MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The Fiscal Year *2019 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), Treasury, in cooperation with OMB, must submit an audited (by GAO) financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the U.S. 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 financial information provided by 162 federal consolidation entities (see organizational chart on the next page and Appendix A). As it has for the past 22 years, GAO issued a disclaimer of opinion on the accrual-based, consolidated financial statements for the fiscal years ended September 30, 2019 and 2018. GAO also issued a disclaimer of opinion on the sustainability financial statements, which consist of the 2019 and 2018 SLTFP; the 2019, 2018, 2017, 2016, and 2015 SOSI; and the 2019 and 2018 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 GAAP. In fiscal year 2019, 35[2] of the 40 most significant entities earned unmodified ("clean") opinions on their financial statements.

The fiscal year 2019 *Financial Report* consists of:

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

This *Financial Report* addresses the government's financial activity and results as of and for the fiscal years ended September 30, 2019 and 2018. Note 27, *Subsequent Events* discusses events that occurred after the end of the fiscal year that may affect the government's financial position and condition.

In addition, the Results in Brief and 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 is organized.

---

[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 fiscal year 1997. The consolidated financial statements include the legislative and judicial branches.

[2] The 35 entities include the Department of Health and Human Services, which received disclaimers of opinion on its 2019, 2018, 2017, 2016, and 2015 SOSI and on its 2019 and 2018 SCSIA.

Exhibit 1

THE UNITED STATES GOVERNMENT

THE CONSTITUTION

LEGISLATIVE BRANCH

THE CONGRESS
SENATE HOUSE

Architect of the Capitol
U.S. 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 U.S.

U.S. Courts of Appeals
U.S. District Courts
Territorial Courts
U.S. Court of International Trade
U.S. Court of Federal Claims
Administrative Office of the U.S. Courts
Federal Judicial Center
U.S. Sentencing Commission

CHIEF FINANCIAL OFFICERS ACT AGENCIES (24)

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 THE TRANSPORTATION
DEPARTMENT OF THE TREASURY
DEPARTMENT OF VETERANS AFFAIRS
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

SIGNIFICANT CONSOLIDATION ENTITIES (16)

EXPORT-IMPORT BANK OF THE U.S.
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
NATIONAL RAILROAD RETIREMENT INVESTMENT TRUST
OVERSEAS PRIVATE INVESTMENT CORPORATION
PENSION BENEFIT GUARANTY CORPORATION
RAILROAD RETIREMENT BOARD
SECURITIES AND EXCHANGE COMMISSION
SECURITY ASSISTANCE ACCOUNTS
SMITHSONIAN INSTITUTION
TENNESSEE VALLEY AUTHORITY
U.S. POSTAL SERVICE

OTHER CONSOLIDATION ENTITIES LISTED IN APPENDIX A OF THIS FINANCIAL REPORT (122)

The Government's Financial Position and Condition

This *Financial Report* presents 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

	2019	2018*	Increase / (Decrease) $	Increase / (Decrease) %
FINANCIAL MEASURES (Dollars in Billions)				
Gross Cost	**$ (5,287.2)**	**$ (4,808.5)**	**$ 478.7**	**10.0%**
Less: Earned Revenue	$ 418.4	$ 392.8	$ 25.6	6.5%
Gain/(Loss) from Changes in Assumptions	$ (198.9)	$ (125.2)	$ 73.7	58.9%
Net Cost	**$ (5,067.7)**	**$ (4,540.9)**	**$ 526.8**	**11.6%**
Less: Tax and Other Revenues	**$ 3,621.0**	**$ 3,384.3**	**$ 236.7**	**7.0%**
Unmatched Transactions & Balances	$ 1.6	$ (2.4)	$ 4.0	(166.7%)
Net Operating Cost	**$ (1,445.1)**	**$ (1,159.0)**	**$ 286.1**	**24.7%**
Budget Deficit	**$ (984.4)**	**$ (779.0)**	**$ 205.4**	**26.4%**
Assets:				
Cash & Other Monetary Assets	$ 524.6	$ 507.5	$ 17.1	3.4%
Loans Receivable, Net	$ 1,425.8	$ 1,419.1	$ 6.7	0.5%
Inventories & Related Property, Net	$ 355.7	$ 337.5	$ 18.2	5.4%
Property, Plant & Equipment, Net	$ 1,106.9	$ 1,090.5	$ 16.4	1.5%
Other	$ 579.0	$ 482.1	$ 96.9	20.1%
Total Assets	**$ 3,992.0**	**$ 3,836.7**	**$ 155.3**	**4.0%**
Liabilities:				
Federal Debt Held by the Public & Accrued Interest	$ (16,861.0)	$ (15,812.7)	$ 1,048.3	6.6%
Federal Employee & Veteran Benefits	$ (8,440.3)	$ (7,982.3)	$ 458.0	5.7%
Other	$ (1,643.5)	$ (1,562.4)	$ 81.1	5.2%
Total Liabilities	**$ (26,944.8)**	**$ (25,357.4)**	**$ 1,587.4**	**6.3%**
Net Position (Assets minus Liabilities)	**$ (22,952.8)**	**$ (21,520.7)**	**$ 1,432.1**	**6.7%**
SUSTAINABILITY MEASURES (Dollars in Trillions)				
Social Insurance Net Expenditures:				
Social Security (OASDI)	$ (16.8)	$ (16.2)	$ 0.6	3.7%
Medicare (Parts A, B, & D)	$ (42.2)	$ (37.7)	$ 4.5	11.9%
Other	$ (0.1)	$ (0.1)	$ -	- %
Total Social Insurance Net Expenditures	**$ (59.1)**	**$ (54.0)**	**$ 5.1**	**9.4%**
Total Federal Non-Interest Net Expenditures	**$ (49.0)**	**$ (46.2)**	**$ 2.8**	**6.1%**
75-Year Fiscal Gap (Percent of Gross Domestic Product)[1]	**(3.8%)**	**(4.1%)**	**(0.3%)**	**(7.3%)**

*Restated (see Financial Statement Note 1.U)

[1]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 3.8 percent of GDP on average is needed (4.1 percent of GDP on average in 2018). See Financial Statement Note 23.

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

- During fiscal year 2019, the budget deficit increased by $205.4 billion (26.4 percent) to $984.4 billion and net operating cost increased by $286.1 billion (24.7 percent) to $1.4 trillion.
- The government's gross costs of $5.3 trillion, less $418.4 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 $198.9 billion in net losses from changes in assumptions (e.g., interest rates, inflation, disability claims rates) yields the government's net cost of $5.1 trillion, an increase of $526.8 billion or 11.6 percent over fiscal year 2018.
- Deducting $3.6 trillion in tax and other revenues, with some adjustment for unmatched transactions and balances, results in a "bottom line" net operating cost of $1.4 trillion for fiscal year 2019, an increase of $286.1 billion or 24.7 percent over fiscal year 2018.
- Comparing total 2019 government assets of $4.0 trillion to total liabilities of $26.9 trillion (comprised mostly of $16.9 trillion in federal debt held by the public and accrued interest payable[3], and $8.4 trillion of federal employee and veterans benefits payable) yields a negative net position of $23.0 trillion.
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2019, debt held by the public, excluding accrued interest, was $16.8 trillion. This amount, plus intragovernmental debt ($6.0 trillion) equals gross federal debt, which, with some adjustments, is subject to the statutory debt limit. As of September 30, 2019, the government's total debt subject to the debt limit was $22.7 trillion. The statutory debt limit was most recently suspended through July 31, 2021.

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 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 $49.0 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 $59.1 trillion, a $5.1 trillion increase over 2018 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. 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 $779.0 billion in fiscal year 2018 to $984.4 billion in fiscal year 2019. The deficit-to-GDP ratio in 2019 was 4.6 percent, an increase from 3.8 percent in fiscal year 2018 and above the 3.2 percent average over the past 40 years.[6]
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2019, the $16.8 trillion in debt held by the public, excluding accrued interest, equates to approximately 79 percent of GDP.
- The 2019 SOSI projection of $59.1 trillion net PV excess of expenditures over receipts over 75 years represents about 4.1 percent of the PV of GDP over 75 years. The excess of total projected non-interest spending over receipts of $49.0 trillion from the SLTFP represents 3.2 percent of GDP over 75 years. As discussed in this *Financial Report*, changes in 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 3.8 percent of GDP on average is needed (4.1 percent of GDP on average in the 2018 projections). The fiscal gap represents 20.3 percent of 75-year present value receipts and 17.4 percent of 75-year present value non-interest spending.

---

[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, FRB, 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 transfers from the General Fund, which are presented, and by accounting convention, eliminated in the SOSI. For the fiscal year 2019 and 2018 SOSI, the amounts eliminated totaled $36.8 trillion and $32.9 trillion, respectively.

[6] Final Monthly Treasury Statement (as of September 30, 2019 and 2018), Joint Statement of Treasury Secretary Steven T. Mnuchin and Acting OMB Director Russel Vought on Budget Results for Fiscal Year 2019

Fiscal Year 2019 Financial Statement Audit Results

For fiscal year 2019, GAO issued a disclaimer of audit opinion on the accrual-based, governmentwide financial statements, as it has for the past 22 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 232 of this *Financial Report*, discusses GAO's findings.

Twenty-two of the 24 entities required to issue audited financial statements under the CFO Act received unmodified audit opinions, as did 13 of 16 additional significant consolidation entities (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. SFFAS No. 47, *Reporting Entity*, provides criteria for identifying organizations that are consolidation entities, disclosure entities, and related parties. Such criteria are summarized in Note 1A and in Appendix A, which lists the entities included in this *Financial Report* by these categories. The assets, liabilities, results of operations, and related activity for consolidation entities are consolidated in the financial statements.

Fannie Mae and Freddie Mac meet the criteria for disclosure entities and, consequently, are not consolidated into the government's financial statements. However, the values of the investments in such entities, changes in value, and related activity with these entities are included in the consolidated financial statements. The FR System is a disclosure entity and is not consolidated into the government's financial statements. See Note 1A—Significant Accounting Policies, Reporting Entity and Note 25—Disclosure Entities and Related Parties for additional information. In addition, per SFFAS No. 31, *Accounting for Fiduciary Activities*, fiduciary funds are not consolidated in the government financial statements.[8]

Most significant consolidation entities prepare financial reports that include financial and performance related information, as well as Annual Performance Reports. More information may be obtained from entities' websites indicated in Appendix A and at https://www.performance.gov/.

The following pages contain a more detailed discussion of the government's financial results for fiscal year 2019, 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*, 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* 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 GAAP for federal entities.[9] These principles are tailored to the government's unique characteristics and circumstances. For example, entities 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.

[7] The 22 entities include the Department of Health and Human Services, which received disclaimers of opinions on its 2019, 2018, 2017, 2016, and 2015 SOSI and its 2019 and 2018 SCSIA. The 13 entities include the FDIC, the NCUA, and the FCSIC, which operate on a calendar year basis (December 31 year-end). Statistic reflects 2018 audit results for these organizations if 2019 results are not available.

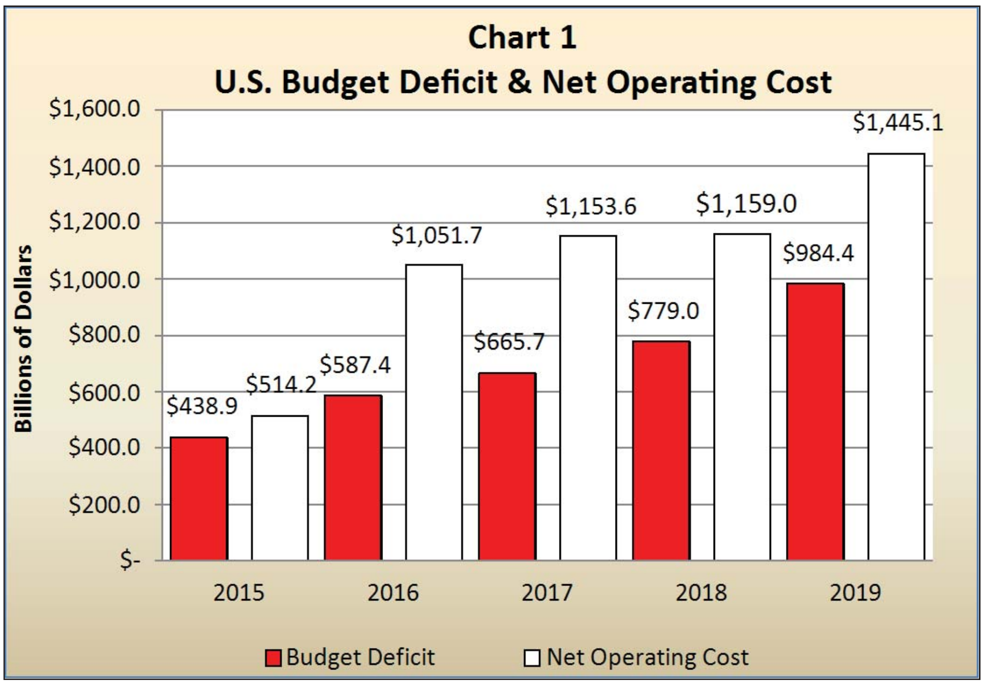
[8] See Note 21—Fiduciary Activities

[9] Under GAAP, most U.S. government revenues are recognized on a 'modified cash' basis, (see Financial Statement Note 1.B). 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, RRP; and 25 years for the Black Lung program. The Statement of Long-Term Fiscal Projections presents the 75-year 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*" • Entity-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 1, 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 $205.4 billion (about 26.4 percent) from approximately $779.0 billion in fiscal year 2018 to about $984.4 billion in fiscal year 2019 due to lower growth in receipts compared to the increase in outlays in fiscal year 2019. The $133.5 billion (4.0 percent) increase in receipts can be attributed primarily to higher social insurance and retirement receipts, net individual income tax receipts, customs duties, net corporation income tax receipts, and excise taxes, partially offset by lower deposits of earnings by the Federal Reserve, and other miscellaneous receipts. Outlays increased $338.9 billion (8.3 percent). Contributing to the dollar increase over fiscal year 2018 were higher outlays for Medicare, Defense, Medicaid, Social Security, and interest on the Treasury debt held by the public (public debt).[11]

The Treasury Department's September 2019 MTS is the source of receipts, spending, and deficit information for this Report. The MTS presents primarily cash-based spending, or outlays, for the fiscal year in a number of ways, including by month, by entity, and by budget function classification. The federal budget is divided into approximately 20 categories, or budget functions, as a means of organizing federal spending by primary purpose (e.g., National Defense, Transportation, and Health). Multiple entities may contribute to one or more budget functions, and a single budget function may be associated

[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.
[11] 10/25/19 press release -- Joint Statement of Treasury Secretary Steven T. Mnuchin and OMB Director Mick Mulvaney on Budget Results for Fiscal Year 2019.

with only one entity. For example, DOD, DHS, DOE, and multiple other entities administer programs that are critical to the broader functional classification of National Defense. DOD, OPM, and many other entities also administer Income Security programs (e.g., retirement benefits, housing, financial assistance). By comparison, the Medicare program is a budget function category unto itself and is administered exclusively at the federal level by HHS. Federal spending information by budget function and other categorizations may be found in the September 2019 MTS.[12]

The government’s largely accrual-based net operating cost increased by $286.1 billion (24.7 percent) to $1.4 trillion during fiscal year 2019. As explained below, net operating costs are affected by both changes in revenues and costs.

Table 2 provides a summary of the items reported in the *Reconciliation of Net Operating Cost and Budget Deficit*, which articulates the relationship between the government’s accrual-based net operating cost and the primarily cash-based budget deficit. From Table 2, the $460.7 billion net difference between the government’s budget deficit and net operating cost for fiscal year 2019, is mostly attributable to: (1) a $458.0 billion net increase in liabilities for federal employee and veteran benefits payable; (2) a $24.3 billion increase in insurance and guarantee program liabilities; (3) an $18.1 billion increase in environmental and disposal liabilities; (4) an $89.1 billion increase in taxes receivable; and (5) a $45.3 billion timing difference between when credit reform costs are recorded in the budget versus net operating cost.

Table 2: Net Operating Cost vs. Budget Deficit

Dollars in Billions		2019		2018*
Net Operating Cost	**$**	**(1,445.1)**	**$**	**(1,159.0)**
Change in:				
Federal Employee and Veteran Benefits Payable	$	458.0	$	282.2
Insurance and guarantee program liabilities	$	24.3	$	(32.3)
Environmental and disposal liabilities	$	18.1	$	112.8
Taxes Receivable	$	(89.1)	$	(7.8)
Timing Differences - Credit Reform Costs	$	45.3	$	5.0
Other, Net	$	4.1	$	20.1
Subtotal - Net Difference:	$	460.7	$	380.0
Budget Deficit	**$**	**(984.4)**	**$**	**(779.0)**

*Restated (see Financial Statement Note 1.U)

[12] Final Monthly Treasury Statement for Fiscal Year 2019 through September 30, 2019 and Other Periods.

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. [13]

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

Dollars in Billions		2019		2018*		Increase / (Decrease) $	%
Gross Cost	**$**	**(5,287.2)**	**$**	**(4,808.5)**	**$**	**478.7**	**10.0%**
Less: Earned Revenue	$	418.4	$	392.8	$	25.6	6.5%
Gain/(Loss) from Changes in Assumptions	$	(198.9)	$	(125.2)	$	73.7	58.9%
Net Cost	**$**	**(5,067.7)**	**$**	**(4,540.9)**	**$**	**526.8**	**11.6%**
Less: Tax and Other Revenues	**$**	**3,621.0**	**$**	**3,384.3**	**$**	**236.7**	**7.0%**
Unmatched Transactions and Balances	$	1.6	$	(2.4)	$	4.0	(166.7%)
Net Operating Cost	**$**	**(1,445.1)**	**$**	**(1,159.0)**	**$**	**286.1**	**24.7%**

*Restated (see Financial Statement Note 1.U)

Table 3 shows that the government's "bottom line" net operating cost increased $286.1 billion (24.7 percent) during 2019 from $1.2 trillion to $1.4 trillion. This increase is due mostly to a $526.8 billion (11.6 percent) increase in entity net costs, which more than offset a $236.7 billion (7.0 percent) increase in tax and other revenues over the past fiscal year as discussed in the following.

Gross Cost and Net Cost

The Statement of Net Cost starts with the government's total gross costs of $5.3 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 $5.1 trillion (See Chart 2), a $526.8 billion (11.6 percent) increase over fiscal year 2018.

Typically, the annual change in the government's net cost is impacted by a variety of offsetting increases and decreases across entities. For example, offsetting changes in net cost during fiscal year 2019 included:

- Entities 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, these net losses from changes in assumptions amounted to $198.9 billion in fiscal year 2019, a loss increase (and a corresponding net cost increase) of $73.7 billion compared to fiscal year 2018. The primary entities that administer programs impacted by these assumptions – typically federal employee pension and benefit programs – are the OPM, VA, and DOD. These

[13] 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 entities. These amounts are described in greater detail in the Other Information section of this *Financial Report*.

entities recorded losses from changes in assumptions in the amounts of $0.3 billion, $58.0 billion, and $139.0 billion, respectively.

- o These actuarial estimates and the resulting gains or losses from changes in assumptions can sometimes cause significant swings in total entity costs from year to year. For example, for fiscal year 2019, changes in net cost at OPM ($9.4 billion decrease), VA ($70.7 billion increase), and DOD ($210.0 billion increase), were impacted by the corresponding changes in gains or losses from assumption changes at these entities.

- A $210.0 billion increase at DOD primarily due to a $122.2 billion loss increase from changes in assumptions as referenced above as well as increases in net costs across DOD's major programs, including military operations, readiness, support; procurement; military personnel; and R&D;
- $79.8 billion and $62.6 billion increases at HHS and SSA, respectively, were primarily due to cost increases of the benefit programs that these entities administer (HHS – Medicare and Medicaid programs, SSA – OASDI programs);
- A $70.7 billion net increase at VA due largely to actuarial losses from experience.
- An $87.3 billion decrease at DOE largely due to refined environmental liability estimates, including comparatively lower estimate increases as well as estimates related to dilution and disposal strategies for surplus plutonium;
- A $74.2 billion increase at Education stemming mostly from reestimates of subsidy expenses associated with its direct loan programs, including changes in estimation methods and comparative cost increases for Education's Income-Driven Repayment (IDR) plans[14] as well as enhancements in estimation methodology with respect to deferment and forbearance actions; and
- A $46.3 billion increase in interest on debt held by the public due largely to an increase in the debt. Interest costs increased by 13.0 percent from 2018 to 2019 and by 60.9 percent over the past five years.

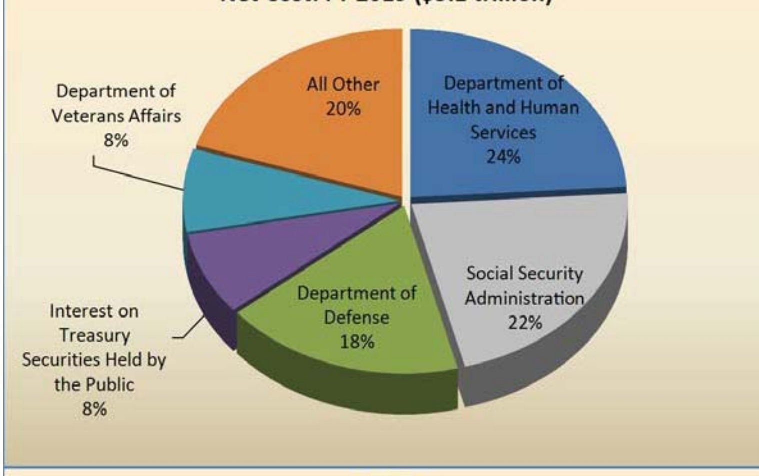


Chart 2
Net Cost: FY 2019 ($5.1 trillion)

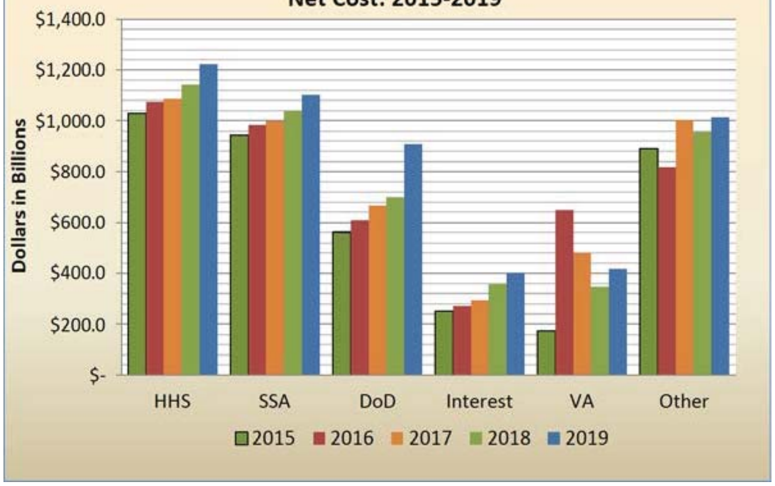


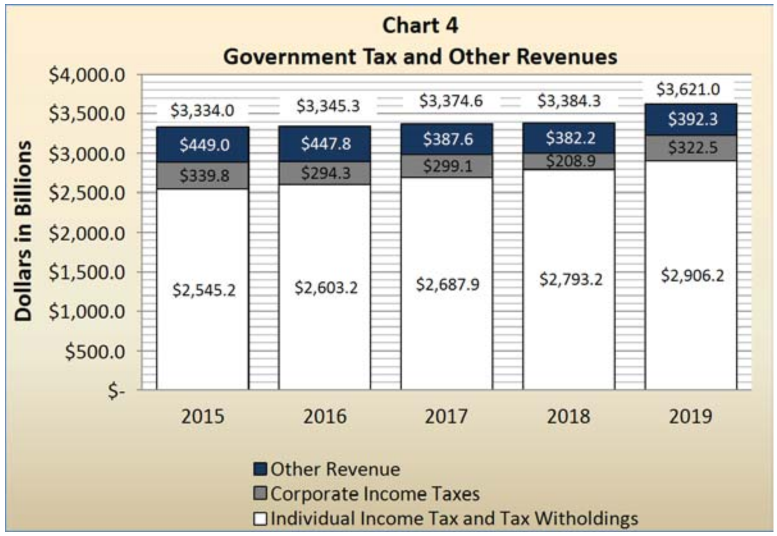
Chart 3
Net Cost: 2015-2019

Chart 2 shows the composition of the government's net cost. In fiscal year 2019, nearly three fourths of total net cost came from HHS, SSA, DOD, and VA. Interest on Treasury securities (i.e., debt) held by the public contributed an additional 8 percent, and the other entities included in the government's fiscal year 2019 Statement of Net Cost accounted for a combined 20 percent of the government's total net cost for fiscal year 2019. Chart 3 shows the five-year trend in these costs. These entities have consistently incurred the largest entity shares of the government's total net cost in recent years. As indicated above, HHS and SSA net costs for fiscal year 2019 ($1.2 trillion and $1.1 trillion, respectively) are attributable to major social insurance programs administered by these entities. DOD net costs of $908.4 billion relate primarily to operations, readiness, and support; personnel; research; procurement; and retirement and health benefits. VA costs of $417.6 billion support health, education and other benefits programs for our nation's veterans. From Chart 3, over the past five years, HHS, SSA, DOD, VA, and Interest costs have increased 18.7 percent, 16.5 percent, 61.7 percent, 138.2 percent, and 60.9 percent, respectively.

[14] Traditionally, federal student loans have had flat, 10-year repayment schedules, making it difficult for borrowers to pay at the start of their careers when their salaries are lower. The recent expansion of IDR plans provides flexible repayment schedules based on the borrower's monthly income. Education's Agency Financial Report, p. 23-24.

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 4 shows that total tax and other revenue increased by $236.7 billion or 7.0 percent to $3.6 trillion for fiscal year 2019. This increase is attributable mainly to an overall growth in individual income tax collections and withholdings, partially offset by reduced deposit of earnings from the FR System.[15] Tax revenues and receivables also increased as a result of a provision of the TCJA, which provided a one-time tax on previously unrepatriated foreign earnings at lower rates that taxpayers may elect to pay over several years. In particular, these provisions contributed $83.5 billion of a total $113.6 billion increase in corporate income tax revenue for fiscal year 2019. Earned revenues from Table 3 are not considered "taxes and other revenue" and, thus, are not shown in Chart 4. Individual income tax and tax withholdings and corporate income taxes accounted for about 80.3 percent and 8.9 percent of total revenue, respectively in fiscal year 2019; other revenues from Chart 4 include Federal Reserve earnings, excise taxes, unemployment taxes, and customs duties.



As previously shown in Table 3, the increase in tax and other revenue only partially offset the increase in net cost, resulting in a $286.1 billion increase in the government's bottom line net operating cost to $1.4 trillion for fiscal year 2019.

Tax Expenditures

Tax and other revenues reported reflect the effects of tax expenditures, which are special exclusions, exemptions, deductions, tax credits, preferential tax rates, and tax deferrals that allow individuals and businesses to reduce taxes they may otherwise owe. Tax expenditures may be viewed as alternatives to other policy instruments, such as spending or regulatory programs. For example, the government supports college attendance through both spending programs and tax expenditures. The government uses Pell Grants to help low- and moderate-income students afford college and allows certain funds used to meet college expenses to grow tax free in special college savings accounts. Tax expenditures may include deductions and exclusions which reduce the amount of income subject to tax (e.g., deductions for personal residence mortgage interest). Tax credits, which reduce tax liability dollar for dollar for the amount of credit (e.g., child tax credit), are also considered tax expenditures. Tax expenditures may also allow taxpayers to defer tax liability.

Receipts in the calculation of surplus or deficit, and tax revenues in the calculation of net position, reflect the effect of tax expenditures. As discussed in more detail in the Other Information section of this *Financial Report*, tax expenditures will generally lower federal government receipts although tax expenditure estimates do not necessarily equal the increase in federal revenues (or the change in the budget balance) that would result from repealing these special provisions.

Tax expenditures are reported annually in the Analytical Perspectives of the *Budget*. In addition, current and past tax expenditure estimates and descriptions can be found at the following location from the U.S. Treasury's Office of Tax Policy: https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures.

---

[15] Fiscal year 2019 Department of the Treasury AFR, p. 36

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 of the government, 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 MD&A section, the financial statements, and RSI sections of this *Financial Report.*

Table 4: Assets and Liabilities

Dollars in Billions	2019	2018*	Increase / (Decrease) $	Increase / (Decrease) %
Assets				
Cash & Other Monetary Assets	$ 524.6	$ 507.5	$ 17.1	3.4%
Loans Receivable, Net	$ 1,425.8	$ 1,419.1	$ 6.7	0.5%
Inventories & Related Property, Net	$ 355.7	$ 337.5	$ 18.2	5.4%
Property, Plant & Equipment, Net	$ 1,106.9	$ 1,090.5	$ 16.4	1.5%
Other	$ 579.0	$ 482.1	$ 96.9	20.1%
Total Assets	**$ 3,992.0**	**$ 3,836.7**	**$ 155.3**	**4.0%**
Less: Liabilities, comprised of:				
Federal Debt Held by the Public & Accrued Interest	$ (16,861.0)	$ (15,812.7)	$ 1,048.3	6.6%
Federal Employee & Veteran Benefits	$ (8,440.3)	$ (7,982.3)	$ 458.0	5.7%
Other	$ (1,643.5)	$ (1,562.4)	$ 81.1	5.2%
Total Liabilities	**$ (26,944.8)**	**$ (25,357.4)**	**$ 1,587.4**	**6.3%**
Net Position (Assets Minus Liabilities)	**$ (22,952.8)**	**$ (21,520.7)**	**$ 1,432.1**	**6.7%**

*Restated (see Financial Statement Note 1.U)

Assets

As of September 30, 2019, the government's $4.0 trillion in assets are comprised mostly of net loans receivable ($1.4 trillion) and net PP&E ($1.1 trillion).[16]

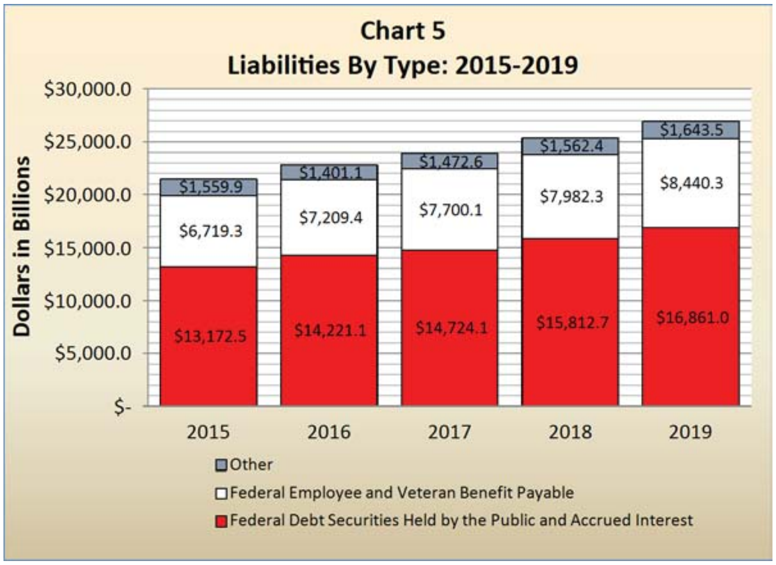
The federal government's direct loans and loan guarantee programs are used to promote the nation's welfare by making financing available to segments of the population not served adequately by non-federal institutions, or otherwise providing for certain activities or investments. For those unable to afford credit at the market rate, federal credit programs provide subsidies in the form of direct loans offered at an interest rate lower than the market rate. For those to whom non-federal financial institutions are reluctant to grant credit because of the high risk involved, federal credit programs guarantee the payment of these non-federal loans and absorb the cost of defaults. For example, Education supports individuals engaged in education programs through a variety of student loan, grant and other assistance programs. USDA administers loan programs to support the nation's farming and agriculture community. Also, HUD loan programs support affordable homeownership, as well as the construction and rehabilitation of housing projects for the elderly and persons with disabilities. From Financial Statement Note 4, Education's Federal Direct Student Loan Program accounted for $1.1 trillion (78.8 percent) of total net loans receivable. Education's direct student loan program receivables balances have grown by more than 190 percent since fiscal year 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.[17]

Federal government PP&E includes many of the physical resources that are vital to the federal government's ongoing operations, including buildings, structures, facilities, equipment, internal use software, and general purpose land. DOD comprises approximately 69.4 percent of the government's reported PP&E of $1.1 trillion as of September 30, 2019.

[16] For financial reporting purposes, other than multi-use heritage assets, stewardship assets of the government are not recorded as part of PPE. 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.

[17] With the enactment of the SAFRA Act, which was included as part of the HCERA (P. L. 111-152), no new loans were originated under the FFEL Program (guaranteed loan program) since July 1, 2010. See Department of Education fiscal year 2019 AFR p. 52.

Liabilities



As indicated in Table 4 and Chart 5, of the government's $26.9 trillion in total liabilities, the largest liability is federal debt securities held by the public and accrued interest, the balance of which increased by $1.0 trillion (6.6 percent) to $16.9 trillion as of September 30, 2019.

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 $458.0 billion (5.7 percent) during fiscal year 2019, to about $8.4 trillion. This total amount is comprised of $2.6 trillion in benefits payable for the current and retired civilian workforce, and $5.8 trillion for the military and veterans. OPM administers the largest civilian pension plan, covering about 3.1 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.

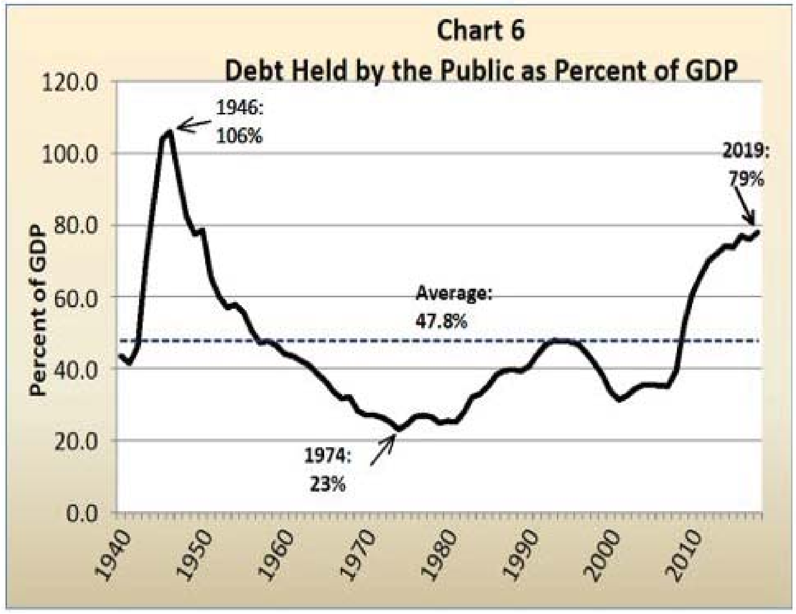
The government's publicly-held debt, or federal debt held by the public, and accrued interest (Balance Sheet liability) totaled $16.9 trillion as of September 30, 2019. It is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, FRBs, 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 fiscal year 2019, new borrowings were $11.8 trillion, and repayments of maturing debt held by the public were $10.7 trillion, both increases from fiscal year 2018.

In addition to debt held by the public, the government has about $6.0 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 ($303.3 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 must 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 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* (P.L. 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 August 2, 2019 through July 31, 2021. It is important to note that increasing or suspending the debt limit does not increase spending or authorize new spending; rather, it permits the U.S. to continue to honor pre-existing commitments to its citizens, businesses, and investors domestically and around the world.

2019, debt subject to the statutory limit was $22.7 trillion[18] (see sidebar).

The federal debt held by the public measured as a percent of GDP (debt-to-GDP ratio) (Chart 6) 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 6 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 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 fiscal year 2014.
- The debt was 79 percent of GDP at the end of fiscal year 2019 (compared to 78 percent at the end of fiscal year 2018 and as reported in the fiscal year 2018 *Financial Report*).[19] From Chart 6, since 1940, the average debt-to-GDP ratio is 47.8 percent.

---

[18]During fiscal years 2019 and 2018, Treasury faced two delays in raising the statutory debt limit that required it to depart from its normal debt management procedures and to invoke legal authorities to avoid exceeding the statutory debt limit. During these periods, extraordinary actions taken by Treasury have resulted in federal debt securities not being issued to certain federal government accounts with the securities being restored including lost interest to the affected federal government accounts subsequent to the end of the delay period. The first delay occurred beginning on December 9, 2017 and ending on February 9, 2018, with the enactment of the BBA of 2018 (P. L. 115-123) which suspended the statutory debt limit through March 1, 2019. The second delay in raising the statutory debt limit occurred beginning on March 2, 2019 and ending on August 2, 2019, with the enactment of the BBA of 2019 (P. L. 116-37) which suspended the statutory debt limit through July 31, 2021.

[19]10/15/2019 press release: Joint Statement of Treasury Secretary Steven T. Mnuchin and Acting OMB Director Russel Vought on Budget Results for Fiscal Year 2019.

The Economy in Fiscal Year 2019

Table 5: National Economic Indicators*

	FY 2019	FY 2018
Real GDP Growth	2.1%	3.1%
Personal Consumption Expenditures	2.6%	3.4%
Average monthly payroll job change (thousands)	188	219
Unemployment rate (percent, end of period)	3.5%	3.7%
Consumer Price Index (CPI)	1.7%	2.3%
CPI, excluding food and energy	2.4%	2.2%
Real Disposable Personal Income	3.3%	4.0%
Real Average Hourly Earnings	2.2%	0.8%

* Some FY2018 data may differ from the FY2018 Financial Report due to updates and revisions.

A review of U.S. economic performance places the discussion of the government's financial results in a broader context. As summarized in Table 5, the U.S. economy grew at a more moderate pace during fiscal year 2019, and payroll job creation slowed modestly. Even so, the economy generated jobs at a pace more than sufficient to account for new entrants to the labor force, which pushed the unemployment rate to a 49-year low by Fall 2019, even as the labor force participation rate (LFPR) increased to a 6-year high. The fiscal year was also noteworthy for a deceleration in the pace of headline inflation – despite consistently strong wage gains, tight labor markets, and rising labor force participation - although core inflation (which excludes food and energy) accelerated modestly. Growth in real disposable (after-tax) personal income (DPI) slowed somewhat in fiscal year 2019, but non-farm labor productivity growth accelerated and business and consumer sentiment remained at elevated levels.

During fiscal year 2019, the U.S. economic recovery became the longest in U.S. history. Real (i.e., inflation-adjusted) GDP grew by 2.1 percent over the four quarters of fiscal year 2019, following growth of 3.1 percent during the previous fiscal year. Personal consumption expenditures continued to lead growth, while government spending and business fixed investment also made solid contributions. Over the four quarters of fiscal year 2019, growth of consumer spending moderated to 2.6 percent from 3.4 percent in the previous fiscal year, and the pace of government spending grew 2.2 percent, matching its growth rate in fiscal year 2018. However, the pace of business fixed investment slowed to 1.4 percent, after rising by 6.8 percent in fiscal year 2018. Business investment was constrained in fiscal year 2019 by a number of international headwinds – such as slowing global growth, policy uncertainty, and low oil prices – as well as temporary domestic disruptions, including reduced equipment investment in connection with the grounding of the Boeing 737 MAX airplane. Although residential investment declined 1.1 percent during fiscal year 2019, matching the decline during fiscal year 2018, the housing sector found a firmer footing during the latter part of the latest fiscal year, aided by improved affordability, strong labor markets, and elevated consumer and homebuilder sentiment. Net exports posed a smaller drag on growth in fiscal year 2019 than in fiscal year 2018, while inventory investment posed a small drag on growth in fiscal year 2019 after making a small positive contribution the previous fiscal year.

Labor market strength continued in fiscal year 2019, exhibited by solid employment growth, low unemployment, and plentiful job opportunities. After the economy created 2.6 million jobs during fiscal year 2018, an additional 2.3 million jobs were added during fiscal year 2019. The unemployment rate ended the fiscal year at 3.5 percent in September 2019, its lowest level since December 1969 and down 0.2 percentage point from September 2018. By the end of fiscal year 2019, the number of unemployed persons in the economy had decreased by 292,000 to 5.75 million – the smallest number in nearly 19 years. Moreover, by the end of fiscal year 2019 job openings had exceeded the number of unemployed for 19 consecutive months. Starting in March 2018 and for the first time since the job openings survey was first conducted in 2000, the number of job openings exceeded the number of potential workers seeking employment, despite rising labor force participation.

During fiscal year 2019, headline inflation slowed, pulled down by lower energy prices, but core inflation accelerated modestly. The CPI rose 1.7 percent over the twelve months of fiscal year 2019, decelerating from the 2.3 percent pace during the previous fiscal year. Core inflation was 2.4 percent over the fiscal year ending September 2019, ticking up from the 2.2 percent pace during fiscal year 2018.

Relatively low inflation and moderate nominal DPI growth helped to maintain purchasing power in real terms in fiscal year 2019. Real DPI grew 3.3 percent over the twelve months of fiscal year 2019, after growing by 4.0 percent during the previous fiscal year. Nominal average hourly earnings grew at a consistently stronger pace during fiscal year 2019, which helped boost wages in real terms. Real average hourly earnings increased 2.2 percent during fiscal year 2019, after rising 0.8 percent during the previous fiscal year. Growth of non-farm labor productivity also accelerated during fiscal year 2019, rising by 1.5 percent after growing 1.2 percent during fiscal year 2018.

An Unsustainable Fiscal Path

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 SLTFP 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[20] for fiscal year 2019 and fiscal year 2018.

Fiscal Sustainability

A sustainable fiscal policy is one where the debt-to-GDP ratio is stable or declining over the long term. The projections in this *Financial Report* indicate that current policy is not sustainable. As discussed below, if current policy is left unchanged, the debt-to-GDP ratio is projected to rise from its current level of 79 percent in 2019 to 84 percent by 2022, to over 100 percent by 2030, and to 474 percent in 2094 and to even higher levels, 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 3.8 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 fiscal gap increases the magnitude of spending and/or revenue changes necessary to stabilize the debt-to-GDP ratio. For example, the magnitude of spending cuts and/or revenue increases necessary to close the gap rises about 18 percent if reforms are delayed ten years, and a further 24 percent 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 projections discussed here assume current policy[21] remains unchanged, and hence, are neither forecasts nor predictions. Nevertheless, the projections demonstrate that policy changes must be enacted to move towards fiscal sustainability.

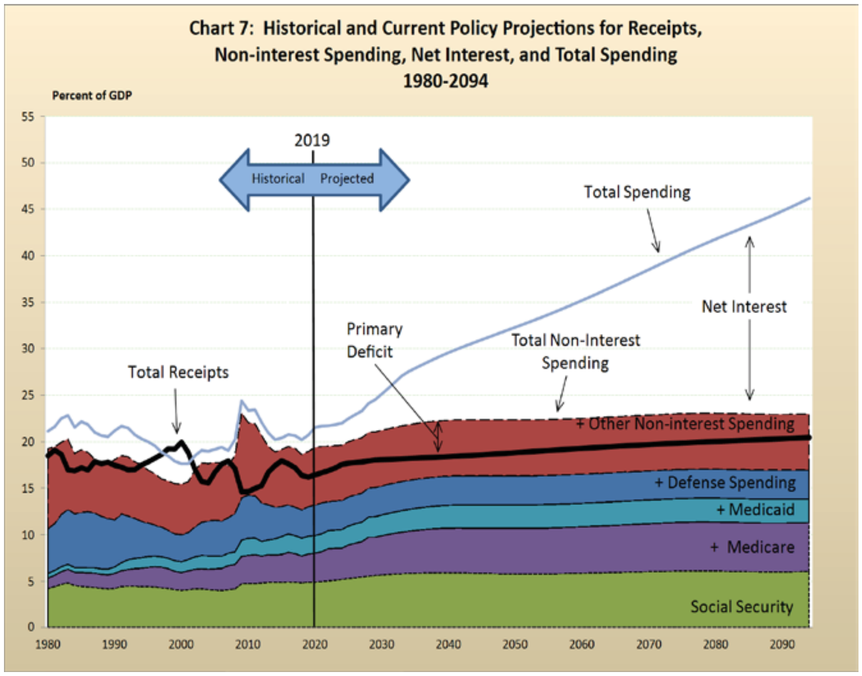
The Primary Deficit, Interest, and Debt

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 8 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 2.1 percent of GDP over 2013 through 2019. This primary deficit ratio was still high enough that the debt-to-GDP ratio increased further, ending 2019 at 79 percent. The primary deficit ratio is projected to rise to 2.9 percent in 2020 and then shrink slightly through 2024 as the economy grows. After 2024, 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 deficit ratios that reach 3.1 percent of GDP in 2028. The primary deficit ratio peaks at 3.9 percent in 2040, gradually decreases beyond that point as aging of the population continues at a slower pace, and reaches 2.5 percent of GDP in 2094.

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 ARRA and the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*. The share subsequently increased to 18 percent of GDP by 2015, then decreased to 16.2 percent in 2019, following enactment of the *TCJA*, below its 30-year average of 17.2 percent.

[20] For the purposes of the SLTFP 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.

[21] 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).



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.

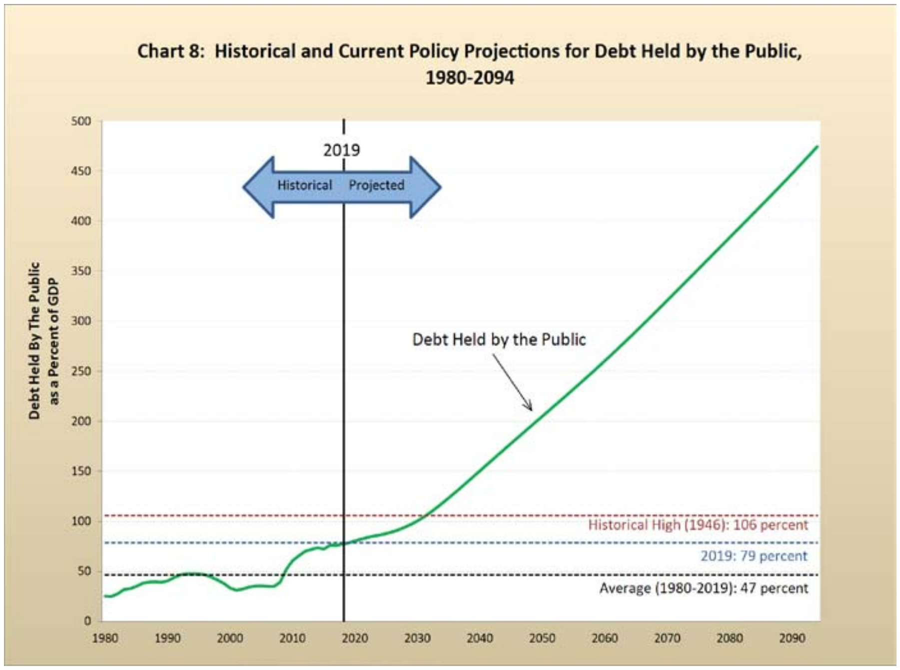
Non-interest spending as a share of GDP is projected to rise gradually from 19.0 percent in 2019 to 21.0 percent in 2029 and ends at 23.0 percent in 2094. Beginning in 2020, these increases are principally due to faster growth in Medicare, Medicaid, and Social Security spending (see Chart 7). Over the next 25 years, the spending shares of GDP of Social Security, Medicare, and Medicaid are projected to increase by about 0.9 percentage points, 1.8 percentage points, and 0.6 percentage points, respectively partly due to the aging of the population. After 2035, 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.

On a present value basis, deficit projections reported in the FY 2019 *Financial Report* increased in present-value terms but decreased as a percent of the current 75-year present value of GDP. As discussed in Note 23, the largest factor affecting the projections was updates of economic and demographic assumptions. Larger GDP is attributable both to stronger growth assumptions in the projection window and lower projected interest rates that raise the present value of future-year GDP values. Other factors affecting the change in these projections included the effect of new Social Security and Medicare program-specific actuarial assumptions and the change in reporting period - the effect of shifting calculations from 2019 through 2093 to 2020 through 2094 - as well as the effect of actual budget results for 2019 and updated budget estimates from the 2020 President's Budget.

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 *PPACA* exchange subsidies – are highly uncertain. In particular, enactment of the PPACA in 2010 and the *MACRA* in 2015 established cost controls for Medicare hospital and physician payments whose long-term effectiveness of which is not yet clear. The Medicare spending projections in the long-term fiscal projections are based on the projections in the 2019 Medicare Trustees' Report, which assume the PPACA 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.

As discussed in Note 23 for the Fiscal Year 2019 report, other key assumptions include, but are not limited to the following. For receipts, individual income taxes are assumed to be the same share as those used in the President's Budget for fiscal year 2020, including the continuation of individual income and estate and gift tax provisions of the TCJA and the tendency of effective tax rates to increase as growth in income per capita outpaces inflation. Congressional action is required to make these changes. Corporate income tax receipts are assumed to be the same share of GDP as projected in the President's Budget in the short term, which incorporates the expected effects of the TCJA, and then grow with GDP over the long term. For discretionary spending, the projections assume that discretionary spending (1) stays within statutory caps that apply through 2021 under the 2019 BBA (or is approximately 6.5 percent of GDP), and (2) falls to a 6.1 percent share of GDP in 2022 and grows to a 6.2 percent share in 2029, where it remains thereafter. Congressional action is required to fund this assumed discretionary spending. GDP, interest, and other economic and demographic assumptions are the same as those that underlie the most recent Social Security and Medicare Trustees' Report projections, adjusted for historical revisions that occur annually. See Note 23—Long-Term Fiscal Projections for more information about the assumptions used in this analysis.

The primary deficit-to-GDP projections in Chart 7, projections for interest rates, and projections for GDP together determine the debt-to-GDP ratio projections shown in Chart 8. That ratio was 79 percent at the end of fiscal year 2019 and under current policy is projected to be 84 percent by 2022, over 100 percent by 2030, and 474 percent by 2094. The change in debt held by the public from one year to the next generally represents the budget deficit, the difference between total spending and total receipts. The debt-to-GDP ratio rises continually in great part because higher levels of debt lead to higher net interest expenditures, and higher net interest expenditures lead to higher debt.[22] The continuous rise of the debt-to-GDP ratio indicates that current policy is unsustainable.



These debt-to-GDP projections are lower than the corresponding projections in 2018 *Financial Report* and higher than the corresponding projections in the 2017 *Financial Report*. For example, the last year of the 75-year projection period used in the fiscal year 2017 *Financial Report* is 2092. In the fiscal year 2019 *Financial Report*, the debt-to-GDP ratio for 2092 is projected to be 461 percent, which compares with 522 and 297 percent projected for that same year in the fiscal year 2018 *Financial Report* and the fiscal year 2017 *Financial Report,* respectively.[23]

The Fiscal Gap and the Cost of Delaying Policy Reform

The 75-year fiscal gap is one measure of the degree to which current 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 2094 to remain at its level in 2019 (79 percent). The projections show that projected primary deficits average 3.2 percent of GDP over the next 75 years under current policy. If policies were adopted to eliminate the fiscal gap, the average primary surplus over the next 75 years would be 0.6 percent of GDP, 3.8 percentage points higher than the projected present value of receipts less non-interest spending shown in the basic financial statement. Hence, the 75-year fiscal gap is estimated to equal 3.8 percent of GDP. This amount is, in turn, equivalent to 20.3 percent of 75-year present value receipts and 17.4 percent of 75-year present value non-interest spending. The fiscal gap was estimated at 4.1 percent in the 2018 *Financial 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

Cost of Delaying Fiscal Reform

Period of Delay	Change in Average Primary Surplus
Reform in 2020 (No Delay)	3.8 percent of GDP between 2020 and 2094
Reform in 2030 (Ten-Year Delay)	4.5 percent of GDP between 2030 and 2094
Reform in 2040 (Twenty-Year Delay)	5.6 percent of GDP between 2040 and 2094

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 3.8 percent of GDP on average between 2020 and 2094 (i.e., some combination of reducing spending and increasing revenue by a combined 3.8 percent of GDP on average over the 75-year projection period). Table 6 shows that delaying policy reform forces larger and more abrupt policy reforms

[22] 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 0.3 percent of GDP each year, with the same effect on debt as if the primary deficit was higher by that amount.

[23] See the Note 23 of the *Fiscal Year 2018 Financial Report of the U.S. Government* for more information about changes in the long term fiscal projections between fiscal years 2017 and 2018.

over shorter periods. For example, if policy reform is delayed by 10 years, closing the fiscal gap requires increasing the primary surpluses by 4.5 percent of GDP on average between 2030 and 2094. Similarly, delaying reform by 20 years requires primary surplus increases of 5.6 percent of GDP on average between 2040 and 2094. The differences between the required primary surplus increases that start in 2030 and 2040 (4.5 and 5.6 percent of GDP, respectively) and that which starts in 2020 (3.8 percent of GDP) is a measure of the additional burden that delay would impose on future generations. Future generations are harmed by 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 12 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 rise over the 75-year projection period and beyond if current policy is unchanged, which implies that current policy is not sustainable and must ultimately change. If policy changes are not so abrupt as to slow economic growth, then the sooner policy changes are adopted to avert these trends, the smaller the changes to revenue and/or spending that would be required to achieve sustainability over the long term. While the estimated magnitude of the fiscal gap is subject to a substantial amount of uncertainty, it is nevertheless nearly certain that current fiscal policies cannot be sustained indefinitely.

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 SOSI focuses on the government’s “social insurance” programs: Social Security, Medicare, Railroad Retirement, and Black Lung.[24] 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 $59.1 trillion over 75 years as of January 1, 2019 for the “Open Group,” an increase of $5.1 trillion over net expenditures of $54.0 trillion projected in the 2018 *Financial Report*.[25] The current-law 2019 amounts reported for Medicare reflect the physician payment levels expected under the MACRA payment rules and the PPACA-mandated reductions in other Medicare payment rates, but not the payment reductions and/or delays that would result from trust fund depletion.[26] 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 from the General Fund to Medicare Parts B and D are eliminated in the consolidation of the SOSI at the governmentwide level and as such, the General Fund transfers that are used to finance Medicare Parts B and D are not included in table 7. For the fiscal year 2019 and 2018 SOSI, the amounts eliminated totaled $36.8 trillion and $32.9 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.

[24] The Black Lung Benefits Act 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 https://www.dol.gov/owcp/regs/compliance/ca_main.htm

[25] '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.

[26] MACRA permanently replaces the 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	2019	2018	Increase / (Decrease) $	Increase / (Decrease) %
Open Group (Net):				
Social Security (OASDI)	$ (16.8)	$ (16.2)	$ 0.6	3.7%
Medicare (Parts A, B, & D)	$ (42.2)	$ (37.7)	$ 4.5	11.9%
Other	$ (0.1)	$ (0.1)	$ -	0.0%
Total Social Insurance Expenditures, Net (Open Group)	**$ (59.1)**	**$ (54.0)**	$ 5.1	9.4%
Total Social Insurance Expenditures, Net (Closed Group)	**$ (80.4)**	**$ (73.9)**	$ 6.5	8.8%
Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*				
Open Group				
Social Security (OASDI)	(1.1%)	(1.2%)		
Medicare (Parts A, B, & D)	(3.0%)	(2.9%)		
Total (Open Group)	**(4.1%)**	**(4.0%)**		
Total (Closed Group)	**(5.6%)**	**(5.5%)**		

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 2019 & 2018 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 Trustees Reports, the two values are averaged to estimate the 'Other' and Total Net Social Insurance Expenditures as percent of GDP. As a result, totals may not equal the sum of components due to rounding.

Table 8 identifies the principal reasons for the changes in projected social insurance amounts during 2019 and 2018.

Table 8: Changes in Social Insurance Projections

Dollars in Trillions	2019	2018
Net Present Value (NPV) - Open Group (Beginning of the Year)	**$ (54.0)**	**$ (49.0)**
Changes In:		
Valuation Period	$ (1.9)	$ (2.0)
Demographic data, assumptions, and methods	$ 0.8	$ 0.7
Economic data, assumptions, and methods[1]	$ (1.0)	$ (0.5)
Law or policy	$ -	$ (1.0)
Methodology and programmatic data[1]	$ 0.5	$ 0.2
Economic and other healthcare assumptions[2]	$ (3.0)	$ (1.5)
Change in projection base[2]	$ (0.5)	$ (0.9)
Net Change in Open Group measure	$ (5.1)	$ (5.0)
NPV - Open Group (End of the Year)	**$ (59.1)**	**$ (54.0)**

1 Relates to SSA.
2 Relates to HHS.

The following briefly summarizes the significant changes for the current valuation (as of January 1, 2019) as disclosed in Note 22, Social Insurance. Note 22 is compiled from disclosures included in the financial reports of those entities administering these programs, including SSA and HHS. See Note 22 for additional information.

- Change in valuation period (affects both Social Security and Medicare): This change replaces a small negative net cash flow for 2018 with a much larger negative net cash flow for 2093. As a result, the present value of the estimated future net cash flows decreased (became more negative) by $1.9 trillion.
- Changes in demographic data, assumptions, and methods (affects both Social Security and Medicare): The ultimate demographic assumptions for the current valuation are the same as those for the prior period. However, the starting demographic values and the way these values transition to the ultimate assumptions were changed. These changes included, but were not limited to the number of LPR, lower birth rates than originally assumed, and higher death rates than projected in prior valuations for ages 65 and older. Overall, changes to these assumptions caused the present value of the estimated future net cash flows to increase (become less negative) by $0.8 trillion.

- Changes in economic data and assumptions (affects Social Security only): Several changes were made to the ultimate economic assumptions since the last valuation period. Lower assumed total-economy labor productivity growth and a lower assumed ultimate interest rate all contribute to lower projected cash flow while a change in projected ultimate inflation rates and an increase in the projected real wage differential partly offset the changes that have a negative effect. Overall, changes to these assumptions caused the present value of the estimated future net cash flows to decrease (become more negative) by $1.0 trillion.
- Changes in methodology and programmatic data (affects Social Security only). Several methodological improvements and updates of program-specific data are included in the current valuation, including, but not limited to: (1) the ultimate disability incidence rate was lowered from 5.4 per thousand exposed in the prior valuation to 5.2 in the current valuation; (2) as in the prior valuation, the current valuation uses a 10-percent sample of newly-entitled worker beneficiaries in 2015 to project average benefit levels of retired-worker and disabled-worker beneficiaries. For the current valuation, the model's projection of earnings for workers becoming newly entitled in future years was improved to better reflect the "dispersion" in taxable earnings levels observed from 1970 to 2010; and (3) The current valuation includes an improvement in the method for calculating future benefit levels for those who are awarded benefits more than two years after their date of initial benefit entitlement. This improvement mainly affects DI benefit levels. Overall, changes to these assumptions caused the present value of the estimated future net cash flows to increase (become less negative) by $0.5 trillion.
- Changes in economic and other healthcare assumptions (affects Medicare only): The economic assumptions used in the Medicare projections are the same as those used for the OASDI (described above) and are prepared by the Office of the Chief Actuary at SSA. In addition to the economic assumptions changes described above, the healthcare assumptions are specific to the Medicare projections. Changes to these assumptions in the current valuation include: lower assumed growth in economy-wide productivity, which results in higher payment updates for certain providers; faster projected spending growth for physician-administered drugs under Part B; higher projected drug manufacturer rebates and slower overall drug price increases assumed in the short-range period. The net impact of these changes caused the present value of the estimated future net cash flows to decrease (become more negative) by $3.0 trillion.
- Change in Projection Base (affects Medicare only): Actual income and expenditures in 2018 were different than what was anticipated when the 2018 Medicare Trustees' Report projections were prepared. Part A payroll tax income was lower and expenditures were higher than anticipated, based on actual experience. For both Part B and Part D, total income and expenditures were higher than estimated based on actual experience. The net impact of the Part A, B, and D projection base changes is a decrease in the estimated future net cash flow. Actual experience of the Medicare Trust Funds between January 1, 2018 and January 1, 2019 is incorporated in the current valuation and is more than projected in the prior valuation. The net impact of the Part A, B, and D projection base changes is a decrease (become more negative) in the estimated future net cash flow by $0.5 trillion.

Projected net expenditures for Medicare Parts A and B declined significantly between fiscal year 2009 and fiscal year 2010 reflecting provisions of the PPACA. 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 2019, 2018, 2017, 2016 and 2015 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.[27] According to the Medicare Trustees' Report, spending on Medicare is projected to rise from its current level of 3.7 percent of GDP to 6.0 percent in 2043 and to 6.5 percent in 2093.[28] As for Social Security, combined spending is projected to generally increase from its current level of 4.9 percent of GDP to about 5.9 percent by 2039, declining to 5.8 percent by 2052 and then generally increase to 6.0 percent by 2093. The government collects and maintains funds supporting the Social Security and Medicare programs in Trust Funds. A scenario in which projected funds expended exceed projected funds received, as reported in the SOSI, will cause the balances in those Trust Funds to deplete over time. Table 9 summarizes additional current status and projected trend information, including years of projected depletion, for the Medicare and Social Security Trust Funds.

[27] A Summary of the 2019 Annual Social Security and Medicare Trust Fund Reports, p. 1-2.
[28] Percent of GDP amounts are expressed in gross terms (including amounts financed by premiums and state transfers).

Table 9: Trust Fund Status		
Fund	**Projected Depletion**	**Projected Post-Depletion Trend**
Medicare Hospital Insurance (HI)*	2026 (unchanged from FY 2018 Report)	In 2026, trust fund income is projected to cover 89 percent of benefits, decreasing to 78 percent in 2043, then increasing to 83 percent by 2093.
Combined Old-Age Survivors and Disability Insurance (OASDI)**	2035 (2034 in FY 2018 Report)	In 2035, trust fund income is projected to cover 80 percent of scheduled benefits, decreasing to about 75 percent by 2093.

* Source: 2019 Medicare Trustees Report ** Source: 2019 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, 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*.

Financial Management

Enterprise Risk Management

The Administration is committed to promoting and facilitating a risk-aware culture across the federal government by developing a federal ERM framework and ERM strategies for adoption by federal agencies. ERM is a tool used by agencies to systematically identify, assess, mitigate, manage, and prepare for risks that could interfere with an agency's ability to achieve its mission and goals. ERM promotes risk-informed decision making that allows resources to be prioritized and allocated based on risk. It encourages agencies to target their limited resources to activities likely to produce the greatest improvement in program performance.

Using ERM techniques, federal agencies establish internal controls to address management challenges that cut across multiple agencies' functions and reduce associated risk to an acceptable level. In this way, ERM integrates risk management and internal control processes. The 2016 update to OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, stresses the importance of applying ERM to all financial management activities, including charge cards and payment integrity. In 2019, the updated OMB Circular A-11, Part 6, integrated ERM into agency strategic planning and performance measurement processes. Also in 2019, the CFOC established an ERM Executive Steering Committee to identify and share ERM best practices, develop a federal ERM maturity model (a self-assessment tool used to assist in ERM implementation), promote ERM integration with mission and mission support functions, and facilitate constructive coordination with oversight entities

Results-Oriented Accountability for Grants

Approximately $700 billion is spent annually on grants and cooperative agreements. Grants managers, both internal and external to the government, report that approximately 40 percent of their time is spent using antiquated processes to monitor compliance with grant requirements rather than using data analytics to monitor grant results. The PMA[29] CAP Goal #8, Results-Oriented Accountability for Grants, provides a comprehensive roadmap for improving grants management and reducing grant recipient reporting burden. Increased efficiencies in the grant-making process will provide recipients more time to devote to delivering intended results of the grant, rather than managing compliance with the process, thereby helping agencies[30] more effectively achieve their missions.

The Grants CAP Goal will be achieved by: standardizing the grants management business process and data, building shared information technology (IT) infrastructure, establishing a standard risk management framework across grant programs, and ensuring that new grant programs are designed to reflect measurable goals. To support the standardization of the business process and data and the building of shared IT infrastructure, OMB issued M 18-24, "Strategies to Reduce Grant Recipient Reporting Burden" in 2018.

M-18-24 requires agencies to evaluate all systems and methods used to collect information from grant recipients to determine if the same data are being collected by the agency more than once. In addition, M-18-24 requires agencies to prepare for the adoption of grants management standards and complete a readiness assessment using the Grants Management Federal Integrated Business Framework.

Since the issuance of M-18-24, OMB released an initial set of draft grants management data elements that were developed by an inter-agency work group. From November 2018 to February 2019, the draft grants management data elements were made available for public comment and more than 1,100 comments were received and reviewed, resulting in the issuance by OMB of Version 1.0 of Grants Management Standards in the fall of 2019. In accordance with OMB memo M-19-16, "Centralized Mission Support Capabilities for the Federal Government," once the initial set of standards are finalized, agencies will be required to ensure that ongoing and future grants management system investments follow the standards available at https://ussm.gsa.gov/. Future implementation of the standards will promote interoperability of systems using consistent data, reduce the number of grants management systems, and promote a risk-based, data-driven approach to managing federal grants.

In addition, under the Grants CAP Goal, OMB worked with agencies during 2019 to reduce the maximum number of audit areas (e.g., allowable costs, eligibility, and cash management) from twelve to seven in the Compliance Supplement. Although grantees will still be required to comply with all twelve requirements for the management of federal programs, the areas to be audited will be limited to those seven that pose the greatest risk or that produced the greatest number of audit findings in the past. The 2019 Single Audit Compliance Supplement specifies the areas of review that are required for individual grant programs.

---

[29] For further information about the PMA and CAP Goals, see https://www.whitehouse.gov/omb/management/pma/

[30] The term "agency" is used in the Financial Management section of the Management's Discussion and Analysis rather than the term "entity," which is used throughout the rest of the *Financial Report*. SFFAS No. 47, *Reporting Entity*, defines the term "entity" for federal financial reporting purposes and addresses both component and governmentwide financial reporting. The term entity is generally broader than "agency" because it refers to agencies, components of agencies, and the federal government as a whole. The term "agency" is used in this section because the laws, policies, and plans discussed in this section apply to "agencies" as defined in particular laws or policy guidance documents and because the laws, policies, and plans discussed in this section do not generally define the term "entity."

Getting Payments Right

Preventing improper payments in the federal government is a priority for the Administration and in March 2018, the PMA CAP Goal #9, Getting Payments Right, was established with an emphasis on reducing monetary loss and making payments correctly the first time. In addition to the historical focus on identifying and addressing improper payment issues after they occur, the CAP goal has a renewed focus on systemic enhancements intended to prevent improper payments from occurring. This CAP Goal has resulted in exceptional collaboration across the CFO community to reduce monetary loss and prevent improper payments through five strategies. The strategies are: (1) Clarifying and Streamlining Requirements, (2) Identify Monetary Loss Root Causes, (3) Strategic Data Use (using data to prevent improper payments), (4) Mitigation Strategies (using non-data methods to prevent improper payments), and (5) Strengthen State Partnerships. Details on current progress and future actions under the CAP goal can be found at: https://www.performance.gov/CAP/getting-payments-right/.

Starting in fiscal year 2018, agencies with programs reporting more than $100 million in monetary loss began providing a quarterly scorecard on PaymentAccuracy.gov. These scorecards provide information on the actions taken and progress made on preventing improper payments that would result in monetary loss to the government. Additional details on the programs' fiscal year 2019 improper payment data can be found at https://paymentaccuracy.gov/

In fiscal year 2020, OMB will continue to work with agencies, the CFOC, and other stakeholders, as part of the Getting Payments Right CAP Goal, to improve the identification of the root causes of improper payments that result in monetary loss and to promote data analytic methods that take a comprehensive view of an agency's payment lifecycle.

Leveraging Data as a Strategic Asset

The DATA Act amended the *Federal Funding Accountability and Transparency Act of 2006* by linking federal government contract, loan, and grant spending to federal programs and requiring that all federal spending be displayed on a website in searchable, downloadable, and machine-readable formats.

The USAspending.gov website, which Treasury launched in April 2018 in accordance with the DATA Act, allows users to examine more than $4 trillion in federal spending and identify communities, businesses and non-profit entities that have received federal funding. The data are provided by more than 100 federal agencies and is compiled by Treasury on a quarterly basis. The site allows users to explore the data and download reports that are tailored to their specific interests. The site also includes the Data Lab, which provides use cases, data visualizations, and analyses of federal spending and trends. The data are searchable in a machine-readable format and open application programming interface.

In June 2018, OMB issued guidance to improve data quality, M-18-16, Management of Reporting Data Integrity Risk, Appendix A to OMB Circular A-123. The guidance required agencies to develop and implement a data quality plan for fiscal years 2019 and requires a plan for fiscal years 2020 and 2021. The guidance also requires agencies to consider in their assurance statements all internal controls (including controls over DATA Act reporting). In November 2019, GAO noted (in GAO-20-75) that agencies had made significant progress in improving DATA Act data quality.

In June 2019, OMB issued revised guidance related to the Federal Program Inventory in OMB Circular A-11 sections 210.11 and 210.12. The guidance reflects an effort by OMB and agencies to simultaneously satisfy, where possible, the reporting requirements of the DATA Act and the *Government Performance and Results Act Modernization Act*, thereby minimizing agency reporting burden.

Also in June 2019, OMB updated Circular A-11 section 22.6 to require agencies to include machine-readable summary tables in their congressional budget justifications and post their congressional budget justifications to a web address entitled [Agency Name].gov/cj. Congressional budget justifications where such web addresses are linked to the agency spending data found on USASpending.gov.

As the quality of this data in USASpending.gov improves, OMB will work with Treasury and agencies to find additional data sources that could be linked to the site for informational and analytic purposes.

Sharing Quality Financial Management Services

The federal financial management infrastructure (which includes grants) exists in a complex environment of legacy information technology, customized tools built to unique requirements, lack of harmonized standards, 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. Specifically, agencies that provide financial management services to other agencies have done so efficiently and effectively for agencies with more limited financial systems requirements. However, when the service providers have attempted to provide similar services to or share technology with agencies that have more complex requirements, the result has often been cost over-runs and the need for systems upgrades or customization. This is largely due to the greater number of and more complex systems requirements of the 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 has been used to develop and implement recommendations to improve financial management across the government. Results of ongoing efforts to support PMA CAP Goal #5, Sharing Quality Services, can be found at https://www.performance.gov/CAP/sharing-quality-services/.

Financial Management Workforce

The Administration is committed to redefining the role of the federal government by prioritizing activities that advance the federal government financial workforce. The workforce for the 21st Century must enable senior leaders and front-line managers to align staff skills with evolving mission needs. This will require more nimble and agile management of the workforce, including reskilling and redeploying existing workers to keep pace with the current pace of change.

Under the CFOC, a cross-agency "Shape the Workforce" work group has been established. The group was formed to align CFOC efforts with the human capital strategy in the PMA, which is focused on developing a workforce for the 21st century. The group is working to establish a systematic process for identifying and addressing gaps between the financial management workforce of today and the workforce needs of tomorrow. Through this process, CFO leadership will be able to identify the personnel required to meet organizational goals, conduct analyses to determine and close competency and skills gaps, develop strategies to address human capital needs, and assess the effectiveness of CFO office structures. In addition, the cross-agency work group is exploring options for consolidating recruitment efforts and streamlining the hiring process, leveraging technology to improve the financial management workforce, and developing new tools for retention and staff development.

Also, under the CFOC, a cross-agency "Fiscal Management" work group has been established to explore opportunities to automate financial management processes and functions. As a part of this, the National Science Foundation is conducting a pilot focused on intragovernmental payments and collections, seeking to make the payment and collection processes more efficient. Automation of financial management work will consequently allow the financial management workforce to be more efficient and focus on higher-value work.

Audit

Since the passage of the CFO Act, the federal financial community has made significant progress in financial accounting and reporting. As shown in Table 10, for fiscal year 2019, 22 of the 24 CFO Act agencies obtained an unmodified opinion from the independent auditors on their financial statements.[31] In addition, 41 auditor-identified material weaknesses were reported at the end of fiscal year 2019 compared to 40 for 2018. For 2019, 25 of these are associated with DOD, which completed its second full-scope financial statement audit. The other 16 material weaknesses are associated with non-DOD agencies, which represents an improvement from 20 reported in 2018. These results demonstrate that 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. However, weaknesses in financial management practices continue to prevent the government as a whole from achieving an audit opinion.

Table 10: Agency Audit Results: FY 2019

Agency	Audit Opinion	Auditor-Reported Material Weaknesses: Beginning	New	Resolved	Consolidated	Ending
Department of Agriculture (USDA)	Unmodified	2	0	0	0	2
Department of Commerce (DOC)	Unmodified	2	0	2	0	0
Department of Defense (DOD)	Disclaimer	20	9	1	3	25
Department of Education (Education)	Unmodified	1	0	0	0	1
Department of Energy (DOE)	Unmodified	0	0	0	0	0
Department of Health and Human Services (HHS)*	Unmodified	0	0	0	0	0
Department of Homeland Security (DHS)	Unmodified	2	0	0	0	2
Department of Housing & Urban Development (HUD)**	Qualified	5	0	3	1	1
Department of the Interior (DOI)	Unmodified	0	1	0	0	1
Department of Justice (DOJ)	Unmodified	0	1	0	0	1
Department of Labor (DOL)	Unmodified	0	0	0	0	0
Department of State (State)	Unmodified	0	0	0	0	0
Department of Transportation (DOT)	Unmodified	0	0	0	0	0
Department of the Treasury (Treasury)	Unmodified	0	0	0	0	0
Department of Veterans Affairs (VA)	Unmodified	5	0	0	0	5
Agency for International Development (USAID)	Unmodified	1	0	1	0	0
Environmental Protection Agency (EPA)	Unmodified	1	1	1	0	1
General Services Administration (GSA)	Unmodified	0	0	0	0	0
National Aeronautics & 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	1	0	0	1
Social Security Administration (SSA)	Unmodified	0	0	0	0	0
Totals		**40**	**13**	**8**	**4**	**41**

* Unmodified opinion on all statements except SOSI and SCSIA, which received a disclaimer.

** HUD's FY 2019 statements and notes contain FY 2019 data only; FY 2018 data are not provided in the statements or notes.

Agency Financial Management 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 FFMIA remained at 7 in fiscal year 2019, and the number of auditors reporting lack of substantial compliance with one or more of the three Section 803(a) FFMIA requirements fell to 8 in fiscal year 2019 from nine in fiscal year 2018.

As suggested in the "Sharing Quality Financial Management Services" section above, because of the federal government's size and diversity, its financial management infrastructure consists of both legacy and modernized systems and standardized and customized systems. As the government's fiscal agent, Treasury has systems for collecting and disbursing the government's cash and financing disbursements when necessary, recording and reporting on those collections and disbursements, and reporting on all government revenues, expenses, assets, and liabilities.

[31] The 22 entities include HHS, which received an unmodified ("clean") opinion on all statements except the SOSI and the SCSIA.

The first four sections above[32] summarize what OMB and agencies have been doing and plan to do to improve financial management, including financial management systems. Additionally, Treasury has financial management improvements plans that have governmentwide implications. These plans include standardizing processes, system requirements, and system interfaces. These efforts will allow legacy technology to be decommissioned and reduce the need for manual processes. Also, agencies other than Treasury have plans to improve their financial management and financial reporting systems described in their financial reports, budget requests, and performance plans. Most significantly, DOD has plans to address its material weaknesses in financial reporting, and is bringing its financial systems into compliance with federal financial management systems requirements, including the FFMIA; these plans can be found in the AFR. In addition, DOD's audit remediation efforts include issues related to real property, inventory, OM&S, government property in the possession of contractors, information technology, and reconciling the Department's fund balance with Treasury.

Agency Internal 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. Safeguarding assets is a goal of each of these three objectives.

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

- Appendix A provides for agencies to use a risk-based approach to assess, document, test, and report on internal controls over reporting and data integrity;
- 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 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 41 for fiscal year 2019 and 40 for fiscal year 2018. 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, additional work is needed.

Agency Legal Compliance

Federal agencies are required to comply with a wide range of laws and regulations, including appropriations, employment, and 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.

Efficient Use of Real Property Assets

The federal government owns a significant amount of real property assets worldwide, with a majority of its holdings located in the U.S. These real property holdings include assets that are classified by property type in the FRPP as: land, buildings, and structures. The FRPP defines land as acreage and a building as a constructed asset that is enclosed with walls and a roof that provides space for agencies to perform activities, store materials, or provide space for people to live or work. A structure is defined as any constructed asset that does not meet the building definition above (i.e., fence, tower, parking structure). Further information can be found in the FRPP Data Dictionary available at https://www.gsa.gov/policy-regulations/policy/real-property-policy/asset-management/federal-real-property-council-frpc/frpc-guidance-library.

Land

The federal government owns roughly 640 million acres, which represents about 28 percent, of all U.S. land. Four major federal land management agencies administer 610.1 million acres, or 95 percent, of this land. They are the BLM, Fish and Wildlife Service, and National Park Service in DOI; and the Forest Service in USDA. These lands are managed for many purposes, primarily related to conservation, preservation, recreation, and the extraction of natural resources such as timber, minerals, oil, and gas. Much of the land managed by DOI and USDA is public domain land and is generally intended to be retained by the government for use by future generations. This and other land that qualifies as stewardship land is not valued

[32] These sections are "Results-Oriented Accountability for Grants," "Getting Payments Right," "Leveraging Data as a Strategic Asset," and "Sharing Quality Financial Management Services."

on the governmentwide Balance Sheet but is discussed in Note 24 and in AFRs. In addition, DOD (excluding the Army Corps of Engineers) uses stewardship land for military bases, training ranges, and other military related functions.

Structures

The government owns structures that are affixed to the land and in many instances cannot easily be physically separated from the land; these include parking structures, power plants, power generating stations, dams, and space exploration structures. These structures are managed by agencies such as DOE, the Army Corps of Engineers, and NASA. The federal government charges fees for the use of some of these structures, which defray some of the costs of the assets. The receipt of such user fees (e.g., sales of electrical power) is recorded as revenue. Structures are generally reflected on the Balance Sheet at cost, net of depreciation, and any environmental or other liabilities associated with structures are reflected on the Balance Sheet in accordance with generally accepted accounting principles.

Buildings

A large portion of the government's real property inventory includes federally owned buildings, with the majority in the custodial care of DOD. In general, agencies hold and manage buildings for administrative use to achieve their mission. The government does not hold buildings or any real property assets for investment or land banking purposes. Buildings owned by the government (and the land associated with the buildings) are generally reflected on the Balance Sheet at cost, net of depreciation. As noted above with structures, any environmental or other liabilities associated with buildings (and the land underneath the buildings) are also reflected on the Balance Sheet in accordance with generally accepted accounting principles. Any buildings (or structures, including the land underneath the buildings or structures) that are not in service are included on the Balance Sheet at net realizable value. After the government identifies buildings or other real property for disposal, it carries out public or negotiated sales, demolitions, public benefit conveyances, and, on occasion, property exchanges.

The federal domestic building inventory is diverse and contains 252,000 buildings reflecting 2.6 billion square feet of space as of 2016 (which is the most recent year for which reliable data are available). Several current real property initiatives being pursued are discussed below.

Transformation Efforts to Optimize the Use of Federal Real Property

On July 12, 2018, OMB issued Memorandum M-18-21 to require all federal entities to designate senior real property officers to coordinate all aspects of their real property programs and to serve on the FRPC. The FRPC seeks to provide comprehensive governmentwide strategic direction to help optimize the federal real property portfolio to achieve statutory missions while managing costs over the short, mid, and long-term. The FRPC will address current challenges such as the lack of a comprehensive strategic approach to asset management, funding challenges, poor data quality, and legislative requirements by creating a governance structure, to include an Executive Steering Committee and working groups. Led by direction from the Executive Steering Committee, the working groups will map their outputs to the FRPC strategic direction to revise the national strategy's policy framework, standardize the business processes and data, and diagnose and address root causes.

On November 6, 2019, OMB issued Memorandum M-20-03, providing detailed guidance to agencies to implement the Capital Programming Guide in OMB Circular A-11. The goal of the guidance is to ensure that an agency's real property portfolio helps it efficiently achieve its mission. The Memo provides standards for agencies to use to develop a consistent methodology for allocating resources to real property. This resource allocation will occur as a part of the annual budget formulation process, with agencies systematically identifying their real property needs and assessing their existing real property assets. This process of reviewing real property holdings, acquisitions, and dispositions and linking clearly articulated long-term real property requirements to options that consider the life-cycle of real property is intended to allow agencies and policymakers to have the information necessary to optimize the federal real property portfolio. This should lead to the elimination of excess capacity, cost-effective long-term investments in real property, and annually updated information about the condition of existing property.

The new strategic direction reflected in Memorandum 20-03 will build on the results of the RTF policy, which was issued in 2015 and requires the CFO Act agencies to reduce the size of their federal real property portfolios by improving the use of government-owned buildings and by reducing the amount of leased space and the number of excess and underutilized properties. In addition, under the RTF policy, the CFO Act agencies developed and annually update five-year Real Property Efficiency Plans to identify reductions to their portfolios over a five-year time-period. In fiscal years 2016 through 2018, the CFO Act agencies reduced their fiscal year 2015 RTF baselines (which is the amount of space the CFO Act agencies held or occupied in 2015) by 16.2 million square feet. Under the RTF policy, the CFO Act agencies will validate square footage and operations and maintenance costs in their AFRs to show that they are continuing to reduce their real property footprint over time.

Additionally, governmentwide real property management will be improved by implementation of the *Federal Assets Sale and Transfer Act of 2016* (FASTA) and the FPMRA. To date, OMB has met, by the required deadlines, all of its responsibilities under FASTA (with a yearly data call to all federal agencies for recommendations to the to-be-established Real Property Reform Board) and under FPMRA (with the establishment of the FRPC and the issuance of a yearly report).

Together with the newly constituted FRPC, OMB will continue to work to optimize its use of federal real property throughout 2020.

Conclusion

The federal government has seen significant progress in financial management since the passage of the CFO Act nearly 30 years ago, but significant challenges remain to realizing the intended financial management reforms of the Act. The issues that the federal government faces today require financial managers to improve both the efficiency and effectiveness of financial management activities, which includes moving toward integrated government operations with standardized business processes, systems, and data. The steps outlined above build on tools and capabilities that are in place today and refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency and effectiveness of 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 agencies included in the U.S. government's consolidated financial statements. Details about the information in this *Financial Report* can be found in these agencies' financial statements included in their PARs and AFRs. This *Financial Report*, as well as those from previous years, is also available at the Treasury, OMB, and GAO websites at: https://www.fiscal.treasury.gov/reports-statements/; 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.*