MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The Fiscal Year *2018 Financial Report of the United States Government (Financial Report)* provides the President, Congress, and the American people with a comprehensive view of the federal government's financial position and condition, and discusses important financial issues and significant conditions that may affect future operations, including the need to achieve fiscal sustainability over the medium and long term.

Pursuant to 31 United States Code (U.S.C.) § 331(e)(1), the Department of the Treasury (Treasury), in cooperation with the Office of Management and Budget (OMB), must submit an audited (by the Government Accountability Office or GAO) financial statement for the preceding fiscal year, covering all accounts and associated activities of the executive branch of the United States (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 158 federal consolidation entities (see organizational chart on the next page and Appendix A). As it has for the past 21 years, GAO issued a disclaimer of opinion on the accrual-based, consolidated financial statements for the fiscal years ended September 30, 2018 and 2017. GAO also issued a disclaimer of opinion on the sustainability financial statements, which consist of the 2018 and 2017 Statements of Long-Term Fiscal Projections (SLTFP); the 2018, 2017, 2016, 2015, and 2014 Statements of Social Insurance (SOSI); and the 2018 and 2017 Statements of Changes in Social Insurance Amounts (SCSIA). A disclaimer of opinion indicates that sufficient information was not available for the auditors to determine whether the reported financial statements were fairly presented in accordance with U.S. Generally Accepted Accounting Principles (GAAP). In fiscal year 2018, 35[2] of the 40 most significant entities earned unmodified ("clean") opinions on their financial statements.

The fiscal year 2018 *Financial Report* consists of:

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

This *Financial Report* addresses the government's financial activity and results as of and for the fiscal years ended September 30, 2018 and 2017. Note 26, *Subsequent Events* discusses events that occurred after the end of the fiscal year which may affect the government's financial position and condition.

In addition, the 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.

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[1] The *Government Management Reform Act* of 1994 has required such reporting, covering the executive branch of the Government, beginning with financial statements prepared for 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 2018, 2017, 2016, 2015, and 2014 SOSI and on its 2018 and 2017 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

SIGNIFICANT CONSOLIDATION ENTITIES

DEPARTMENT OF AGRICULTURE
DEPARTMENT OF COMMERCE
DEPARTMENT OF DEFENSE
DEPARTMENT OF EDUCATION
DEPARTMENT OF ENERGY
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF HOMELAND SECURITY
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
DEPARTMENT OF THE INTERIOR
DEPARTMENT OF JUSTICE
DEPARTMENT OF LABOR
DEPARTMENT OF STATE
DEPARTMENT OF TRANSPORTATION
DEPARTMENT OF THE TREASURY
DEPARTMENT OF VETERANS AFFAIRS

OTHER SIGNIFICANT CONSOLIDATION ENTITIES

ENVIRONMENTAL PROTECTION AGENCY
GENERAL SERVICES ADMINISTRATION
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
NATIONAL SCIENCE FOUNDATION
OFFICE OF PERSONNEL MANAGEMENT
SMALL BUSINESS ADMINISTRATION
SOCIAL SECURITY ADMINISTRATION
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
U.S. NUCLEAR REGULATORY COMMISSION
SECURITY ASSISTANCE ACCOUNTS
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
SMITHSONIAN INSTITUTION
TENNESSEE VALLEY AUTHORITY
U.S. POSTAL SERVICE

OTHER CONSOLIDATION ENTITIES ARE LISTED IN APPENDIX A OF THIS FINANCIAL REPORT

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

		2018		2017*	Increase / (Decrease) $		Increase / (Decrease) %
FINANCIAL MEASURES (Dollars in Billions)							
Gross Cost	**$**	**(4,808.5)**	**$**	**(4,606.2)**	**$**	**202.3**	**4.4%**
Less: Earned Revenue	$	392.8	$	431.9	$	(39.1)	(9.1%)
Gain/(Loss) from Changes in Assumptions	$	(125.2)	$	(356.5)	$	(231.3)	(64.9%)
Net Cost	**$**	**(4,540.9)**	**$**	**(4,530.8)**	**$**	**10.1**	**0.2%**
Less: Tax and Other Revenues	$	3,384.3	$	3,374.6	$	9.7	0.3%
Unmatched Transactions & Balances	$	(2.4)	$	2.6	$	(5.0)	(192.3%)
Net Operating Cost	**$**	**(1,159.0)**	**$**	**(1,153.6)**	**$**	**5.4**	**0.5%**
Budget Deficit	**$**	**(779.0)**	**$**	**(665.7)**	**$**	**113.3**	**17.0%**
Assets:							
Cash & Other Monetary Assets	$	507.5	$	271.2	$	236.3	87.1%
Loans Receivable, Net	$	1,419.1	$	1,350.2	$	68.9	5.1%
Inventories & Related Property, Net	$	337.5	$	326.7	$	10.8	3.3%
Property, Plant & Equipment, Net	$	1,090.5	$	1,087.0	$	3.5	0.3%
Other	$	482.1	$	499.8	$	(17.7)	(3.5%)
Total Assets	**$**	**3,836.7**	**$**	**3,534.9**	**$**	**301.8**	**8.5%**
Liabilities:							
Federal Debt Held by the Public & Accrued Interest	$	(15,812.7)	$	(14,724.1)	$	1,088.6	7.4%
Federal Employee & Veteran Benefits	$	(7,982.3)	$	(7,700.1)	$	282.2	3.7%
Other	$	(1,562.5)	$	(1,472.6)	$	89.9	6.1%
Total Liabilities	**$**	**(25,357.5)**	**$**	**(23,896.8)**	**$**	**1,460.7**	**6.1%**
Net Position (Assets minus Liabilities)	**$**	**(21,520.8)**	**$**	**(20,361.9)**	**$**	**1,158.9**	**5.7%**
SUSTAINABILITY MEASURES (Dollars in Trillions)							
Social Insurance Net Expenditures:							
Social Security (OASDI)	$	(16.1)	$	(15.4)	$	0.7	4.5%
Medicare (Parts A, B, & D)	$	(37.6)	$	(33.5)	$	4.1	12.2%
Other	$	(0.1)	$	(0.1)	$	-	0.0%
Total Social Insurance Net Expenditures	**$**	**(53.8)**	**$**	**(49.0)**	**$**	**4.8**	**9.8%**
Total Federal Non-Interest Net Expenditures	**$**	**(46.2)**	**$**	**(16.2)**	**$**	**30.0**	**185.2%**
75-Year Fiscal Gap (Percent of Gross Domestic Product)[1]		**(4.1%)**		**(2.0%)**		**2.1%**	**105.0%**

*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 4.1 percent of GDP on average is needed (2.0 percent of GDP on average in 2017). See Financial Statement Note 23.

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

- During fiscal year 2018, the budget deficit increased by 17.0 percent and gross cost increased by 4.4 percent, while net cost, tax and other revenues, and net operating cost each increased by less than one percent.
- The government's gross costs of $4.8 trillion, less $392.8 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 $125.2 billion in net losses from changes in assumptions (e.g., interest rates, inflation, disability claims rates) yields the government's net cost of $4.5 trillion, a slight increase of $10.1 billion or 0.2 percent over fiscal year 2017.
- Deducting $3.4 trillion in tax and other revenues, with some adjustment for unmatched transactions and balances, results in a "bottom line" net operating cost of $1.2 trillion for fiscal year 2018, an increase of $5.4 billion or 0.5 percent over fiscal year 2017.
- Comparing total 2018 government assets of $3.8 trillion to total liabilities of $25.4 trillion (comprised mostly of $15.8 trillion in federal debt held by the public and accrued interest payable[3], and $8.0 trillion of federal employee and veterans benefits payable) yields a negative net position of $21.5 trillion.
- The budget deficit is primarily financed through borrowing from the public. As of September 30, 2018, debt held by the public, excluding accrued interest, was $15.8 trillion. This amount, plus intragovernmental debt ($5.8 trillion) equals gross federal debt, which, with some adjustments, is subject to the statutory debt limit. As of September 30, 2018, the government's total debt subject to the debt limit was $21.5 trillion. The statutory debt limit was most recently suspended through March 1, 2019.

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

- The SLTFP shows that the present value (PV)[4] of total non-interest spending, including Social Security, Medicare, Medicaid, defense, and education, etc.), over the next 75 years, under current policy, is projected to exceed the PV of total receipts by $46.2 trillion (total federal non-interest net expenditures from Table 1).
- The SOSI shows that the PV of the government's expenditures for Social Security and Medicare Parts A, B and D, and other social insurance programs over 75 years is projected to exceed social insurance revenues[5] by about $53.8 trillion, a $4.8 trillion increase over 2017 social insurance projections.
- The two sustainability measures in Table 1 differ primarily because total non-interest net expenditures from the SLTFP include the effects of general revenues and non-social insurance spending, neither of which is included in the SOSI.

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

- The budget deficit (i.e., including the consolidated receipts and outlays from federal funds and the Social Security Trust Fund) increased from $665.7 billion in fiscal year 2017 to $779.0 billion in fiscal year 2018. The deficit-to-GDP ratio in 2018 was 3.9 percent, an increase from 3.5 percent in fiscal year 2017 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, 2018, the $15.8 trillion in debt held by the public, excluding accrued interest, equates to approximately 78 percent of GDP.
- The 2018 SOSI projection of $53.8 trillion net PV excess of expenditures over receipts over 75 years represents about 4.0 percent of the PV of GDP over 75 years. The excess of total projected non-interest spending over receipts of $46.2 trillion from the SLTFP represents 3.3 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 4.1 percent of GDP on average is needed (2.0 percent of GDP on average in the 2017 projections). The fiscal gap represents 21.9 percent of 75-year present value receipts and 18.6 percent of 75-year present value non-interest spending.

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

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

[5] Social Security is funded by the payroll taxes and revenue from taxation of benefits. Medicare Part A is funded by the payroll taxes, revenue from taxation of benefits, and premiums that support those programs. Medicare Parts B and D are primarily financed by general revenues and premiums. By accounting convention, these general revenues are eliminated in consolidation at the governmentwide level and, as such, are not included in the SOSI. For the fiscal year 2018 and 2017 SOSI, the amounts eliminated totaled $32.9 trillion and $30.0 trillion, respectively.

[6] Final Monthly Treasury Statement (as of September 30, 2018 and 2017), Joint Statement of Treasury Secretary Steven T. Mnuchin and OMB Director Mick Mulvaney on Budget Results for Fiscal Year 2018

Fiscal Year 2018 Financial Statement Audit Results

For fiscal year 2018, GAO issued a disclaimer of audit opinion on the accrual-based, governmentwide financial statements, as it has for the past 21 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 226 of this *Financial Report*, discusses GAO's findings.

22 of the 24 entities required to issue audited financial statements under the *Chief Financial Officers* (CFO) *Act* received unmodified audit opinions, as did 13 of 16 additional significant reporting 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. Statement of Federal Financial Accounting Standards (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.

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (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 Federal Reserve System (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 reporting 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 www.performance.gov.

The following pages contain a more detailed discussion of the government's financial results for fiscal year 2018, the budget, the economy, the debt, and a long-term perspective about fiscal sustainability, including the government's ability to meet its social insurance benefits obligations. The information in this *Financial Report*, when combined with the *Budget of the U.S. Government (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.

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[7] The 22 entities include the Department of Health and Human Services, which received disclaimers of opinions on its 2018, 2017, 2016, 2015, and 2014, SOSI and its 2018 and 2017 SCSIA. The 13 entities include the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Farm Credit System Insurance Corporation (FCSIC), which operate on a calendar year basis (December 31 year-end). Statistic reflects 2017 audit results for these organizations if 2018 results are not available.

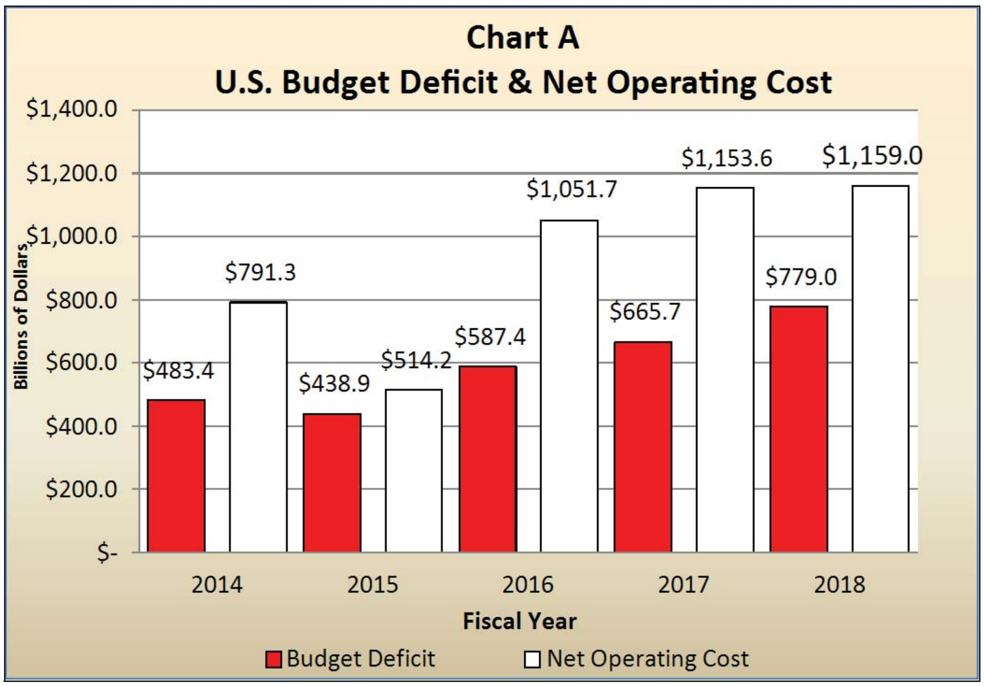
[8] See Note 21—Fiduciary Activities

[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, Railroad Retirement programs; and 25 years for the Black Lung program. The Statement of Long-Term Fiscal Projections presents the present value of the projected future receipts and non-interest spending for the federal government.

Budget of the U.S. Government	Financial Report of the U.S. Government
Prepared primarily on a "*cash basis*" • Initiative-based and prospective: focus on current and future initiatives planned and how resources will be used to fund them. • Receipts ("cash in"), taxes and other collections recorded when received. • Outlays ("cash out"), largely recorded when payment is made.	Prepared on an "*accrual and modified cash basis*" • 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 A, net operating cost typically exceeds the budget deficit due largely to the inclusion of cost accruals associated with increases in estimated liabilities for the government's postemployment benefit programs for its military and civilian employees and veterans as well as environmental liabilities.



The government's primarily cash-based[10] budget deficit increased by $113.3 billion (about 17.0 percent) from approximately $665.7 billion in fiscal year 2017 to about $779.0 billion in fiscal year 2018 due to lower growth in receipts compared to the increase in outlays in fiscal year 2018. The $13.8 billion (0.4 percent) increase in receipts can be attributed primarily to higher net individual income tax receipts, excise taxes, social insurance and retirement receipts, and customs duties. Outlays increased $127.1 billion (3.2 percent). Contributing to the increase over fiscal year 2017 were higher outlays for Defense, Medicaid, Social Security, disaster relief and flood insurance, Refundable Premium Tax Credits and cost sharing reductions, interest on the Treasury debt held by the public (public debt), and lower government-sponsored enterprises' (GSE) receipts (i.e., dividends from Fannie Mae and Freddie Mac), which are an offset to outlays.[11]

The Treasury Department's September 2018 Monthly Treasury Statement (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, Health). Multiple entities may contribute to one or more budget functions, and a single

[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] 10/15/18 press release -- Joint Statement of Treasury Secretary Steven T. Mnuchin and OMB Director Mick Mulvaney on Budget Results for Fiscal Year 2018.

budget function may be associated with only one entity. For example, the Department of Defense (DOD), Department of Homeland Security (DHS), the Department of Energy (DOE), and multiple other entities administer programs that are critical to the broader functional classification of National Defense. DOD, the Office of Personnel Management (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 the Department of Health and Human Services (HHS). Federal spending information by budget function and other categorizations may be found in the September 2018 MTS.[12]

The government's largely accrual-based net operating cost remained largely unchanged at $1.2 trillion increasing by $5.4 billion (0.5 percent) during fiscal year 2018. 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 $380.0 billion net difference between the government's budget deficit and net operating cost for fiscal year 2018, is mostly attributable to: (1) a $282.2 billion net increase in liabilities for federal employee and veteran benefits payable, (2) a $112.8 billion increase in environmental and disposal liabilities; and (3) several offsetting items, including, but not limited to a $32.3 billion decrease in insurance and guarantee program liabilities and a $15.9 billion increase in Accounts Payable. These affect net operating cost, but not the budget deficit.

Table 2: Net Operating Cost vs. Budget Deficit

Dollars in Billions	2018	2017*
Net Operating Cost	**$ (1,159.0)**	**$ (1,153.6)**
Change in:		
Federal Employee and Veteran Benefits Payable	$ 282.2	$ 490.7
Environmental and Disposal Liabilities	$ 112.8	$ 17.9
Insurance and guarantee program liabilities	$ (32.3)	$ 15.5
Accounts payable	$ 15.9	$ 8.4
Other, Net	$ 1.4	$ (44.6)
Subtotal - Net Difference:	$ 380.0	$ 487.9
Budget Deficit	**$ (779.0)**	**$ (665.7)**

*Restated (see Financial Statement Note 1.U)

[12] Final Monthly Treasury Statement for Fiscal Year 2018 through September 30, 2018 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		2018		2017*	Increase / (Decrease) $		%
Gross Cost	**$**	**(4,808.5)**	**$**	**(4,606.2)**	**$**	**202.3**	**4.4%**
Less: Earned Revenue	$	392.8	$	431.9	$	(39.1)	(9.1%)
Gain/(Loss) from Changes in Assumptions	$	(125.2)	$	(356.5)	$	(231.3)	(64.9%)
Net Cost	**$**	**(4,540.9)**	**$**	**(4,530.8)**	**$**	**10.1**	**0.2%**
Less: Tax and Other Revenues	$	3,384.3	$	3,374.6	$	9.7	0.3%
Unmatched Transactions and Balances	$	(2.4)	$	2.6	$	(5.0)	(192.3%)
Net Operating Cost	**$**	**(1,159.0)**	**$**	**(1,153.6)**	**$**	**5.4**	**0.5%**

*Restated (see Financial Statement Note 1.U)

Table 3 shows that the government's "bottom line" net operating cost remained largely unchanged during 2018 at $1.2 trillion increasing only $5.4 billion (0.5 percent), during the fiscal year. This slight increase is due mostly to a $10.1 billion (0.2 percent) increase in entity net costs, which slightly more than offset a $9.7 billion (0.3 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 $4.8 trillion, subtracts revenues earned for goods and services provided (e.g., Medicare premiums, national park entry fees, and postal service fees), and adjusts the balance for gains or losses from changes in actuarial assumptions used to estimate certain liabilities, including federal employee and veterans benefits to derive its net cost of $4.5 trillion (See Chart C), a $10.1 billion (0.2 percent) increase over fiscal year 2017.

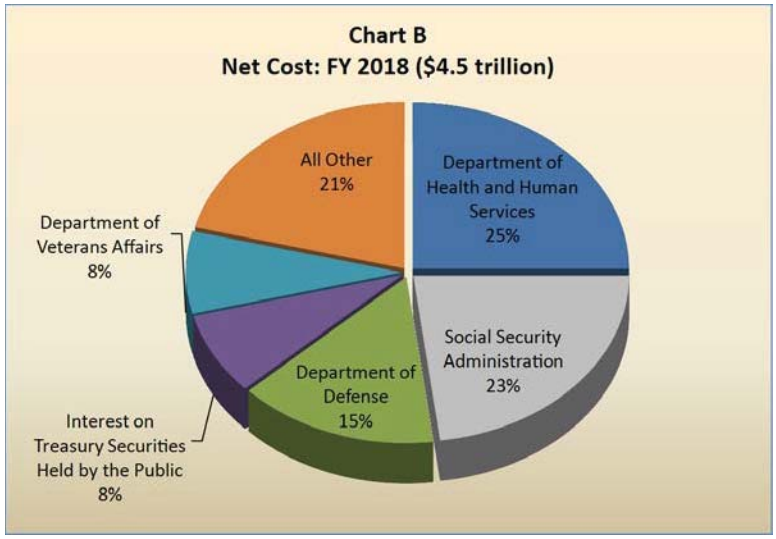
Typically, the annual change in the government's net cost is impacted by a variety of offsetting increases and decreases across entities. For example, offsetting changes in net cost during fiscal year 2018 included:

- 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 $125.2 billion in fiscal year 2018, a loss decrease (and a corresponding net cost decrease) of $231.3 billion compared to fiscal year 2017. The primary entities that administer programs impacted by these assumptions – typically federal employee pension and benefit programs – are the OPM, Department of Veterans Affairs (VA), and DOD. These entities recorded losses from changes in assumptions in the amounts of $26.2 billion, $79.2 billion, and $16.8 billion, respectively – all decreased amounts compared to 2017.

[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*.

- 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 2018, changes in net cost at VA ($132.8 billion decrease), OPM ($66.2 billion decrease), and DOD ($33.0 billion increase), were impacted by the corresponding changes in gains or losses from assumption changes at these entities.

- At DOD, the $33.0 billion net cost increase includes the net effect of a $39.2 billion decrease in earned revenues across the department, as well as increases in the net costs of procurement, military personnel and research and development (R&D). These increases were partially offset by a decrease in losses from changes in assumptions referenced above (net cost decrease), and a decrease in costs of military operations, readiness, and support;
- $56.4 billion and $39.5 billion net cost increases at HHS and the Social Security Administration (SSA), respectively, were primarily due to cost increases of the benefits programs that these entities administer (HHS – Medicare and Medicaid programs, SSA – Old-Age, Survivors, and Disability Insurance (OASDI) programs);
- A $99.6 billion net cost increase at DOE largely due to refined environmental liability estimates, including those for Waste Treatment and Immobilization Plant construction, operating costs, tank farm retrieval, and closure costs at DOE's Hanford site;
- A $20.2 billion net cost decrease at the Pension Benefit Guaranty Corporation (PBGC) stems mostly from higher interest rate factors used to measure liabilities for the single- and multi-employer programs; and
- A $61.0 billion cost increase in interest on debt held by the public due largely to an increase in the debt and average interest rates, as well as inflation adjustments on certain Treasury securities. Interest costs have increased by 20.6 percent in 2018 from 2017 and by 37.4 percent over the past five years.



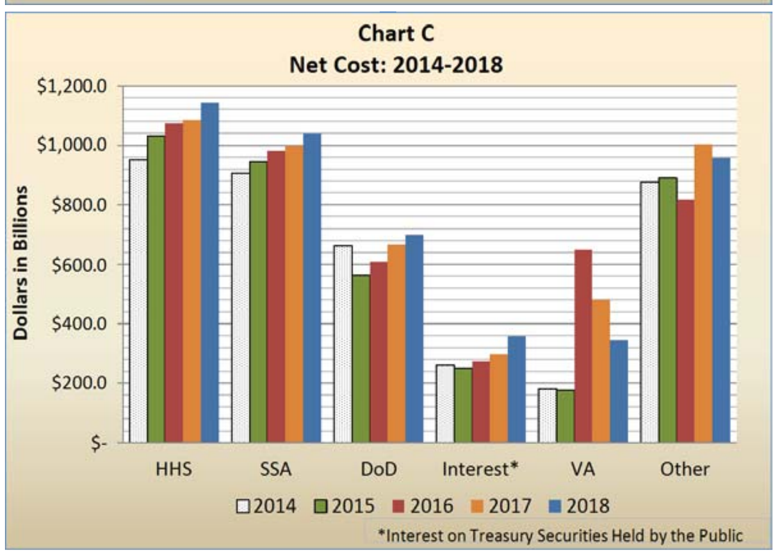
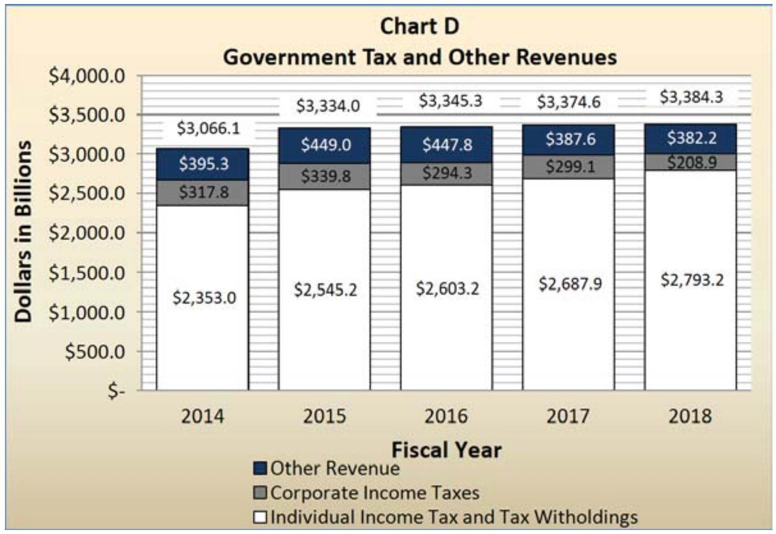


Chart B shows the composition of the government's net cost. In fiscal year 2018, nearly three fourths of total net cost came from HHS, SSA, DOD, and VA. Interest on Treasury securities (i.e., debt) held by the public contributed an additional 8 percent, and the other entities included in the government's fiscal year 2018 Statement of Net Cost accounted for a combined 21 percent of the government's total net cost for fiscal year 2018. Chart C 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 2018 ($1.1 trillion and $1.0 trillion, respectively) are attributable to major social insurance programs administered by these entities. DOD net costs of $698.4 billion relate primarily to operations, readiness, and support; personnel; research; procurement; and retirement and health benefits. VA costs of $346.9 billion support health, education and other benefits programs for our nation's veterans. The $132.8 billion decrease in VA net cost during fiscal year 2018 is primarily due to the decrease in losses from changes in actuarial assumptions as referenced earlier. From Chart C, over the past five years, HHS, SSA, and Interest costs have increased 20.1 percent, 14.6 percent, and 37.4 percent, respectively.

Tax and Other Revenues

As noted earlier, tax and other revenues from the Statement of Operations and Changes in Net Position are deducted from total net cost to derive the government's "bottom line" net operating cost. Chart D shows that total tax and other revenue increased slightly by $9.7 billion or 0.3 percent to $3.4 trillion for fiscal year 2018. This increase is attributable mainly to an overall growth in individual income tax collections, partially offset by reduced estate and corporate income tax collections and deposit of earnings from the FR System.[14] Earned revenues from Table 3 are not considered "taxes and other revenue" and, thus, are not shown in Chart D. Individual income tax and tax withholdings and corporate income taxes accounted for about 82.5 percent and 6.2 percent of total revenue, respectively in fiscal year 2018; other revenues from Chart D include Federal Reserve earnings, excise taxes, unemployment taxes, and customs duties.



As previously shown in Table 3, the increases in net cost and tax and revenues almost entirely offset each other, resulting in the government's bottom line net operating cost remaining largely unchanged at $1.2 trillion for fiscal year 2018.

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.

[14] Fiscal year 2018 Department of the Treasury Agency Financial Report, p. 37

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	2018	2017*	Increase / (Decrease) $	%
Assets				
Cash & Other Monetary Assets	$ 507.5	$ 271.2	$ 236.3	87.1%
Loans Receivable, Net	$ 1,419.1	$ 1,350.2	$ 68.9	5.1%
Inventories & Related Property, Net	$ 337.5	$ 326.7	$ 10.8	3.3%
Property, Plant & Equipment, Net	$ 1,090.5	$ 1,087.0	$ 3.5	0.3%
Other	$ 482.1	$ 499.8	$ (17.7)	(3.5%)
Total Assets	**$ 3,836.7**	**$ 3,534.9**	**$ 301.8**	**8.5%**
Less: Liabilities, comprised of:				
Federal Debt Held by the Public & Accrued Interest	$ (15,812.7)	$ (14,724.1)	$ 1,088.6	7.4%
Federal Employee & Veteran Benefits	$ (7,982.3)	$ (7,700.1)	$ 282.2	3.7%
Other	$ (1,562.5)	$ (1,472.6)	$ 89.9	6.1%
Total Liabilities	**$ (25,357.5)**	**$ (23,896.8)**	**$ 1,460.7**	**6.1%**
Net Position (Assets Minus Liabilities)	**$ (21,520.8)**	**$ (20,361.9)**	**$ 1,158.9**	**5.7%**

*Restated (see Financial Statement Note 1.U)

Assets

As of September 30, 2018, the government's $3.8 trillion in assets are comprised mostly of net loans receivable ($1.4 trillion) and net property, plant, and equipment (PP&E) ($1.1 trillion).[15] From Financial Statement Note 4, The Department of Education's (Education's) Federal Direct Student Loan Program accounted for $1.1 trillion (78.6 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.[16]

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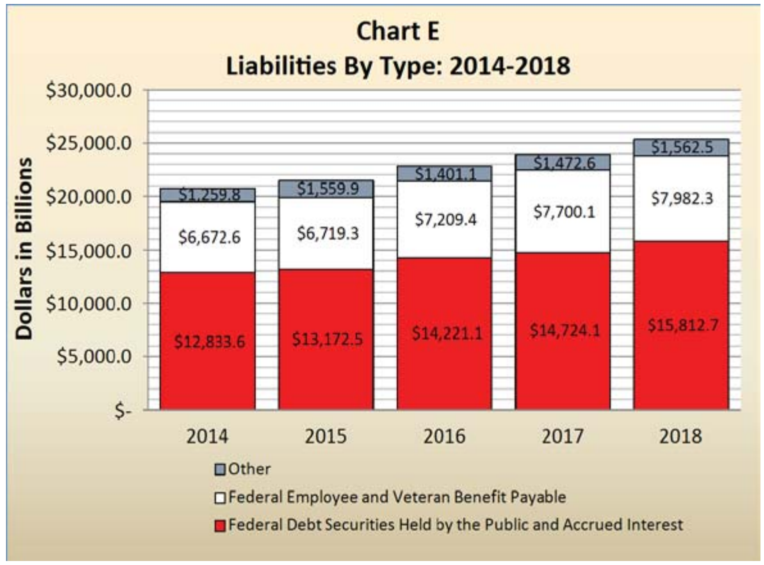
[15] For financial reporting purposes, other than multi-use heritage assets, stewardship assets of the government are not recorded as part of Property, Plant, and Equipment. Stewardship assets are comprised of stewardship land and heritage assets. Stewardship land consists of public domain land (e.g.,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

[16] With the enactment of the SAFRA Act, which was included as part of the *Health Care and Education Reconciliation Act of 2010* (HCERA) (P. L. 111-152), no new loans were originated under the Federal Family Education Loan (FFEL) Program (guaranteed loan program) since July 1, 2010. See Department of Education fiscal year 2018 Agency Financial Report p. 50.

Liabilities



As indicated in Table 4 and Chart E, of the government's $25.4 trillion in total liabilities, the largest liability is federal debt securities held by the public and accrued interest, the balance of which increased by $1.1 trillion (7.4 percent) to $15.8 trillion as of September 30, 2018.

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 $282.2 billion (3.7 percent) during fiscal year 2018, to about $8.0 trillion. This total amount is comprised of $2.5 trillion in benefits payable for the current and retired civilian workforce, and $5.4 trillion for the military and veterans. OPM administers the largest civilian pension plan, covering nearly 2.7 million current employees and 2.6 million annuitants and survivors. The military pension plan covers about 2.1 million current military personnel (including active service, reserve, and National Guard) and approximately 2.3 million retirees and survivors.

Federal Debt

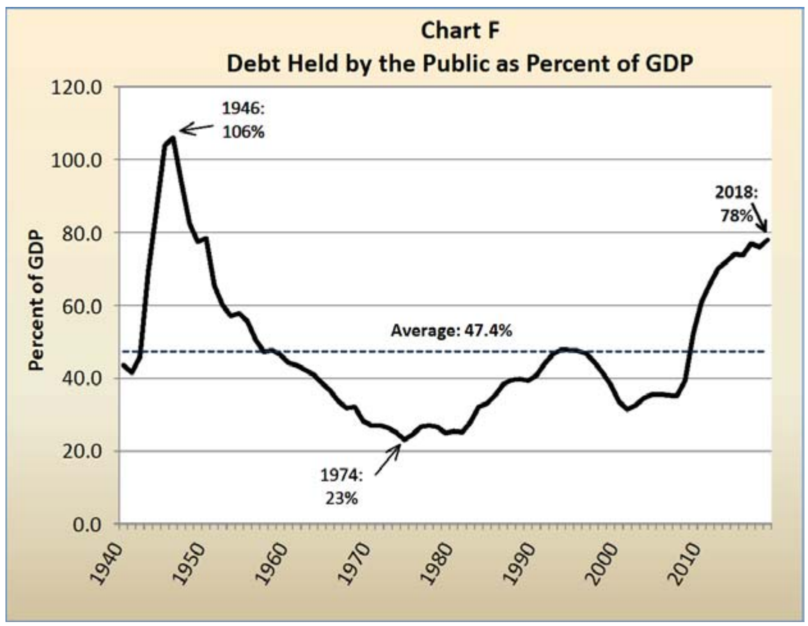
The budget surplus or deficit is the difference between total federal spending and receipts (e.g., taxes) in a given year. The government borrows from the public (increases federal debt levels) to finance deficits. During a budget surplus (i.e., when receipts exceed spending), the government typically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

The government's publicly-held debt, or federal debt held by the public, and accrued interest (Balance Sheet liability) totaled $15.8 trillion as of September 30, 2018. It is comprised of Treasury securities, such as bills, notes, and bonds, net of unamortized discounts and premiums; and accrued interest payable. The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks (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 2018, new borrowings were $10.1 trillion, and repayments of maturing debt held by the public were $9.0 trillion, both increases from fiscal year 2017.

Prior to 1917, Congress approved each debt issuance. In 1917, to facilitate planning in World War I, Congress and the President established a dollar ceiling for federal borrowing. With the Public Debt Act of 1941 (Public Law [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 February 9, 2018 through March 1, 2019. It is important to note that increasing or suspending the debt limit does not increase spending or authorize new spending; rather, it permits the United States to continue to honor pre-existing commitments to its citizens, businesses, and investors domestically and around the world.

In addition to debt held by the public, the government has about $5.8 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 ($301.0 billion) trust funds. Intragovernmental debt is primarily held in government trust funds in the form of special nonmarketable securities by various parts of the government. Laws establishing government trust funds generally require excess trust fund receipts (including interest earnings) over disbursements to be invested in these special securities. Because these amounts are both liabilities of the Treasury and assets of the government trust funds, they are eliminated as part of the consolidation process for the governmentwide financial statements (see Note 11). When those securities are redeemed, e.g., to pay Social Security benefits, the government will need to obtain the resources necessary to reimburse the trust funds. The sum of debt held by the public and intragovernmental debt equals gross federal debt, which (with some adjustments), is subject to a statutory ceiling (i.e., the debt limit). At the end of fiscal year 2018, debt subject to the statutory limit (DSL) was $21.5 trillion[17] (see sidebar).

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



- For most of the nation's history, through the first half of the 20th century, the debt-to-GDP ratio has tended to increase during wartime and decline during peacetime.
- Chart F shows that wartime spending and borrowing pushed the debt-to-GDP ratio to an all-time high of 106 percent in 1946, soon after the end of World War II, but it decreased rapidly in the post-war years,
- The ratio grew rapidly from the mid-1970s until the early 1990s. Strong economic growth and fundamental fiscal decisions, including measures to reduce the federal deficit and implementation of binding "Pay As You Go" (PAYGO) rules (which require that new tax or spending laws not add to the deficit), generated a significant decline in the debt-to-GDP ratio, from a peak of 48 percent in 1993-1995, to 31 percent in 2001.
- During the first decade of the 21st century, PAYGO rules were allowed to lapse, significant tax cuts were implemented, entitlements were expanded, and spending related to defense and homeland security increased. By September 2008, the debt-to-GDP ratio was 39 percent of GDP.
- PAYGO rules were reinstated in 2010, but the extraordinary demands of the last economic and fiscal crisis and the consequent actions taken by the federal government, combined with slower economic growth in the wake of the crisis, pushed the debt-to-GDP ratio up to 74 percent by the end of fiscal year 2014.
- The debt was 78.0 percent of GDP at the end of fiscal year 2018 (compared to 76 percent at the end of fiscal year 2017).[18] From Chart F, since 1940, the average debt-to-GDP ratio is 47.4 percent.

[17]Effective March 2, 2019, the statutory debt limit was set at $22.0 trillion, and on March 4, 2019, the Secretary of the Treasury notified the Congress that the statutory debt limit would be reached on or after that day. When delays in raising the debt limit occur, Treasury must often deviate from its normal debt management operations and take a number of extraordinary measures to meet the government's obligations as they come due without exceeding the debt limit. Treasury began taking these extraordinary actions on March 4, 2019.

[18]10/15/2018 press release: Joint Statement of OMB Director, Mick Mulvaney and Treasury Secretary, Steven T. Mnuchin.

The Economy in Fiscal Year 2018

The U.S. economy's performance provides a useful backdrop against which to evaluate the government's financial results. U.S. economic growth accelerated during fiscal year 2018 due to the Tax Cuts and Jobs Act and deregulation. Net jobs increased from an average of 168,000 jobs per month in fiscal year 2017 to 219,000 jobs per month in fiscal year 2018, and by the end of the fiscal year, the unemployment rate had declined to a 49-year low of 3.7 percent. Headline inflation (as measured by the Consumer Price Index, or CPI) was relatively stable, while core inflation, which excludes food and energy, accelerated. In fiscal year 2018, growth in after-tax personal income as well as productivity held steady at the solid paces seen in the previous fiscal year.

Table 5: National Economic Indicators*

	FY 2018	FY 2017
Real GDP Growth	3.0%	2.3%
Business Fixed Investment Growth	6.8%	5.0%
Residential Investment Growth	0.5%	3.0%
Average monthly payroll job change (thousands)	219	168
Unemployment rate (percent, end of period)	3.7%	4.2%
Consumer Price Index (CPI)	2.3%	2.2%
CPI, excluding food and energy	2.2%	1.7%
Personal Consumption Expenditure (PCE) Price Index	2.0%	1.8%
Personal Consumption Expenditure (PCE) Price Index	1.9%	1.5%

* Some FY2017 data may differ from the FY2017 Financial Report due to updates and revisions.

Buoyed by the first major tax reform in three decades, as well as other pro-growth policies, real (i.e., inflation-adjusted) GDP growth accelerated to 3.0 percent in fiscal year 2018, after growing in the previous fiscal year by 2.3 percent. A marked acceleration in consumption, as well as faster growth in business fixed investment and a significant contribution from net exports, drove growth. Growth of consumer spending strengthened to 2.9 percent in fiscal year 2018, up from 2.4 percent during the previous fiscal year, while business fixed investment accelerated for the second consecutive year, growing by 6.8 percent in the latest fiscal year after increasing at a 5.0 percent pace during fiscal year 2017.

During fiscal year 2018, for the first time in the history of the Job Openings and Labor Turnover Survey (JOLTS), the number of available job openings exceeded the number of unemployed persons. After the economy created 2.0 million payroll jobs during fiscal year 2017, an additional 2.6 million jobs were added during fiscal year 2018, and the average monthly pace of job creation also stepped up from 168,000 during fiscal year 2017 to 219,000 per month in the latest fiscal year. By the end of fiscal year 2018, the number of unemployed persons in the economy had declined by 805,000 to 6.0 million as of September 2018. The unemployment rate declined 0.5 percentage points, from 4.2 percent in September 2017 to 3.7 percent in September 2018, its lowest level since December 1969. During fiscal year 2018, other notable labor market developments included the decline in the unemployment rate for adult women to 3.3 percent, for African Americans to 6.0 percent, and for Hispanics to 4.5 percent, rates that are historically low. Declining unemployment rates are associated with faster economic growth rates and rising incomes.

During fiscal year 2018, headline inflation edged up, while core inflation accelerated more noticeably. The CPI rose 2.3 percent during fiscal year 2018, slightly faster than the 2.2 percent during fiscal year 2017, while core inflation accelerated to 2.2 percent, higher than the 1.7 percent reading during fiscal year 2017. The increase in the Federal Reserve's preferred measure of inflation, the Personal Consumption Expenditure (PCE) price index, was also relatively stable at the headline level, ticking up to 2.0 percent in fiscal year 2018 from 1.8 percent in fiscal year 2017. Over the course of the fiscal year, however, inflation by this measure decelerated later in the year. The PCE price index rose by 1.85 percent headline and 1.7 percent core in the last six months of fiscal year 2018 at a compound annual rate, and, in the final three months, rose by 1.5 headline and 1.4 percent core at a compound annual rate.

Growth of nominal disposable personal income (DPI) held steady during fiscal year 2018, which helped to stabilize purchasing power in real terms. Real DPI grew 2.8 percent in fiscal year 2018, matching the 2.8 percent rate during fiscal year 2017. Towards the end of fiscal year 2018, growth of nominal average hourly earnings also accelerated, helping to boost wages in real terms. Real average hourly earnings increased 0.5 percent during fiscal year 2018, after rising only 0.2 percent the previous fiscal year.

The housing market showed signs of slowing during fiscal year 2018, partly reflecting the marked rise in mortgage rates over the fiscal year. Residential investment grew by 0.5 percent, after a 3.0 percent advance during the previous fiscal year. Home price growth began to slow towards the end of the fiscal year. Existing home sales declined throughout fiscal year 2018, while new home sales tailed off at the very end of the fiscal year. However, the monthly average level of new residential construction spending was a bit higher during 2018 compared to 2017. Other indicators that drive housing demand are strong, such as labor force participation and household formation.

Growth of labor productivity held relatively steady during fiscal year 2018. Productivity growth rose 1.3 percent during fiscal year 2018, after increasing by 1.4 percent during fiscal year 2017. Growth in these two fiscal years contrasted sharply with the 0.1 percent decline in productivity growth during fiscal year 2016.

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[19] for fiscal year 2018 and fiscal year 2017.

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 78 percent in 2018 to 84 percent by 2022, to over 100 percent by 2030, and to 530 percent in 2093 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 4.1 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 20 percent if reforms are delayed ten years, and about 46 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[20] remains unchanged, and hence, are neither forecasts nor predictions. Nevertheless, policy changes must be enacted so that actual financial outcomes will be different than those projected.

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 H shows receipts, non-interest spending, and the difference – the primary deficit – expressed as a share of GDP. The primary deficit-to-GDP ratio spiked during 2009 through 2012 due to the 2008-09 financial crisis and the ensuing severe recession, as well as the increased spending and temporary tax reductions enacted to stimulate the economy and support recovery. These elevated primary deficits resulted in a sharp increase in the ratio of debt to GDP, which rose from 39 percent at the end of 2008 to 70 percent at the end of 2012. As an economic recovery took hold, the primary deficit ratio fell, averaging 1.9 percent of GDP over 2013 through 2018. This primary deficit ratio was still high enough that the debt-to-GDP ratio increased further, ending 2018 at 78 percent. The primary deficit ratio is projected to rise to 2.9 percent in 2019 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 3.0 percent of GDP in 2028. The primary deficit ratio peaks at 4.1 percent in 2039, gradually decreases beyond that point as aging of the population continues at a slower pace, and reaches 2.5 percent of GDP in 2093.

Primary deficit trends are heavily influenced by tax receipts. Receipts as a share of GDP were markedly depressed in 2009 through 2012 because of the recession and tax reductions enacted as part of the *American Recovery and Reinvestment Act of 2009* (ARRA) and the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*. The share subsequently increased to 18 percent of GDP by 2015, then decreased to 16.5 percent in 2018, following enactment of the *Tax Cuts and Jobs Act of* 2018 (TCJA), below its 30-year average of 17.3 percent.

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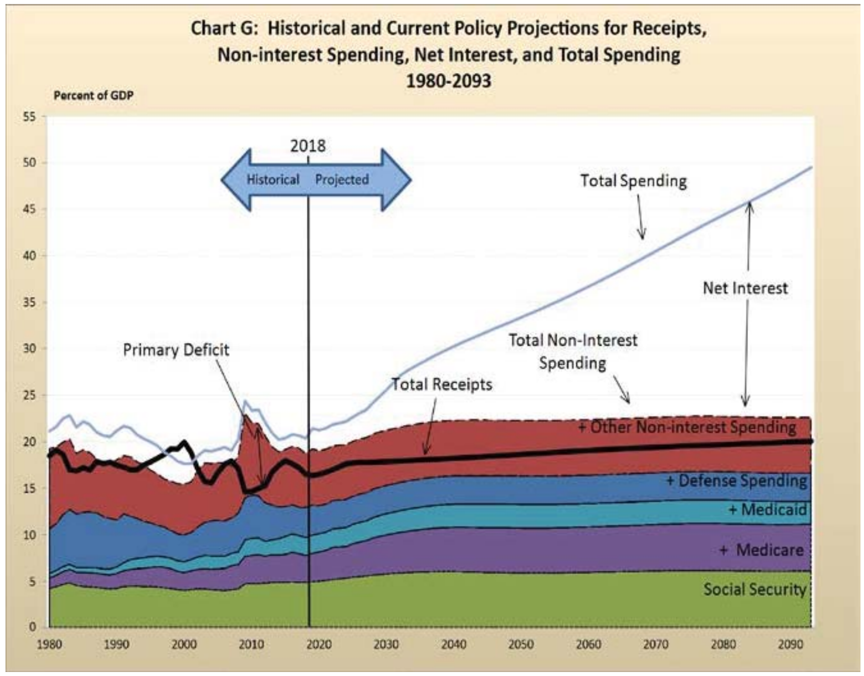
[19] For the purposes of the Statement of Long-Term Fiscal Projections and this analysis, spending is defined in terms of outlays. In the context of federal budgeting, spending can either refer to: (1) budget authority – the authority to commit the government to make a payment; (2) obligations – binding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

[20] 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).



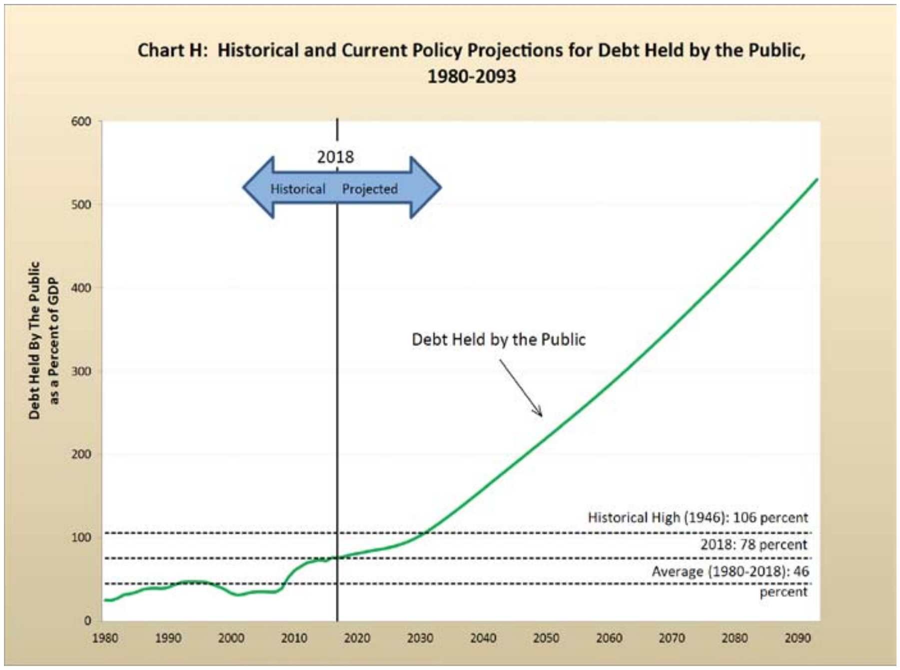
Receipts are projected to grow slightly more rapidly than GDP over the projection period as increases in real incomes cause more taxpayers and a larger share of income to fall into the higher individual income tax brackets.

Non-interest spending as a share of GDP is projected to rise gradually from 18.7 percent in 2018 to 21.0 percent in 2029, and ends at 22.6 percent in 2093. Beginning in 2020, these increases are principally due to faster growth in Medicare, Medicaid, and Social Security spending (see Chart G). Over the next 25 years, the aging of the baby boom generation is projected to increase the Social Security, Medicare, and Medicaid spending shares of GDP by about 1.0 percentage points, 1.7 percentage points, and 0.6 percentage points, respectively. 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.

One of the most important assumptions underlying the projections is the future growth of health care costs. As discussed in Note 22, these future growth rates – both for health care costs in the economy generally and for Federal health care programs such as Medicare, Medicaid, and *Affordable Care Act* (ACA) exchange subsidies – are highly uncertain. In particular, enactment of the ACA in 2010 and the *Medicare Access and CHIP Reauthorization Act (MACRA)* in 2015 established cost controls for Medicare hospital and physician payments whose long-term effectiveness is still to be demonstrated. The Medicare spending projections in the long-term fiscal projections are based on the projections in the 2018 Medicare trustees' report, which assume the ACA and MACRA cost control measures will be effective in producing a substantial slowdown in Medicare cost growth. As discussed in Note 22, the Medicare projections are subject to much uncertainty about the ultimate effects of these provisions to reduce health care cost growth. For the long-term fiscal projections, that uncertainty also affects the projections for Medicaid and exchange subsidies, because the cost per beneficiary in these programs is assumed to grow at the same reduced rate as Medicare cost growth per beneficiary.

As discussed in Note 23, the primary deficit projections reported in the Fiscal Year 2018 Financial Report increased compared to those reported in the Fiscal Year 2017 Financial Report. These increases are attributable to a number of factors, but in great part to: (1) use of fiscal year 2018 actual budget results that differed from projections made in prior years, including lower corporate and individual income tax receipts, and higher non-defense discretionary spending as a result of the increased discretionary spending caps in the Bipartisan Budget Act of 2018 (BBA 2018); and (2) revised assumptions, including those related to corporate income taxes to reflect enactment of the TCJA, and to growth in discretionary spending. For the Fiscal Year 2018 Financial Report, corporate income tax receipts are assumed to be the same share of GDP as projected in the 2018 Midsession Review, which incorporates the expected effects of the TCJA. In addition, the projections assume that individual income and estate and gift tax provisions of the TCJA are permanently extended; Congressional action is required to make this change. With regard to discretionary spending, previous statements assumed that it followed the caps established by the Budget Control Act of 2011 (BCA) and then grew with nominal GDP in the years after caps expired. However, discretionary spending has not been limited to the caps established in the BCA. Instead, budget deals in 2013, 2015, and 2018 raised the caps in each of the years 2014 through 2019. Therefore, as a reasonable representation of current policy, the 2018 projections assume that discretionary spending grows at the same rate as nominal GDP beyond 2019, rather than being limited to the statutory caps, subject to Joint Committee on Deficit Reduction spending controls. Congressional action is required to make this change. 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 G, projections for interest rates, and projections for GDP together determine the debt-to-GDP ratio projections shown in Chart H. That ratio was 78 percent at the end of fiscal year 2018 and under current policy is projected to be 84 percent by 2022, over 100 percent by 2030, and 530 percent in 2093. The change in debt held by the public from one year to the next is approximately equal to 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.[21] The continuous rise of the debt-to-GDP ratio indicates that current policy is unsustainable.



These debt-to-GDP projections are higher than the corresponding projections in both the fiscal year 2017 and fiscal year 2016 *Financial Reports*. For example, the last year of the 75-year projection period used in the fiscal year 2016 *Financial Report* is 2091. In the fiscal year 2018 *Financial Report*, the debt-to-GDP ratio for 2091 is projected to be 513 percent, which compares with 293 and 252 percent projected for that same year in the fiscal year 2017 *Financial Report* and the fiscal year 2016 *Financial Report,* respectively.[22]

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 2093 to remain at its level in 2018 (78 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 0.8 percent of GDP, 4.1 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 4.1 percent of GDP. This gap represents 21.9 percent of 75-year present value receipts and 18.6 percent of 75-year present value non-interest spending. The fiscal gap was estimated at 2.0 percent in the 2017 *Financial Report*, 2.1 percentage points lower than estimated in this Report.

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

Table 6 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 4.1 percent of GDP on average between 2019

Table 6

Costs of Delaying Fiscal Reform

Period of Delay	Change in Average Primary Surplus
Reform in 2019 (No Delay)	4.1 percent of GDP between 2019 and 2093
Reform in 2029 (Ten-Year Delay)	4.9 percent of GDP between 2029 and 2093
Reform in 2039 (Twenty-Year Delay)	6.0 percent of GDP between 2039 and 2093

Note: Reforms taking place in 2018, 2028, and 2038 from the 2017 Financial Report were 2.0, 2.4, and 3.0 percent of GDP, respectively.

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

[22] See the Note 23 of the *Fiscal Year 2017 Financial Report of the U.S. Government* for more information about changes in the long term fiscal projections between fiscal years 2016 and 2017.

and 2093 (i.e., some combination of reducing spending and increasing revenue by a combined 4.1 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 over shorter periods. For example, if policy reform is delayed by 10 years, closing the fiscal gap requires increasing the primary surpluses by 4.9 percent of GDP on average between 2029 and 2093. Similarly, delaying reform by 20 years requires primary surplus increases of 6.0 percent of GDP on average between 2039 and 2093. The differences between the required primary surplus increases that start in 2029 and 2039 (4.9 and 6.0 percent of GDP, respectively) and that which starts in 2019 (4.1 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 11 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 hinder economic growth, then the sooner policies 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, there is little doubt that current policy is not sustainable.

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

Social Insurance

The long-term fiscal projections reflect government receipts and spending as a whole. The SOSI focuses on the government's "social insurance" programs: Social Security, Medicare, Railroad Retirement, and Black Lung. [23] 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 $53.8 trillion over 75 years as of January 1, 2018 for the "Open Group," an increase of $4.8 trillion over net expenditures of $49.0 trillion projected in the 2017 *Financial Report*.[24] The current-law 2018 amounts reported for Medicare reflect the physician payment levels expected under the MACRA payment rules and the ACA-mandated reductions in other Medicare payment rates, but not the payment reductions and/or delays that would result from trust fund depletion.[25] Similarly, current-law projections for Social Security do not reflect benefit payment reductions and/or delays that would result from fund depletion. By accounting convention, the transfers of general revenues are eliminated in the consolidation of the SOSI at the governmentwide level and as such, the general revenues that are used to finance Medicare Parts B and D are not included in these calculations. For the fiscal year 2018 and 2017 SOSI, the amounts eliminated totaled $32.9 trillion and $30.0 trillion, respectively. SOSI programs and amounts are included in the broader fiscal sustainability analysis in the previous section, although on a slightly different basis (as described in Note 23).

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

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

[24]'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.

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

Table 7: Social Insurance Future Expenditures in Excess of Future Revenues

Dollars in Trillions	2018	2017	Increase / (Decrease) $	%
Open Group (Net):				
Social Security (OASDI)	$ (16.1)	$ (15.4)	$ 0.7	4.5%
Medicare (Parts A, B, & D)	$ (37.6)	$ (33.5)	$ 4.1	12.2%
Other	$ (0.1)	$ (0.1)	$ -	0.0%
Total Social Insurance Expenditures, Net (Open Group)	**$ (53.8)**	**$ (49.0)**	$ 4.8	9.8%
Total Social Insurance Expenditures, Net (Closed Group)	**$ (73.5)**	**$ (68.2)**	$ 5.3	7.8%
Social Insurance Net Expenditures as a % of Gross Domestic Product (GDP)*				
Open Group				
Social Security (OASDI)	(1.2%)	(1.2%)		
Medicare (Parts A, B, & D)	(2.9%)	(2.8%)		
Total (Open Group)	**(4.0%)**	**(4.0%)**		
Total (Closed Group)	**(5.5%)**	**(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 2018 & 2017 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 2018 and 2017.

Table 8: Changes in Social Insurance Projections

Dollars in Trillions	2018	2017
Net Present Value (NPV) - Open Group (Beginning of the Year)	**$ (49.0)**	**$ (46.7)**
Changes In:		
Valuation Period	$ (1.9)	$ (2.0)
Demographic data and assumptions	$ 0.7	$ (0.2)
Economic data and assumptions[1]	$ (0.5)	$ (0.6)
Law or policy	$ (1.0)	$ -
Methodology and programmatic data[1]	$ 0.2	$ -
Economic and other healthcare assumptions[2]	$ (1.5)	$ (0.3)
Change in projection base[2]	$ (0.9)	$ 0.7
Net Change in Open Group measure	$ (4.8)	$ (2.3)
NPV - Open Group (End of the Year)	**$ (53.8)**	**$ (49.0)**

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

The following briefly summarizes the significant changes for the current valuation (as of January 1, 2018) 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 2017 with a much larger negative net cash flow for 2092. 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): For the current valuation, the only change to the ultimate demographic assumptions was a small decrease of 10,000 Lawful Permanent Resident (LPR) immigrants per annum in the future. 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 lower birth rates than originally assumed, the observed persistent drop in the total fertility rate in recent years is now assumed to be a loss of potential births rather than just a deferral to this period, and higher death rates than projected in prior valuations for Medicare experience 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 $700 billion.
- Changes in economic data and assumptions (affects Social Security only): The ultimate economic assumptions for the current valuation period are the same as those for the prior year valuation. However, the starting economic values and the way these values transition to the ultimate assumptions were changed. These changes included: the estimated level of

potential GDP was reduced by about 1 percent in 2017 and throughout the projection period, meaning that cumulative growth in actual GDP is 1 percent less over the remainder of the projected recovery than assumed in the prior valuation; near-term interest rates were decreased, and lower than expected ratios of and assumed extended recoveries for labor compensation to GDP and taxable payroll to GDP. Overall, changes to these assumptions caused the present value of the estimated future net cash flows to decrease (become more negative) by $500 billion.

- Changes in Law or Policy: Between the prior and current valuation periods, no new laws, regulations, or policies were enacted that are expected to have significant effects on the OASDI or Medicare programs. However, the current valuations for each program do incorporate some notable changes with negligible effects on the present value of estimated cash flows:
    - For Social Security, the 2012 Deferred Action for Childhood Arrivals (DACA) program is assumed to be phased out over the next two years (the prior valuation assumed that the 2012 DACA program would continue indefinitely); and the TCJA includes the elimination of the individual mandate penalty of the *Patient Protection and Affordable Care Act*, which is expected to cause some individuals to drop employer-sponsored health insurance, increase OASDI-covered wages, and taxable payroll slightly.
    - For Medicare, legislation that affected the present value of estimated cash flows includes but is not limited to: The *Disaster Tax Relief and Airport and Airway Extension Act of 2017* and the *Bipartisan Budget Act of 2018 (BBA)*.

  Overall, these 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 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: utilization rate assumptions for inpatient hospital use and utilization rate and case mix assumptions for skilled nursing facilities were decreased; payment rates to private health plans are higher than projected in last year's report; higher projected manufacturer rebates. The net impact of these changes caused the present value of the estimated future net cash flows to decrease (become more negative) by $1.5 trillion.
- Change in Projection Base (affects Medicare only): Actual income and expenditures in 2017 were different than what was anticipated when the 2017 Medicare Trustees Report projections were prepared. Part A payroll tax income was lower and expenditures were higher than anticipated, based on actual experience. Part B total income and expenditures were higher than estimated based on actual experience. For Part D, actual income and expenditures were both lower than prior estimates. The net impact of the Part A, B, and D projection base changes is a decrease (become less negative) in the estimated future net cash flow by $900 billion.

Projected net expenditures for Medicare Parts A and B declined significantly between fiscal year 2009 and fiscal year 2010 reflecting provisions of the ACA. As reported in Note 22, uncertainty remains about whether the projected cost savings and productivity improvements will be sustained in a manner consistent with the projected cost growth over time. Note 22 includes an alternative projection to illustrate the uncertainty of projected Medicare costs. As indicated earlier, GAO disclaimed opinions on the 2018, 2017, 2016, 2015 and 2014 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.[26] According to the Medicare Trustees' Report, spending on Medicare is projected to rise from its current level of 3.7 percent of GDP to 5.9 percent in 2042 and to 6.2 percent in 2092.[27] As for Social Security, combined spending is projected to generally increase from its current level of 4.9 percent of GDP to about 6.1 percent by 2038, declining to 5.9 percent by 2052 and then generally increase to 6.1 percent by 2092. The government collects and maintains funds supporting the Social Security and Medicare programs in Trust Funds. A scenario where 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.

[26] A Summary of the 2018 Annual Social Security and Medicare Trust Fund Reports, p. 1-2 and the 2017 Medicaid Actuarial Report
[27] 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 (2029 in FY 2017 Report)	In 2026, trust fund income is projected to cover 91 percent of benefits, decreasing to 78 percent in 2042, then increasing to 85 percent by 2092.
Combined Old-Age Survivors and Disability Insurance (OASDI)**	2034 (unchanged from FY 2017 Report)	In 2034, trust fund income is projected to cover 79 percent of scheduled benefits, decreasing to about 74 percent by 2092.

* Source: 2018 Medicare Trustees Report ** Source: 2018 OASDI Trustees Report

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

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

Financial Management

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 rather than using data analytics to monitor results. The President's Management Agenda (PMA) Cross Agency Priority (CAP) Goal #8, Results-Oriented Accountability for Grants, provides a comprehensive roadmap for improving grants management and reducing recipient reporting burden. Increased efficiencies in the grant-making process will provide recipients more time to perform work associated with the grant, thereby helping agencies[28] more effectively achieve their missions.

The CAP Goal strategy focuses on standardizing grants data, modernizing digital tools, and using data to promote decision making that is based on risk and performance. In support of the CAP goal, OMB issued "Strategies to Reduce Grant Recipient Reporting Burden," M-18-24, which requires agencies to increase grant program efficiency, promote evaluation of grant programs, and reduce reporting burden.

M-18-24 requires agencies to use the System for Award Management (SAM) information to comply with award requirements, reducing the recipient burden and government cost of having multiple agencies request the same information (except under limited circumstances) from the grant recipient. M-18-24 also requires agencies to evaluate all systems and other methods used to collect information from recipients to determine if the same data is being collected by the agency multiple times and to develop a strategy to eliminate any duplicative requests.

OMB is leading an agency-wide Grants Management Data Standards Work Group, and in September 2018, the Group completed an initial set of draft grants management data standards. In November 2018, a Draft Grants Management Data Standards Feedback website was set up to gather public input on the data standards. Input from the public will be used in finalizing the data standards that will allow inter-agency grants data to be created, reduce the number of grants management systems, and promote a risk-based, data-driven approach to managing federal grants.

Getting Payments Right

Preventing improper payments within the federal government is a priority for the Administration and OMB. In March 2018, OMB released the PMA CAP Goal #9, Getting Payments Right. 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 to preventing improper payments from occurring at all. This CAP Goal has resulted in exceptional collaboration across the CFO community to identify the causes of improper payments through two main strategies: (1) reducing monetary loss and (2) clarifying and streamlining reporting requirements. For agencies with programs reporting more than $100 million in monetary loss in fiscal year 2018, a scorecard must be completed quarterly and posted 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.

Just as it did in fiscal year 2018, in fiscal year 2019, OMB will continue to work with agencies 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. In addition, OMB will continue to work with Treasury on outreach related to the Do Not Pay Business Center and the services they provide to agencies to ensure payment integrity. In June 2018, OMB released Circular A-123, Appendix C (M-18-20), Requirements for Payments Integrity Improvement to create a unified, comprehensive, and less burdensome set of requirements.

In fiscal year 2018, program performance was mixed, with some programs experiencing significant increases in improper payment estimates and others showing signs of improvement. As in the past, agencies recovered approximately $20 billion in overpayments through payment recapture audits and other methods. The estimated amount of improper payments increased in general across programs in fiscal year 2018, roughly in line with increases in program outlays. More details on fiscal year 2018 improper payment data can be found at PaymentAccuracy.gov.

In fiscal year 2019, OMB will continue to work with agencies, the Chief Financial Officers Council (CFOC), and other stakeholders as part of the Getting Payments Right CAP Goal. In addition, OMB will continue to rely on agency inspector general (IG) recommendations for additional program-specific improvements. OMB will also continue to improve communications with the public about improper payment rates and amounts.

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[28]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."

Leveraging Data as a Strategic Asset

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

The improved and expanded USAspending.gov website was launched on April 2, 2018. The new website allows taxpayers to examine nearly $4 trillion in federal spending and observe how this money flows from Congressional appropriations to local communities and businesses. The data from over 100 federal agencies is compiled by Treasury and will continue to be published on a quarterly basis. The new site allows users to explore information and download reports that are catered to their specific interests. The new site also includes a new feature, the Data Lab, which provides additional use cases, data visualizations, and analysis with insights into federal spending and trends.

In November 2017, GAO and many agency Offices of Inspector General published audits of the quality of the data as required under the DATA Act. As a result of these audits, 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 requires agencies to develop and implement a Data Quality Plan for fiscal years 2019 through 2021 at a minimum. Agencies are required to integrate Enterprise Risk Management (ERM) processes and internal controls and agencies are also required to consider in their assurance statements all internal controls (including financial and non-financial controls, and controls over DATA Act, financial, and all other reporting). The CFOC and key stakeholders from the procurement and financial assistance communities developed a DATA Act Data Quality Playbook as a resource tool for management and the audit communities.

As the quality of this data improves, OMB will work with Treasury and agencies to find additional data sources that could be linked to the DATA Act to better inform the public about the purpose and results of spending.

Sharing Quality Financial Management Services

The federal financial management infrastructure exists in a complex environment of legacy information technology, customized tools built to unique requirements, and business processes that do not fully leverage modern technology. The sharing of financial technology and services has been successful for smaller agencies, but has not met expectations for larger agencies. A cross-agency subgroup of the CFOC developed the core business framework for financial management that was used in the fall of 2017 to explore industry capabilities for smarter use of technology in federal financial management. This information is being 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, will be provided in fiscal year 2019. Please visit https://www.performance.gov/CAP/CAP_goal_5.html for additional information regarding CAP Goal #5.

Audit

Since the passage of the *CFO Act of 1990*, the federal financial community has made significant progress in financial accounting and reporting. As shown in Table 10, for fiscal year 2018, 22 of the 24 CFO Act agencies obtained an opinion from the independent auditors on their financial statements.[29] In addition, 40 auditor-identified material weaknesses were reported at the end of both fiscal years 2017 and 2018. For 2018, half of these are associated with DOD, which just completed its first full-scope financial statement audit. The other half are associated with non-DOD agencies, which experienced a 25 percent reduction in material weaknesses, overall, from 27 at the end of fiscal year 2017 to 20 at the end of 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 two of the CFO Act agencies and the government as a whole from achieving an audit opinion.

Table 10: Agency Audit Results: FY 2018

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	1	1	0	0	2
Department of Defense (DOD)	Disclaimer	13	8	0	1	20
Department of Education (Education)	Unmodified	0	1	0	0	1
Department of Energy (DOE)	Unmodified	0	0	0	0	0
Department of Health and Human Services (HHS)*	Unmodified	1	0	1	0	0
Department of Homeland Security (DHS)	Unmodified	2	0	0	0	2
Department of Housing & Urban Development (HUD)	Disclaimer	9	0	2	2	5
Department of the Interior (DOI)	Unmodified	0	0	0	0	0
Department of Justice (DOJ)	Unmodified	0	0	0	0	0
Department of Labor (DOL)	Unmodified	1	0	1	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	1	0	1	0	0
Department of Veterans Affairs (VA)	Unmodified	6	0	1	0	5
Agency for International Development (USAID)	Unmodified	1	0	0	0	1
Environmental Protection Agency (EPA)	Unmodified	2	0	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	0	0	0	0
Social Security Administration (SSA)	Unmodified	0	0	0	0	0
Totals		**40**	**10**	**7**	**3**	**40**

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

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

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 *Federal Financial Management Improvement Act* (FFMIA) fell to seven in fiscal year 2018 from eight in fiscal year 2017, and the number of auditors reporting lack of substantial compliance with one or more of the three Section 803(a) FFMIA requirements fell to nine in fiscal year 2018 from ten in fiscal year 2017.

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.

The first four sections above[30] summarize what OMB and agencies have been doing and plan to do to improve financial management, including financial management systems. In addition, Treasury has financial management improvements plans that will have governmentwide implications, which are described in its fiscal year 2018 agency financial report (https://home.treasury.gov/about/budget-financial-reporting-planning-and-performance/agency-financial-report) and its fiscal year 2020 budget request and performance plan (https://home.treasury.gov/about/budget-financial-reporting-planning-and-performance/budget-requestannual-performance-plan-and). Also, other agencies 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; all of these plans can be found in the agency financial report (https://comptroller.defense.gov/odcfo/afr2018.aspx). In addition to focusing on financial systems, DOD's audit remediation efforts include issues related to real property, inventory, operating materials and supplies (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.

In response to major management challenges to achieving their mission and goals, agencies continue to recognize the utility of ERM as a tool to identify, assess, mitigate, manage and prepare for risk. ERM contributes to risk-informed decision-making, encouraging a proactive rather than reactive approach to risk, and fostering a risk-aware culture. It also allows agencies to make better decisions in a resource-constrained environment and focus more on performance than compliances in various areas, including grants management. Under ERM, internal controls are not limited to compliance and financial reporting. Rather, internal controls are a means to address management challenges that cut across multiple agency functions and reduce the risk to an acceptable level. OMB has promoted ERM as a management tool, and the 2016 update to OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, explains ERM and the importance of integrating ERM with internal control processes.

OMB Circular No. A-123 implements the requirements of 31 U.S.C. 3512 (c) 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 changes incorporated in GAO's updated *Standards for Internal Control in the Federal Government* and contains multiple appendices that address one or more of the objectives of effective internal control.

- 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 new requirements for determining compliance with the FFMIA that are intended to reduce the cost, risk, and complexity of financial system modernizations.

As noted above, the total number of reported material weaknesses for the CFO Act agencies as of the issuance of this *Financial Report* was 40 for fiscal years 2018 and 2017. Effective internal controls are a challenge at the agency level and at the governmentwide level, with GAO reporting that at the governmentwide level, material weaknesses resulted in ineffective internal control over financial reporting. While progress is being made at many agencies and across the government in identifying and resolving internal control deficiencies, continued work is needed.

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

Agency Legal Compliance

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

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 Federal Real Property Profile (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/.

Land

The federal government owns roughly 640 million acres, about 28 percent, of the 2.27 billion acres of land in the United States. Four major federal land management agencies administer 610.1 million acres, or 95 percent, of this land. They are the Bureau of Land Management, Fish and Wildlife Service, and National Park Service in the Department of Interior (DOI); and the Forest Service in the U.S. Department of Agriculture (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 on the governmentwide Balance Sheet, but is discussed in Note 24 and in agency financial reports. In addition, DOD (excluding the Army Corps of Engineers) administers 11.4 million acres of land in the United States (as of September 30, 2014), consisting of military bases, training ranges, and more. Numerous other agencies administer the remaining federal acreage.

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 federal 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, as of 2016, contains 252,000 buildings reflecting 2.6 billion square feet of space. The domestic portfolio requires approximately $18.8 billion in annual operation and maintenance expenditures, including approximately $7.3 billion in annual lease costs. The replacement value for the government's 232,000 owned buildings is approximately $1 trillion, and the repair costs are $115 billion. It should be noted, however, that replacement value is not synonymous with fair market value. Within both the owned and leased inventories, there are opportunities to use space more effectively and efficiently. Several initiatives 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 with the authority to coordinate all aspects of their real property programs and to serve on the Federal Real Property Council (FRPC). The reconstituted FRPC seeks to provide comprehensive governmentwide strategic direction that optimizes 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 the burden of legislative requirements by creating a governance structure to include an Executive Steering Committee (ESC) and working groups. Led by direction from the ESC, 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.

The new strategic direction will build on the results of the Reduce the Footprint (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 and 2017, the CFO Act agencies reduced their fiscal year 2015 RTF baselines (which is the amount of space the CFO Act agencies held/occupied in 2015) by 12.4 million square feet, resulting in an annual estimated cost avoidance of $125 million. Under the RTF policy, the CFO Act agencies will continue to validate square footage and operations and maintenance costs in their Performance and Accountability Reports (PARs) or 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 *Federal Property Management Reform Act of 2016* (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).

Finally, to support increased reduction targets, the General Services Administration (GSA) and OMB developed a new management tool within the FRPP database that enables the CFO Act agencies to fully analyze the efficiency of their portfolios and to collocate with other agencies. In addition, GSA issued technical guidance in fiscal year 2017 to establish mandatory FRPP data validation and verification requirements that will enhance agencies' abilities to implement data driven decision making when developing their annual RTF reduction targets.

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

Conclusion

The federal government has seen significant progress in financial management since the passage of the CFO Act more than 25 years ago; yet significant challenges remain. The issues that the federal government faces today require financial managers to move beyond the status quo and improve both the efficiency and effectiveness of financial management activities. The steps outlined above build on tools and capabilities that are in place today, and refocus energies on critical and emerging priorities – cutting wasteful spending, improving the efficiency 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 *Financial Report's* financial statements. Details about the information in this *Financial Report* can be found in these agencies' financial statements included in their Performance and Accountability and Agency Financial Reports. This *Financial Report*, as well as those from previous years, is also available at the Treasury, OMB, and GAO websites at: http://www.fiscal.treasury.gov/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.*