delaying Policy Reform

The 75-year fiscal gap is one measure of the degree to which current fiscal policy is unsustainable. It is the amount by which primary surpluses over the next 75 years must, on average, rise above current-policy levels in order for the debt-to-GDP ratio in 2092 to remain at its level in 2017 (76 percent). This fiscal gap is estimated to equal 2.0 percent of GDP. The projections show that projected primary deficits average 1.2 percent of GDP over the next 75 years under current policies. If policies were adopted to eliminate the fiscal gap, the average primary surplus over the next 75 years would be 0.8 percent of GDP, 2.0 percentage points higher than the projected present value of receipts less non-interest spending shown in the basic financial statement. The 75-year fiscal gap represents 10.0 percent of 75-year present value receipts and 9.4 percent of 75-year present value non-interest spending. The fiscal gap was estimated at 1.6 percent in the 2016 *Financial Report*, 0.4 percentage points lower than estimated in this Report.

In these projections, closing the fiscal gap requires running substantially positive primary surpluses, rather than simply eliminating the primary deficit. The primary reason is that the projections assume future interest rates will exceed the growth rate of GDP. Achieving primary balance (that is, running a primary surplus of zero) implies that the debt grows each year by the amount of interest spending, which under these assumptions would result in debt growing faster than GDP.

Table 6

Costs of Delaying Fiscal Reform

Period of Delay	Change in Average Primary Surplus
Reform in 2018 (No Delay)	2.0 percent of GDP between 2018 and 2092
Reform in 2028 (Ten-Year Delay)	2.4 percent of GDP between 2028 and 2092
Reform in 2038 (Twenty-Year Delay)	3.0 percent of GDP between 2038 and 2092

Note: Reforms taking place in 2017, 2027, and 2037 from the 2016 Financial Report were 1.6, 1.9, and 2.4 percent of GDP, respectively.

Table 6 shows the cost of delaying policy reform to close the fiscal gap by comparing policy reforms that begin in three different years. Immediate reform would require increasing primary surpluses by 2.0 percent of GDP on average between 2018 and 2092 (i.e., some combination of reducing spending and increasing revenue by a combined 2.0 percent of GDP on average

[23] The change in debt each year is also affected by certain transactions not included in the budget deficit, such as changes in Treasury's cash balances and the nonbudgetary activity of Federal credit financing accounts. These transactions are assumed to hold constant at about 0.4 percent of GDP each year, with the same effect on debt as if the primary deficit was higher by that amount.

[24] See the Note 23 of the *FY 2016 Financial Report of the U.S. Government* for more information about changes in the long term fiscal projections between FY 2015 and FY 2016.

over the 75-year projection period). Table 6 shows that delaying policy reform forces larger and more abrupt policy reforms over shorter periods. For example, if policy reform is delayed by 10 years, any reforms must increase the primary surplus by 2.4 percent of GDP on average between 2028 and 2092. Similarly, delaying reform by 20 years requires primary surplus increases of 3.0 percent of GDP on average between 2038 and 2092. The differences between the required primary surplus increases that start in 2028 and 2038 (2.4 and 3.0 percent of GDP, respectively) and that which starts in 2018 (2.0 percent of GDP) is a measure of the additional burden that delay would impose on future generations. Future generations are harmed by such a policy reform delay, because the higher the primary surplus is during their lifetimes the greater the difference is between the taxes they pay and the programmatic spending from which they benefit.

Conclusion

The past nine years saw the national debt nearly double as a share of GDP, bringing it to a level not seen since shortly after World War II. The debt-to-GDP ratio is projected to remain relatively stable over the next decade and then rise indefinitely if current policies are unchanged, which implies that current policies are not sustainable and must ultimately change. As long as policy changes are not so abrupt as to hinder economic growth, the sooner policies are adopted to avert these trends, the smaller the changes to revenue and/or spending will need to be to achieve sustainability over the long term. While the estimated magnitude of the fiscal gap is subject to a substantial amount of uncertainty, there is little doubt that current policy is not sustainable.

These long-term fiscal projections and the topic of fiscal sustainability are discussed in further detail in Note 23 and the RSI section of this *Financial Report*.

Social Insurance

The long-term fiscal projections reflect Government receipts and spending as a whole. The Statement of Social Insurance (SOSI) focuses on the Government's "social insurance" programs: Social Security, Medicare, Railroad Retirement, and Black Lung. [25] For these programs, the SOSI reports: (1) the actuarial present value of all future program revenue (mainly taxes and premiums) - excluding interest - to be received from or on behalf of current and future participants; (2) the estimated future scheduled expenditures to be paid to or on behalf of current and future participants; and (3) the difference between (1) and (2). Amounts reported in the SOSI and in the RSI section in this *Financial Report* are based on each program's official actuarial calculations.

Table 7 summarizes amounts reported in the SOSI, showing that net social insurance expenditures are projected to be $49.0 trillion over 75 years as of January 1, 2017 for the "Open Group," an increase of $2.3 billion over net expenditures of $46.7 trillion projected in the 2016 *Financial Report*.[26] The current-law 2017 amounts reported for Medicare reflect the physician payment levels expected under the MACRA payment rules and the ACA-mandated reductions in other Medicare payment rates, but not the payment reductions and/or delays that would result from trust fund depletion.[27] Similarly, current-law projections for Social Security do not reflect benefit payment reductions and/or delays that would result from fund depletion. By accounting convention, the transfers of general revenues are eliminated in the consolidation of the SOSI at the governmentwide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations even though the expenditures on these programs are included. For the FY 2017 and 2016 SOSI, the amounts eliminated totaled $30.0 trillion and $28.7 trillion, respectively. SOSI programs and amounts are included in the broader fiscal sustainability analysis in the previous section, although on a slightly different basis (as described in Note 23).

The amounts reported in the SOSI provide perspective on the Government's long-term estimated exposures for social insurance programs. These amounts are not considered liabilities in an accounting context. Future benefit payments will be recognized as expenses and liabilities as they are incurred based on the continuation of the social insurance programs' provisions contained in current law. The social insurance trust funds account for all related program income and expenses. Medicare and Social Security taxes, premiums, and other income are credited to the funds; fund disbursements may only be made for benefit payments and program administrative costs. Any excess revenues are invested in special non-marketable U.S. Government securities at a market rate of interest. The trust funds represent the accumulated value, including interest, of all prior program surpluses, and provide automatic funding authority to pay cover future benefits.

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[25] The *Black Lung Benefits Act* (BLBA) provides for monthly payments and medical benefits to coal miners totally disabled from pneumoconiosis (black lung disease) arising from their employment in or around the nation's coal mines. See http://www.dol.gov/owcp/regs/compliance/ca_main.htm

[26] 'Closed' Group and 'Open' Group differ by the population included in each calculation. From the SOSI, the 'Closed' Group includes: (1) participants who have attained eligibility and (2) participants who have not attained eligibility. The 'Open' Group adds future participants to the 'Closed' Group. See 'Social Insurance' in the Required Supplementary Information section in this *Financial Report* for more information.

[27] The *Medicare Access and CHIP Reauthorization Act* (MACRA) of 2015 permanently replaces the sustainable growth rate (SGR) formula, which was used to determine payment updates under the Medicare physician fee schedule with specified payment updates through 2025. The changes specified in MACRA also establish differential payment updates starting in 2026 based on practitioners' participation in eligible alternative payment models; payments are also subject to adjustments based on the quality of care provided, resource use, use of certified electronic health records, and clinical practice improvement.

Table 7: Social Insurance Future Expenditures in Excess of Future Revenues				
Dollars in Trillions	**2017**	**2016**	Increase / (Decrease) **$**	**%**
Open Group (Net):				
Social Security (OASDI)	$ (15.4)	$ (14.1)	$ 1.3	9.2%
Medicare (Parts A, B, & D)	$ (33.5)	$ (32.5)	$ 1.0	3.1%
Other	$ (0.1)	$ (0.1)	$ 0.0	0.0%
Total Social Insurance Expenditures, Net (Open Group)	**$ (49.0)**	**$ (46.7)**	$ 2.3	4.9%
Total Social Insurance Expenditures, Net (Closed Group)	**$ (68.2)**	**$ (64.9)**	$ 3.3	5.1%
Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*				
Open Group				
Social Security (OASDI)	(1.2%)	(1.1%)		
Medicare (Parts A, B, & D)	(2.8%)	(2.7%)		
Other	0.0%	0.0%		
Total (Open Group)	**(4.0%)**	**(3.8%)**		
Total (Closed Group)	**(5.5%)**	**(5.3%)**		

Source: Statement of Social Insurance (SOSI). Amounts equal estimated present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain 'Social Insurance' programs (e.g., Social Security, Medicare). 'Open Group' totals reflect all current and projected program participants during the 75-year projection period. 'Closed Group' totals reflect only current participants.
* GDP values used are from the 2017 & 2016 Social Security and Medicare Trustees Reports and represent the present value of GDP over the 75-year projection period. As the GDP used for Social Security and Medicare differ slightly in the Trust Fund Reports, the two values are averaged to estimate the 'Other' and Total Net Social Insurance Expenditures as percent of GDP.

Table 8 identifies the principal reasons for the changes in projected social insurance amounts during 2017 and 2016.

Table 8: Changes in Social Insurance Projections		
Dollars in Trillions	**2017**	**2016**
Net Present Value (NPV) - Open Group (Beginning of the Year)	**$ (46.7)**	**$ (41.5)**
Changes In:		
Valuation Period	$ (2.0)	$ (1.7)
Demographic data and assumptions	$ (0.2)	$ 1.1
Economic data and assumptions[1]	$ (0.6)	$ (0.9)
Law or policy	$ -	$ 0.3
Economic and other healthcare assumptions[2]	$ (0.3)	$ (3.4)
Change in projection base[2]	$ 0.7	$ (0.6)
Net Change in Open Group measure	$ (2.3)	$ (5.2)
NPV - Open Group (End of the Year)	**$ (49.0)**	**$ (46.7)**

1 Relates to SSA.
2 Relates to HHS.
Note: Some totals may not equal sum of components due to rounding.

The following briefly summarizes the significant changes for the current valuation (as of January 1, 2017) as disclosed in Note 22, Social Insurance. See Note 22 for additional information.

- Change in valuation period (relates to both Social Security and Medicare): This change replaces a small negative net cash flow for 2016 with a much larger negative net cash flow for 2091. As a result, the present value of the estimated future net cash flows decreased (became more negative) by $2.0 trillion.

- Changes in economic data and assumptions (relates to Social Security only): For the current valuation, the only change to any of the ultimate assumptions was to the ultimate average real wage differential,[28] which was assumed to be 1.20 percent, an approximate 0.01 percent decrease from the previous year. The assumed real-wage differential for the first 10 years of the projection period was also lower than previous years. Otherwise, the ultimate economic assumptions for the current valuation period are the same as those for the prior year valuation. However, the starting economic values and the way these values transition to the ultimate assumptions were changed. Most significantly, an assumed weaker recovery from the recent recession than previously expected led to a reduction in the ultimate level of actual and potential GDP of about 1.0 percent for all years after the short-range period. Overall, changes to these assumptions caused the present value of the estimated future net cash flows to decrease (become more negative) by $576 billion.
- Change in Projection Base (relates to Medicare only): Actual income and expenditures in 2016 were different than what was anticipated when the 2016 Medicare Trustees Report projections were prepared. Part A income was higher and expenditures were lower than anticipated, based on actual experience. Part B total income and expenditures were higher than estimated based on actual experience. For Part D, actual income and expenditures were both lower than prior estimates. Actual experience of the Medicare Trust Funds between January 1, 2016 and January 1, 2017 is incorporated in the current valuation and is slightly more favorable than projected in the prior valuation. The net impact of the Part A, B, and D projection base changes is an increase (become less negative) in the estimated future net cash flow by $700 billion.

Projected net expenditures for Medicare Parts A and B declined significantly between FY 2009 and FY 2010 reflecting provisions of the ACA. As reported in Note 22, uncertainty remains about whether the projected cost savings and productivity improvements will be sustained in a manner consistent with the projected cost growth over time. Note 22 includes an alternative projection to illustrate the uncertainty of projected Medicare costs. As indicated earlier, GAO disclaimed opinions on the 2017, 2016, 2015, 2014 and 2013 SOSI because of these significant uncertainties.

Costs as a percent of GDP of both Medicare and Social Security, which are analyzed annually in the Medicare and Social Security Trustees' Reports, are projected to increase substantially through the mid-2030s because: (1) the number of beneficiaries rises rapidly as the baby-boom generation retires and (2) the lower birth rates that have persisted since the baby boom cause slower growth in the labor force and GDP.[29] According to the Medicare Trustees' Report, spending on Medicare is projected to rise from its current level of 3.6 percent of GDP to 5.6 percent in 2041 and to 5.9 percent in 2091.[30] As for Social Security, combined spending is projected to generally increase from its current level of 4.9 percent of GDP to about 6.1 percent by 2037, declining to 5.9 percent by 2050 and then generally increase to 6.1 percent by 2091. Table 9 summarizes additional current status and projected trend information for the Medicare and Social Security Trust Funds.

Table 9: Trust Fund Status

Fund	Projected Depletion	Projected Post-Depletion Trend
Medicare Hospital Insurance (HI)*	2029 (2028 in FY 2016 Report)	In 2029, trust fund income is projected to cover 88 percent of benefits, decreasing to 81 percent in 2041, then increasing to 88 percent by 2091.
Combined Old-Age Survivors and Disability Insurance (OASDI)**	2034 (unchanged from FY 2016 Report)	In 2034, trust fund income is projected to cover 77 percent of scheduled benefits, decreasing to about 73 percent by 2091.

* Source: 2017 Medicare Trustees Report ** Source: 2017 OASDI Trustees Report

Projections assume full Social Security and Medicare benefits are paid after fund depletion contrary to current law.

As previously discussed and as noted in the Trustees' Reports, it is apparent that these programs are on a fiscally unsustainable path. Additional information from the Trustees Reports may be found in the RSI section of this *Financial Report*.

[28] The real wage differential is the annual percentage change in the average covered wage, minus the annual percentage change in the CPI. Source: www.ssa.gov/oact/tr/2014/V_B_econ.html Item 4.
[29] 2017 Trustees Report for Medicare, pp. 5, 29.
[30] Percent of GDP amounts are expressed in gross terms (including amounts financed by premiums and state transfers).

Agency Audit Results, Systems, Controls, and Legal Compliance

Audit

Since the passage of the CFO Act of 1990, the federal financial community has made significant progress in financial accounting and reporting. As shown in Table 10, for FY 2017, 21 of the 24 CFO Act agencies obtained an opinion from the independent auditors on their financial statements.[31] In addition, 45 auditor-identified material weaknesses were reported at the beginning of FY 2017 and 40 were reported at the end of the year. An increasing number of federal agencies have adopted and maintained disciplined financial reporting operations, implemented effective internal controls over financial reporting, and integrated transaction processing with accounting records. These efforts improved the results of financial statement audits. However, weaknesses in financial management practices continue to prevent three of the CFO Act agencies, and the Government as a whole, from achieving an audit opinion.

Table 10: Audit Opinions and Auditor-Reported Material Weaknesses: FY 2017

Agency	Audit Opinion	Auditor-Reported Material Weaknesses				
		Beginning	New	Resolved	Consolidated	Ending
Department of Agriculture (USDA)	Unmodified/Not Audited	2	0	0	0	2
Department of Commerce (DOC)	Unmodified	0	1	0	0	1
Department of Defense (DOD)	Disclaimer	13	0	0	0	13
Department of Education (Education)	Unmodified	0	0	0	0	0
Department of Energy (DOE)*	Pending	0	Pending	Pending	Pending	Pending
Department of Health and Human Services (HHS)	Unmodified	1	0	0	0	1
Department of Homeland Security (DHS)	Unmodified	3	0	1	0	2
Department of Housing and Urban Development (HUD)	Disclaimer	11	1	1	2	9
Department of the Interior (DOI)	Unmodified	0	0	0	0	0
Department of Justice (DOJ)	Unmodified	0	0	0	0	0
Department of Labor (DOL)	Unmodified	2	1	2	0	1
Department of State (State)	Unmodified	0	0	0	0	0
Department of Transportation (DOT)	Unmodified	2	0	2	0	0
Department of the Treasury (Treasury)	Unmodified	1	0	0	0	1
Department of Veterans Affairs (VA)	Unmodified	6	1	0	1	6
Agency for International Development (USAID)	Unmodified	1	0	0	0	1
Environmental Protection Agency (EPA)	Unmodified	2	0	0	0	2
General Services Administration (GSA)	Unmodified	0	0	0	0	0
National Aeronautics and Space Administration (NASA)	Unmodified	0	0	0	0	0
National Science Foundation (NSF)	Unmodified	0	0	0	0	0
Nuclear Regulatory Commission (NRC)	Unmodified	0	0	0	0	0
Office of Personnel Management (OPM)	Unmodified	1	0	0	0	1
Small Business Administration (SBA)	Unmodified	0	0	0	0	0
Social Security Administration (SSA)	Unmodified	0	0	0	0	0
Totals		**45**	**5**	**7**	**3**	**40**

*Audit results for DOE were not available as of the issuance of this *Financial Report*.
Ending Total assumes DOE has zero material weaknesses as of September 30, 2017.

[31] The 21 agencies include HHS, which received unmodified ("clean") opinions on all statements except the SOSI and the SCSIA; DOL, which received clean opinions on all statements except the SCSIA; and USDA, which received a clean opinion only on its balance sheet. DOE expects to issue its audited AFR after the release of this *Financial Report*. For more information, see MD&A footnote #7.

Systems

Federal agencies improved, but continue to face challenges, in implementing financial management systems that meet federal requirements. The number of CFO Act agencies reporting lack of substantial compliance with one or more of the three Section 803(a) requirements of the *Federal Financial Management Improvement Act* (FFMIA) fell to eight in FY 2017 from nine in FY 2016, and the number of auditors reporting lack of substantial compliance with one or more of the three Section 803(a) FFMIA requirements fell to 10 in FY 2017 from 11 in FY 2016.[32]

Controls

Federal managers are responsible for developing and maintaining effective internal controls. Internal controls help to ensure effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The safeguarding of assets is a goal of each of these three objectives.

In response to major management challenges to achieving their mission and goals, agencies continue to recognize the utility of Enterprise Risk Management (ERM) as a tool to identify, assess, mitigate, manage and prepare for risk. ERM contributes to risk-informed decision-making, adopting a proactive rather than a reactive approach to risk, and fostering a risk-aware culture. Under ERM internal controls are not limited to compliance and financial reporting. Instead, internal controls are a means to address management challenges that cut across multiple agency functions. ERM is currently used in the private and public sectors in the U.S. and internationally, including by the governments of the United Kingdom, Canada, and Japan. OMB has promoted ERM as a management tool and the 2016 update to OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, explains ERM and the importance of integrating ERM with internal control processes.

OMB Circular No. A-123 implements the requirements of 31 U.S.C. 3512 (c), (d) (commonly known as the *Federal Managers' Financial Integrity Act* or FMFIA). The Circular's focus for internal controls is on providing agencies a framework for assessing and managing risks more strategically and effectively. The Circular reflects changes incorporated in GAO's updated Standards for Internal Control in the Federal Government and contains multiple appendices that address one or more of the objectives of effective internal control, specifically:

- Appendix A provides a methodology for agency management to assess, document, test, and report on internal controls over financial reporting;
- Appendix B requires agencies to maintain internal controls that reduce the risk of fraud, waste, and error in government charge card programs;
- Appendix C implements the requirements for effective estimation and remediation of improper payments; and
- Appendix D defines new requirements for determining compliance with the FFMIA that are intended to reduce the cost, risk, and complexity of financial system modernizations.

As noted above, the total number of reported material weaknesses for the CFO Act agencies as of the issuance of this *Financial Report* was 40[33] and 45 for FYs 2017 and 2016, respectively. Effective internal controls are a challenge at the agency level and at the governmentwide level, with GAO reporting that at the governmentwide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the Government in identifying and resolving internal control deficiencies, continued work is needed.

Legal Compliance

Federal agencies are required to comply with a wide range of laws and regulations, including appropriations, employment, health and safety, among others. Responsibility for compliance rests with agency management and compliance is addressed as part of agency financial statement audits. Agency auditors test for compliance with selected laws and regulations related to financial reporting and certain individual agency audit reports contain instances of noncompliance. None of these instances were material to the governmentwide financial statements; however, GAO reported that its work on compliance with laws and regulations was limited by the material weaknesses and scope limitations discussed in its report.

[32] The FY 2017 results do not include the Department of Energy (DOE). For FY 2016, DOE and its auditor noted no lack of compliance with one or more of the three section 803(a) requirements of the FFMIA. The FY 2016 results include DOD, HUD, and NSF, which were pending when the FY 2016 FR was released; DOD, HUD, and their auditors noted lack of compliance with one or more of the FFMIA section 803(a) requirements for FY 2016.

[33] The FY 2017 reported results do not include DOE, which had no material weaknesses in FY 2016. As shown in Table 10, if the number of material weaknesses for DOE does not change between FY 2016 and FY 2017, the total for CFO Act agencies for FY 2017 will be 40. The FY 2016 results include DOD, HUD, and NSF, which were pending when the FY 2016 FR was released; HUD's material weaknesses increased by two for 2016, which was not reflected in the FY 2016 FR.

Financial Management Progress and Priorities

Improving the Quality, Utility, and Transparency of Federal Financial Information

The *Digital Accountability and Transparency Act of 2014* (DATA Act), signed on May 9, 2014, sets forth a clear vision for the future of federal spending transparency. The Act amended the *Federal Funding Accountability and Transparency Act of 2006* (FFATA) by requiring that all federal spending be displayed on a website in searchable, downloadable, and machine-readable format and by requiring publication of agency financial data.

In May 2017, OMB and Treasury launched beta.USAspending.gov, a new website connecting financial and award data for the first time for more than 75 federal agencies and in August 2017, OMB and Treasury submitted to Congress a report on the pilot to Reduce Administrative Burden required under section 5 of the DATA Act. OMB and Treasury are continuing to make regular improvements to the completeness of the data and quality of the display.

In November 2017, the Government Accountability Office (GAO) and many agency Offices of Inspector General published audits of the quality of the data as required under the DATA Act. OMB, Treasury, and agencies are reviewing the results of these audits in order to make further improvements to the quality of the data and display in the coming year.

Improving the quality, utility and transparency of federal spending information reflects a commitment to openness, as identified in the U.S. Government's National Action Plan for Open Government.

Improving Program Efficiency

Payment Integrity

Addressing improper payments is necessary for legal compliance and the efficient use of financial resources. In FY 2017, OMB analyzed program-by-program improper payment data and concluded that it was more useful than aggregate improper payment data. For this reason, in November 2017, PaymentAccuracy.gov was updated with program-specific information, and now includes both the amount of improper payments that result in a monetary loss to the government and the amount of improper payments that does not result in monetary loss.

For FY 2017, there were improvements in four of the five programs with the highest payment error activity, including the Earned Income Tax Credit, Medicare Fee for Service (FFS), Medicaid, and Medicare Part C for both monetary and non-monetary losses; however, in some cases these improvements were in the statistical margin of error and may not represent actual changes in losses. Medicare FFS showed the largest improvement, reporting $36 billion in improper payments for FY 2017 compared to $41 billion in improper payments for FY 2016. This was primarily driven by the Centers for Medicare and Medicaid Services (CMS) ongoing efforts to provide more individualized provider education and clarification of Medicare coverage and documentation requirements. In FY 2017, agencies recovered approximately $20 billion in overpayments through payment recapture audits and other methods (just as in FY 2015 and 2016).

In FY 2018, OMB will with work with agencies, the Chief Financial Officers Council (CFOC), and other stakeholders to develop strategies to minimize and eliminate improper payments and to develop a comprehensive strategy that finds customized solutions for agencies that materially contribute to improper payments rates and methods to address root causes. In addition, OMB will continue to rely on agency IG recommendations for additional improvements that can be made in the prevention of improper payments within specific programs.

Other efforts to prevent improper payments leverage advanced data analytics and improved technologies. As part of the continuation of the Do Not Pay Initiative, the Treasury Working System provides agencies a single-point of entry to access data and matching services to help detect, prevent, and recover improper payments during the award or payment lifecycle. Treasury has also begun analyzing data across agencies to identify potential duplicative benefit payments in programs with related missions and beneficiaries. In addition, agency payment integrity tools include the CMS Fraud Prevention System (FPS); the Department of Defense (DOD) Business Activity Monitoring (BAM) tool; the Social Security Administration's (SSA) efforts to intercept payments to beneficiaries who have died or been incarcerated; and the Department of Labor's Unemployment Insurance (UI) Integrity Center of Excellence, a federal-state partnership that helps prevent, detect, and reduce improper payments in the UI program.

The Treasury Working System has 56 agencies performing matches against several databases (e.g., Death Master File, System for Award Management, Treasury Debt Check). In FY 2017, agencies screened over $1.3 billion payments through the Treasury Working System using their payment integration function. While the vast majority of these payments were determined to be proper, the Office of Personnel Management stopped over $25 million in improper payments. In addition to the Treasury Working System, the agency-specific integrity centers have demonstrated solid returns. Currently, SSA has 23 computer matching agreements that generate over $7 billion in annual savings. During FY 2016, HHS took administrative action against 1,044 providers and suppliers as a result of the CMS FPS, resulting in an estimated $527 million in identified savings. For FY 2017, the DOD BAM tool prevented $1.4 billion in improper payments in DOD's commercial payment systems.

Combating improper payments within the federal government is a priority for OMB and agencies who will work to share government data while maintaining privacy. Going forward, the goal of data transparency is to provide relevant granularity that makes it easier for agencies to take action on root cause issues.

Grants Management

The federal government awards approximately $700 billion in federal financial assistance each year to state and local governments and nonprofit organizations. Federal agencies have oversight responsibilities for the funds that they award to nonfederal entities. The effective and efficient oversight of these awards helps agencies to achieve mission success while protecting these resources from fraud, waste, and mismanagement and improper payment. Federal awarding agencies are taking measures to address areas where needed improvement in federal oversight has been identified. The Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, 2 CFR 200 (Uniform Guidance), issued in December of 2014, is the authoritative OMB guidance governing federal financial assistance, which is comprised primarily of grants.

Since adoption of the Uniform Guidance, OMB and 28 federal awarding agencies have been diligently working to implement these requirements.

In addition to Uniform Guidance implementation, OMB in collaboration with the former Council on Financial Assistance Reform (COFAR) and the CFOC recently published the Financial Assistance Career Roadmap. This Roadmap is intended to serve as a resource for agencies and financial assistance professionals to ensure that they have the proper skills and competencies to perform their duties. OMB and COFAR also developed an interactive on-line Grant Training program, consisting of five modules, to aid agencies in training their staff in grant requirements and management.

Starting with FY 2015 submissions, all annual Single Audits of grantees that expend more than $750,000 in federal funds (approximately 38,000) have been available publicly on the Federal Audit Clearinghouse website (https://harvester.census.gov/facweb/Default.aspx). These compliance audits are a valuable tool for agencies and pass-through entities to monitor and manage federal funds efficiently and effectively.

OMB and the federal awarding agencies are committed to working together to continue to ensure that the government promotes effective stewardship over its federal financial assistance funds.

Enhancing Program Efficiency through Mission Support

Mission Support Services and Financial IT

The federal financial management infrastructure exists in a complex environment of legacy information technology, customized tools built to unique requirements, and business processes, that do not fully leverage modern technology. The sharing of financial technology and services has been successful for smaller agencies, but has not met expectations for larger agencies. A cross-agency subgroup of the CFOC developed the core business framework for financial management that was used in the fall of 2017 to explore industry capabilities for smarter use of technology in federal financial management. This information will be included in overall efforts to develop and implement recommendations and solutions that can improve federal financial management.

Efficient Use of Real Property Assets

The federal domestic building inventory is diverse and contains 252,000 buildings requiring approximately $18.8 billion in annual operation and maintenance expenditures, including approximately $7.3 billion in annual lease costs. The domestic portfolio is 2.6 billion square feet in size and the total replacement value of the government's 232,000 owned buildings is approximately $1 trillion, with a repair need of $115 billion. Within both the owned and leased inventories, there are opportunities to realize cost savings by utilizing space more efficiently and reducing the portfolio. In 2013, the "Freeze the Footprint" (FTF) Policy (OMB Management Procedures Memorandum 2013-02) was issued, requiring agencies to freeze their real property footprint. From FY 2013 to FY 2015, when the FTF policy expired, agencies reduced their federal domestic office and warehouse space by 24.7 million square feet. OMB estimates that this 24.7 million square foot reduction will generate $370 million of annual cost avoidance for the government from FY 2016 onward. To improve the quality of federal real property data in annual Performance and Accountability Reports (PARs) or Agency Financial Reports (AFRs), agencies were required to validate and report "Freeze the Footprint" square footage and associated operations and maintenance costs in their 2014 through 2016 PARs or AFRs.

In FY 2017, the Government issued the National Strategy for the Efficient Use of Real Property (Strategy) and its companion implementation policy, the Reduce the Footprint (RTF) policy. The Strategy provides a strategic framework for agencies to measure the efficiency of their real property portfolios in order to identify and prioritize efficiency actions that reduce portfolio size and cost.

The RTF policy requires that agencies reduce the size of the federal real property portfolios to improve utilization of government-owned buildings and reduce reliance on leasing, lower the number of excess and underutilized properties, and improve the cost effectiveness and efficiency of the federal real property portfolio. Agencies have developed and annually update five-year Real Property Efficiency Plans (Plans) to identify reductions to their portfolios over a five-year time-period. In FY 2016, agencies reduced their FY 2015 RTF baselines by 11.2 million square feet, resulting in an annual estimated cost avoidance of $100 million. During the FY 2017 to FY 2021 timeframe, the agencies' Plans target a net office and warehouse reduction of 22.4 million square feet and a reduction of 49.4 million square feet in owned space. The magnitude of the reduction targets indicates that the Strategy and RTF policy will be effective tools to improve the efficiency of the

Government's real property portfolio. Agencies will update their Plans and annual reduction targets in March of 2018. Agencies will continue to validate square footage and operations and maintenance costs in their PARs or AFRs under RTF.

Efficiency will be further improved by OMB's implementation of the Federal Assets Sale and Transfer Act of 2016 (FASTA) and the Federal Property Management Reform Act of 2016 (FPMRA). The RTF Plans help the agencies identify projects appropriate for inclusion in the FASTA process. To date, OMB has met all of its responsibilities under FASTA and FPMRA by the required deadlines.

To support increased reduction targets, the General Services Administration and OMB have developed a new management tool within the Federal Real Property Profile (FRPP) database that enables agencies to fully analyze the efficiency of their portfolios and to collocate with other agencies. The new management tool uses real property performance metrics to measure the efficiency of agencies' portfolios and thereby enable the identification and prioritization of improvement opportunities. The management tool and the improved FRPP data quality resulting from the implementation of GSA's technical guidance issued in FY 2017 (to establish mandatory FRPP data validation and verification requirements), will enhance agencies' abilities to implement data driven decision making when developing their annual RTF reduction targets. Focusing policy on reducing the portfolio, improving the quality of FRPP data through mandatory data validation and verification procedures, and the broad use of the new FRPP management tool will support higher RTF square foot reduction targets and efficiency gains in future years.

Conclusion

The federal government has seen significant progress in financial management since the passage of the CFO Act more than 20 years ago; yet significant challenges remain. The issues that the federal government faces today require financial managers to move beyond the status quo and improve both the efficiency and effectiveness of financial management activities. The steps outlined above leverage the tools and capacities that are in place today, and refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency of our operations and information technology, and laying a foundation for improved data quality and collaboration.

Additional Information

This *Financial Report's* Appendix contains the names and websites of the significant Government entities included in the *Financial Report's* financial statements. Details about the information in this *Financial Report* can be found in these entities' financial statements included in their Performance and Accountability and Agency Financial Reports. This *Financial Report*, as well as those from previous years, is also available at the Treasury, OMB, and GAO websites at: http://www.fiscal.treasury.gov/fsreports/fs_reports_publications.htm; https://www.whitehouse.gov/omb/management/office-federal-financial-management/; and http://www.gao.gov/financial.html, respectively. Other related Government publications include, but are not limited to the:

- *Budget of the United States Government,*
- *Treasury Bulletin,*
- *Monthly Treasury Statement of Receipts and Outlays of the United States Government,*
- *Monthly Statement of the Public Debt of the United States,*
- *Economic Report of the President, and*
- *Trustees' Reports for the Social Security and Medicare Programs.*

Limitations of the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the federal government; the financial condition and changes in financial condition of its social insurance programs; and the federal government's projected long-term trends in receipts, spending, and debt, pursuant to the requirements of 31 U.S.C. § 331(e)(1). These statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.