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United States Government Accountability Office
Washington, DC 20548

January 9, 2009

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, D.C. 20548

Dear Ms. Payne:

The U.S. Government Accountability Office (GAO) is pleased to provide its comments on the Federal Accounting Standards Advisory Board's (FASAB) Exposure Draft entitled *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*.

The GAO strongly supports efforts to improve the transparency of the federal government's current financial condition and future fiscal path. We believe that the FASAB's current deliberation on the presentation of the nation's financial condition is another important step in recognizing the need for greater transparency in federal financial reporting.

We strongly support the need to further refine the government's current reporting model to fully achieve the stewardship financial reporting objective to provide more useful information to readers of the financial statements. The addition of the Statement of Social Insurance (SOSI) as an audited financial statement significantly improved the transparency of social insurance programs. We believe that the addition of the Statement of Fiscal Sustainability is necessary to provide an appropriate comprehensive perspective on the future funding and spending for Social Security and Medicare as well as all other government programs. For example, the Statement of Fiscal Sustainability would provide critical information about whether and the extent to which projected general revenues are less than or greater than projected Medicare Parts B and D benefits (after considering premiums and state transfers which represent about 25% of Medicare Part B and D funding) and discretionary spending that is also funded by general revenue. Such information is not currently provided in the SOSI.

There are a number of approaches for assessing the financial health of the U.S. government. These include assessing the extent to which the U.S. government has sufficient receipts to cover its obligations (1) in the current period and (2) over the long-term. The Statement of Fiscal Sustainability presents information addressing the fundamental question of whether the government can sustain public services, such as social benefits, and meet its obligations as they come due over the long-term.

This is the most significant fiscal question regarding the U.S. Government and is of concern to all citizens. With the current economic downturn, decreased tax receipts, and increased spending on social benefits and government bailouts, it is our view that the adoption of a Statement of Fiscal Sustainability is essential for providing policy-makers with comprehensive information on the condition of the U.S. Government's long-term fiscal health so that prudent actions can be taken.

Our comments, which are detailed in the enclosure to this letter, provide our responses to the questions set forth in the Exposure Draft entitled *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. If you have any questions, please call me at (202) 512-2600 or Robert Dacey, Chief Accountant at (202) 512-7439.

Sincerely yours,

A handwritten signature in cursive script that reads "McCoy Williams".

McCoy Williams
Managing Director
Financial Management and Assurance

Enclosure

GAO Responses on Questions Set Forth in Reporting Comprehensive Long-Term Projections for the U.S. Government

Question 1:

1. This exposure draft proposes reporting that would support FASAB Objective 3, Stewardship, and in particular, Sub-Objective 3B:

Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.¹

Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.²

Do you believe that the proposed reporting adequately supports the above objectives? Are there different reporting requirements that might better support the above objectives or that you believe should be added to the proposed requirements in this exposure draft? If so, please explain.

Response 1:

The current financial reporting model addresses several aspects of FASAB's Objectives of Federal Financial Reporting. The current financial statements of the Consolidated Financial Report (CFR) of the U.S. Government include the:

- Statements of Net Cost,
- Statements of Operations and Changes in Net Position,
- Reconciliation of Net Operation Cost and Unified Budget,
- Statements of Changes in Cash Balance from Unified Budget and Other Activities, and
- Balance Sheets.

These financial statements provide information that is critical for assessing the U.S. financial position which describes the government's financial health as of a distinct point in time based on past events and transactions. Specifically, the current financial statements provide a measurement of the federal government's assets and liabilities as of the end of the fiscal year, as well as the net cost of providing services and the taxes and other revenues recognized during the year. The aforementioned financial statements do not, however, provide sufficient information for determining the government's financial condition and how it may change in the future as stated in the Stewardship objective. The Statement of Fiscal Sustainability would provide a measurement of the government's financial condition and annual changes therein. Financial condition not only considers the government's current and past

¹ Statement of Federal Financial Accounting Concepts 1, par. 134.

² Statement of Federal Financial Accounting Concepts 1, par. 139.

performance, but also its capacity to meet future demand and responsibilities and is a broader and more forward-looking concept than that of financial position. The Statement of Fiscal Sustainability also provides financial and nonfinancial information about the national economy as well as about the government itself and helps to determine whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits.

The Statement of Social Insurance is also a basic financial statement in the CFR and provides long-term projections of receipts and spending for social benefit programs³ and is a step towards supporting the Stewardship Objective Sub-Objective 3B. It is our view that the proposed Statement of Fiscal Sustainability, combined with the current financial statements in the CFR, would more fully support the stewardship financial reporting objective and provide even greater transparency of how the government's financial condition has changed and may change in the future. For example, while payment of scheduled Social Security and Medicare Part A benefits are limited to (1) projected earmarked revenues reflected in the Statement of Social Insurance and (2) amounts held in the respective trust funds as of the valuation date reported in the footnotes, scheduled benefits for Medicare Parts B and D are funded from premiums and state transfers reported in the SOSI (about 25% of funding) as well as general revenues that are not presented in the SOSI (about 75% of funding). Such general revenues are also used to fund all other federal government discretionary spending. A Statement of Fiscal Sustainability would clearly show whether projected general revenues would be sufficient to fund both scheduled Medicare Part B and D benefits as well as all other federal government programs and the extent of any projected excess of spending over revenues.

Question 2:

In this proposed Statement, projections are prepared not to predict the future, but rather to depict results that may occur under various conditions. Accordingly, projections require assumptions to be made about the future. This exposure draft proposes broad and general guidance for selecting policy, economic, and demographic assumptions for long-term projections with a primary focus on the future implications of the continuation of current policy without change for federal government public services and taxation. The guidance begins at paragraph 19. Paragraph 28 explains that although current law is a reasonable starting point in selecting policy assumptions, a simple projection of “current law” would not always reflect current policy without change. Examples are provided.

Do you believe that the guidance for assumptions is appropriate? If not, please suggest alternative guidance. Please provide the rationale for your response.

Response 2:

It is our view that the guidance for the assumptions in the Exposure Draft is generally appropriate. We believe, however, that the guidance for the assumptions articulated in Paragraph 31 should be revised to provide more flexibility, where appropriate. Paragraph 31 requires that the same economic and demographic assumptions be used

³ Includes Federal Old-Age, Survivors and Disability Insurance (Social Security), Medicare Parts A, B, and D, Railroad Retirement benefits, and Black Lung benefits.

for the basic financial statement for Fiscal Sustainability reporting and for Social Security and Medicare in the Statement of Social Insurance. However, in some cases, the assumptions, particularly the economic assumptions may need to differ. For example, an appropriate unified discount rate for all projected receipts and spending in the Statement of Fiscal Sustainability may differ from either the Social Security or Medicare discount rates. Increasing the flexibility in paragraph 31 would allow the use of the most appropriate discount rate and permit changes to other assumptions as appropriate. It is our view, however, that any such differences, between the assumptions used in the Statement of Fiscal Sustainability and those in the SOSI for Social Security and Medicare, be appropriately disclosed.

Question 3:

This exposure draft proposes a basic financial statement and disclosures. (Description begins at paragraph 35 and an illustrative example of the basic financial statement is provided in Appendix B.) The Board has indicated that the primary audiences for the consolidated financial report of the U.S. Government (CFR) are citizens and citizen intermediaries such as journalists and public policy analysts.

Do you believe that the basic financial statement and disclosures would be understandable and meaningful for the primary audiences of the CFR? Please note any changes that you believe should be made to the proposed requirements for the basic financial statement and/or the disclosures.

Response 3:

We believe that the Statement of Fiscal Sustainability with related disclosures would provide important comprehensive information on the nation's long-term financial condition that would be meaningful to the primary audiences of the CFR. In its proposed format, we believe that the Statement of Fiscal Sustainability would clearly communicate the U.S. government's financial condition. Overall, the Statement of Fiscal Sustainability has been structured in a straightforward manner; however, it is our view that the excess of spending over receipts attributed to Medicare Part A and Social Security should be required to be disclosed in the footnotes. This would provide policy-makers and the public with critical information on the composition of the excess between the Social Security and Medicare Part A programs, which are supported by dedicated earmarked funding, and the remaining spending, which is supported by general revenues. This should be accompanied by appropriate narrative that discusses the significance of the different funding mechanisms and the competing demands of Medicare Parts B and D and other discretionary spending (e.g., Defense, and Homeland Security) on general revenues.

To increase the usability of the CFR, summary information included in the Statement of Fiscal Sustainability and some of the related disclosures on the nation's financial condition should be included in Management's Discussion and Analysis. Also, inclusion of such information in *The Federal Government's Financial Health: A Citizens Guide to the Financial Report of the U.S. Government* would improve the accessibility of the information to the citizenry, Congress, and other users who may not read the CFR.

Question 4:

The Board is proposing that the basic financial statement display the difference between projected revenue and projected spending, and that the fiscal gap (the change in non-interest spending and/or revenue that would be necessary to maintain public debt at or below a target percentage of gross domestic product (GDP)) must be reported either on the face of the basic financial statement or in a disclosure. Also, the fiscal gap may be reported for a specific debt level or over a range of debt levels (see paragraph 38). Both options for reporting fiscal gap are illustrated in Appendix B (see pages (narrative on the face of the financial statement) and 61 (disclosure)). See paragraphs A60-A63 in the Basis for Conclusions for an explanation of the pros and cons of the options.

4a. Do you agree with the flexible requirements for reporting fiscal gap?

4b. Do you believe that the illustrative disclosure (Illustration 8 in Appendix B) is clear and understandable?

Response 4:

We agree with the flexible requirements for the reporting of fiscal gap. We believe that there are a number of ways to demonstrate the concept of fiscal gap to users and that the preparer should present the information in an understandable format and sufficiently disclose information to assist the reader in understanding these complex concepts.

Question 5:

Finite and infinite time horizons for fiscal projections are discussed in the Basis for Conclusions, paragraphs A53 through A59. This exposure draft proposes the following requirements regarding time horizons for projections: (a) the projections presented in the basic financial statement should be “sufficient to illustrate long-term sustainability” (for example, traditionally the Social Security program has used a projection period of 75 years for long-term projections); (b) projections for both a finite and an infinite horizon should be provided, one in the basic financial statement and the other in the disclosures; and (c) either the basic financial statement or the disclosures should include projections for Social Security and Medicare based on the time horizon used for long-term projections for Social Security and Medicare in the Statement of Social Insurance (SOSI).

5a. Do you believe that the above requirements for time horizons are appropriate to meet the reporting objectives of Fiscal Sustainability Reporting? Specifically, do you believe that data for both finite and infinite horizon projection periods should be reported? If not, please explain.

5b. Do you believe that there should be a specific time horizon requirement (for example, 75 years) for the basic financial statement for Fiscal Sustainability Reporting and/or the SOSI? If so, what time horizon do you believe should be required?

Response 5:

It is our view that the time requirements are reasonable to meet the reporting objectives of Fiscal Sustainability Reporting. We do not believe that a specific horizon should be required for either the Statement of Fiscal Sustainability or the SOSI. There are advantages to using both finite and infinite time horizons. We prefer that the preparer has the flexibility to determine the time horizon for a period and that the time period selected is sufficient to demonstrate long-term sustainability.

Question 6:

The Board's mission is to issue reporting requirements for the federal government's general purpose financial statements, and not to recommend budget policy. This exposure draft proposes a title for the basic financial statement: "Long-Term Fiscal Projections for the U.S. Government." An alternative title, "Statement of Fiscal Sustainability," might imply to some that the Board has established or plans to establish specific rules that define "fiscal sustainability" and/or budget rules that would result in fiscal sustainability. However, others have indicated that the "plain English" meaning of the words "fiscal" and "sustainability" should be adequate, and that the title "Statement of Fiscal Sustainability" might be more appropriate.

Do you believe that the basic financial statement should be titled:

- a. "Long-Term Fiscal Projections for the U.S. Government,"
- b. "Statement of Fiscal Sustainability,"
- c. "Statement of Financial Condition," or
- d. A title not listed above (please specify).

Please explain the reasons for your choice.

Response 6:

It is our view that the basic financial statement should be titled "Statement of Fiscal Sustainability." We believe that this title is sufficiently clear to convey the purpose of the financial statement which is indicated by the board's working definition of fiscal sustainability. As defined, fiscal sustainability is the federal government's ability to continue, both now and in the future, current policy without change regarding public services and taxation without causing debt to rise continuously as a share of GDP.

Question 7:

This exposure draft proposed a minimum level of disaggregation for the basic financial statement. For project receipts, major programs such as Medicare and Social Security would be show separately form the rest of government. For projected spending, major programs such as Medicare, Social Security, and Medicaid would be show separately from the rest of government. (See paragraphs 36 and A46-A49.)

7a. Do you believe that the above general guidance provides for an appropriate level of disaggregation in the basic financial statement? Please explain the basis for your views.

7b. Do you believe that specific line items (instead of or in addition to the "major programs" required by paragraph 36 of the ED) should be disaggregated in the basic financial statement? If so, please identify the line items and explain your reasoning.

Response 7:

The general guidance regarding the appropriate level of disaggregation in the Statement of Fiscal Sustainability is reasonable. However, as noted in our response to question 3 above, to improve the utility of the Statement of Fiscal Sustainability to policy-makers and the public, it is important to disclose the excess of spending over receipts that can be separately attributed to Medicare Part A and Social Security in the footnotes.

Question 8:

This exposure draft proposes that disclosures should explain and illustrate the major factors impacting projected receipts and spending (such as the rising cost of health care) (see paragraph 42 (a)). Illustrative examples in Appendix B begin on page 52.

8a. Do you believe that an explanation and illustration of the major factors impacting projected receipts and spending will be helpful to readers? Please explain the basis for your view and note any recommended changes in the requirements.

8b. Do you believe that the display of a range for major cost drivers and/or major programs, as shown in Illustrations 1a and 1b in Appendix B should be optional or mandatory? Please explain the basis for your view.

Response 8:

We agree that an explanation and illustration of the major factors impacting projected receipts and spending will be helpful to readers as well as information on how major cost factors have changed or are expected to change. These disclosures will provide additional transparency as to what factors influenced the projections and what factors can be impacted through policy change and/or legislation.

It is also our view that the manner of the display of a range of major cost drivers and or major programs shown as Illustrations 1a and 1b in Appendix B should be optional. We believe that there should be sufficient flexibility to provide information that is useful to readers and that contributes to a better understanding of the complexities of the U.S. financial condition.

Question 9:

This exposure draft proposes that disclosures should explain and illustrate the major factors impacting projected receipts and spending (such as the rising cost of health care) (see paragraph 42(a)). Illustrative examples in Appendix B begin on page 52.

9a. Do you believe that the proposed requirement for alternative scenarios is appropriate? Please explain the basis for your view.

9b. Do you believe that the requirements for additional information regarding alternative scenarios are sufficient? If not, please explain the basis for your view and what additional information you propose.

Response 9:

We agree that the proposed requirements for alternative and related disclosures are appropriate.

Question 10:

Effective Date and Phased Implementation: This proposed Statement would be effective for periods beginning after September 30, 2009 with earlier implementation encouraged. This proposed Statement would require that the financial statement and the disclosures be included in Required Supplementary Information (RSI) for the first three years of implementation, and basic information (for example, basic financial statement and disclosures) for all subsequent years.

10 a. Do you believe that the disclosures would help the reader understand the basic financial statement?

10b. Are there any items that you believe should be added to, or deleted from, the disclosures? If so, please explain.

10c. Do you believe that the final accounting standard should include an appendix that displays illustrative disclosures (see Appendix B)? Why or why not?

Response 10:

It is our view that the disclosures will help the reader understand the basic financial statement. We agree that it is helpful to have an appendix that displays illustrative disclosures in the final standard even though we believe that the specific format of the presentations should be a decision of the preparer.

Question 11:

The Frequently Asked Questions (FAQs) at Appendix C provide a “plain English” explanation of terms and concepts used in long-term projects.

11a. Do you find the FAQs helpful?

11b. Should the Treasury Department be encouraged to include any of the FAQs in the CFR to promote understandability of the terms and concepts? If so, please specify the FAQs that should be considered for inclusion (and/or exclusion).

Response 11:

It is our view that sufficient information should be presented in the financial statements to enable users to understand the terms and concepts discussed in the financial statements. This can be accomplished by incorporating definitions and explanations in the financial statements without the use of FAQs.

Question 12:

Effective Date and Phased Implementation: This proposed Statement would be effective for periods beginning after September 30, 2009 with earlier implementation encouraged. This proposed Statement would require that the financial statement and the disclosures be included as Required Supplementary Information (RSI) for the first three years of implementation, and basic information (for example, basic financial statement and disclosures) for all subsequent years.

12a. Do you believe that this implementation date is reasonable and appropriate?

12b. Do you agree with the phased implementation period (3 years)?

12c. Do you believe that some or all of the required information should remain as RSI after the 3-year implementation period? If so, please explain the basis for your view.

Response 12:

We believe that the implementation date is reasonable and appropriate and we agree with the phased implementation period of 3 years. We also believe that items 41 (e), 42(a), 42 (b), and (42(d) should be retained as RSI.

Question 13:

A significant minority of members supported a proposal that there should be RSI regarding trends in the proportion of U.S. Treasury debt held by foreign investors. This information would remain as RSI and would not be subject to the phased-in implementation in paragraph 44. (See paragraphs A64-A68 in the Basis for Conclusions for a discussion of this proposal and Illustration 10 in Appendix B.)

Do you believe that including RSI regarding the foreign holdings of U.S. Treasury debt would be relevant and useful in meeting the objectives of fiscal sustainability reporting? Please explain why or why not.

Do you believe that the illustrative example provided in Appendix B is clear and understandable?

Response 13:

We do not agree that including in the RSI trends noting the proportion of U.S. Treasury debt held by foreign investors is relevant and useful in meeting the objectives of fiscal sustainability reporting. Treasury securities are purchased primarily by dealers, brokers, and financial institutions who voluntarily report information on security holders to the U.S. Bureau of Public Debt. Although reported by Treasury, the data on securities held by foreign investors is not verifiable and is generally not available until one year after the period being reported. Thus, these circumstances may cause disclosure or audit concerns. Moreover, it would be very difficult to develop assumptions to forecast trends for foreign investors purchasing U.S. Treasuries over the long run. A model for projecting this data does not exist.

While the illustrative example provided in Appendix B is clear and understandable, we do not agree that it is appropriate for inclusion as RSI for the reasons stated above and as articulated in Appendix A: Basis for Conclusions, paragraph A67.

Question 14:

A minority of members supported a proposal that if the proposed Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant gap, RSI (not subject to the phased-in implementation in paragraph 44) should include the identification, explanation, and fiscal impact of one or more policy alternative that would reduce the fiscal gap. (See paragraphs A68-A74 in the Basis for Conclusions for a discussion of this proposal.)

14. Do you believe that if the proposed Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant fiscal gap, the statement and disclosures be accompanied by RSI that includes identification, explanation, and

fiscal impact of one or more policy alternatives that would reduce the fiscal gap?
Please explain why or why not.

Response 14:

We do not agree that the statement and disclosures accompanied by RSI should include the identification, explanation, and fiscal impact of one or more policy alternatives that would reduce fiscal gap. We agree with the views of the majority of members and their rationale as stated in Appendix A: Basis for Conclusions paragraph A74.

Question 15:

This exposure draft proposes that additional information that may be helpful to readers in assessing whether financial burdens without associated benefits were passed on by current-year taxpayers to future-year taxpayers (sometimes referred to as “inter-period equity” or “inter-generational equity”) be included as one way to meet a disclosure requirement for providing context for the data in paragraph 41 (e). (See paragraphs A75-A78) in the Basis for Conclusions for a discussion of this proposal.)

15a. Do you believe that such information should be optional (as proposed in the exposure draft) or required?

15b. Do you believe that further research and analysis should be performed by FASAB to improve the disclosure of such information? Please explain the basis for your views and note any recommended changes for the presentation of inter-period or inter-generational equity.

Response 15:

It is our view that information that may be helpful to readers in assessing inter-generational equity should be required as a disclosure to show whether financial burdens without associated benefits were passed on by current-year taxpayers to future-year taxpayers. We would like to see FASAB conduct further research and analysis relating to inter-period equity to improve the disclosure of such information.