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Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition

by
The Congressional Budget Office*

This paper by the Congressional Budget Office examines two reports on fiscal policy in the United States: the budget and the government's financial statements. The reports differ in concept and scope. Neither provides all of the relevant information about federal finances, but together they offer a more comprehensive perspective on the fiscal implications of present policies.

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Preface, signed by Donald B. Marron, Acting Director, Congressional Budget Office

This Congressional Budget Office (CBO) paper, prepared at the request of the Chairman and Ranking Member of the Senate Budget Committee, examines two reports on fiscal policy: the budget and the government's financial statements. The reports differ in concept and scope. Neither provides all of the relevant information about federal finances, and together they offer a more comprehensive perspective on the fiscal implications of present policies. In keeping with CBO's mandate to provide objective, impartial analysis, the paper makes no recommendations.

David Torregrosa wrote the paper under the direction of Robert Dennis and Marvin Phaup. Andrew Gisselquist assisted with the preparation of the figures, and Linda Lewis Harris assisted with the preparation of the tables.

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1. Summary and introduction[1]

The federal government issues two different reports of its fiscal performance: the budget and the *Financial Report of the United States Government*. Both contain useful information for policy makers, and taken together they provide a richer perspective than can be obtained from either report singly. But to make best use of the reports, it is important to understand their differences and the strengths and limitations of each.

The federal budget largely measures cash flows in and out of the US Treasury and, for the most part, reports those cash flows in the year in which they occur. The financial report, by contrast, primarily uses an accrual basis of accounting to measure assets, liabilities, revenues, and expenses.[2] The principal difference between cash and accrual accounting is the timing of recognition. An accrual system generally recognises transactions when an economic event occurs rather than when the resulting cash flows take place.

The differences between cash and accrual measures are particularly evident in presentations of retirement benefits for federal employees and of federal insurance programmes and in the treatment of the federal government's capital investments:

- The federal budget reports outlays for pension and health benefits to retired federal civilian and military personnel when those payments are made. In contrast, the financial statements report an operating expense for the estimated cost of retirement benefits when those benefits are earned.
- The budget reports payments for federally insured losses when the government pays the claims.[3] In contrast, the financial report records as operating expenses any new insurance claims that are received during the year regardless of when they will be paid.
- The budget reports expenditures on capital investments – property, plant, and equipment – as outlays. In contrast, the financial statements report those expenditures as an exchange of assets on the government's balance sheet and report the associated depreciation expense of those assets as an annual operating cost.

Because of differences in the timing of the recognition of costs, the summary measures of the budget and the financial statements differ significantly from one another. In 2005, the budget recorded a deficit – the amount by which total outlays exceeded total revenues – of USD 319 billion.[4] The financial report's net operating cost – the excess of the cost of operations over revenues – for 2005 was USD 760 billion. That difference resulted largely from increases in retirement liabilities that are reflected in the net operating cost but not in the budget figure.

The budget and the financial report serve different and complementary purposes. The President and the Congress use the budget to set spending and tax priorities. It reports actual cash inflows and outflows for past years and estimates for the current and future years, and it is organised by function and agency. Financial reporting explains changes in the government's financial position based on an accrual-based balance sheet and operating statement. Financial reporting also assists in demonstrating accountability to taxpayers for money raised and expenses incurred through its requirements for agencies to prepare financial reports that are then audited, together with internal accounting and administrative controls. Like the budget, the financial statements largely describe what has already happened, but in comparison, they are more forward-looking in that they reflect the liabilities for some cash flows that will show up in the budget in later years.

The federal government has reported consolidated budget information for at least 85 years (since the enactment of the Budget and Accounting Act of 1921); in contrast, the financial reports have been used for only about 10 years. The first audited financial statement for the United States was issued by the Department of the Treasury in 1997, so it is a work in progress. A comprehensive set of accounting standards is still being developed (and revised).

2. The budget

The federal budget is the basic tool used by the President and the Congress to set the government's fiscal policy. It focuses on revenues and outlays – generally the cash flows that occur with the collection of taxes and other forms of federal income, and the disbursement of funds for various federal programmes and activities. Each year, the President transmits to the Congress a proposed budget, which provides historical budget data, estimates of revenues and outlays under current law, and the projected impact of the Administration's proposals for the current and future fiscal years. (Recent budgets have provided detailed estimates spanning the next five years and some information for the subsequent five years.) Spending in the budget is divided into thousands of individual budget accounts, which determine the purposes for which money can be spent by government agencies. That information, along with similar estimates prepared by the Congressional Budget Office (CBO), is used in policy deliberations by the Congress, which usually adopts a budget plan in the form of a congressional budget resolution. The Congress implements and enforces its budget plan by measuring the impact of subsequent legislation relative to the amounts specified in the budget resolution. Ultimately, the surplus or deficit in any year is the result of the spending that occurs and the revenues that are collected under existing law, as well as the effects of new legislation.

Budget rules and practices have a variety of sources. For example, the concept of a single, unified budget was a key recommendation of the October 1967 *Report of the President's Commission on Budget Concepts*, which remains influential today. The Office of Management and Budget's (OMB's) *Circular No. A-11* provides detailed guidance to agencies on preparing and submitting their budgets. The Congressional Budget and Impoundment Control Act of 1974 governs much of the congressional budget process.[5] It establishes the procedures by which the Congress determines its annual budgetary priorities and then implements and enforces them through the legislative process.

2.1. Budget measures

Although the budget is mostly on a cash basis, in some cases it counts as outlays amounts that are obligated now but will be paid or received in the future – that is, some programmes or activities are reported on an accrual basis. The most significant of those are credit programmes and interest on the public debt:

- The Federal Credit Reform Act of 1990 requires the present value of expected future cash flows from new direct loans and loan guarantees to be recognised in the budget when the loans are disbursed rather than over the life of the loans.[6] That approach was intended to place those credit programmes on a more equal footing with one another and with other programmes in the budget. The financial statements have also adopted that approach for credit programmes.
- Interest on federal debt is also included in the budget as an outlay when the expense is incurred rather than when it is paid. Most debt requires periodic interest payments, so over the course of a year, accruing interest costs is usually not substantially different from reporting interest on a cash basis. But in instances in which interest payments are deferred – as with Treasury savings bonds, other zero-coupon debt[7] and Treasury Inflation-Protected Securities (TIPS) – the timing differences can be significant.

The budget's summary measures include total receipts, total outlays, and the difference, which is the surplus or deficit.[8, 9] In 2005, the budget deficit was USD 319 billion, or 2.6 per cent of gross domestic product (GDP) (see Table 1 and Figure 1).[10]

When the government spends more than it collects, it must borrow from the public. If it collects more than it spends, it reduces the debt. In general, government debt held by the public is the cumulative sum of budgetary imbalances over time – that is, the sum of all past budget surpluses and deficits adjusted for small changes in other sources of financing.[11] At the end of fiscal year 2005, that debt totaled USD 4.6 trillion, or 37.4 per cent of GDP (see Figure 2).[12]

Table 1. **The federal government's budget surplus or deficit and net operating cost**

Billions of US dollars

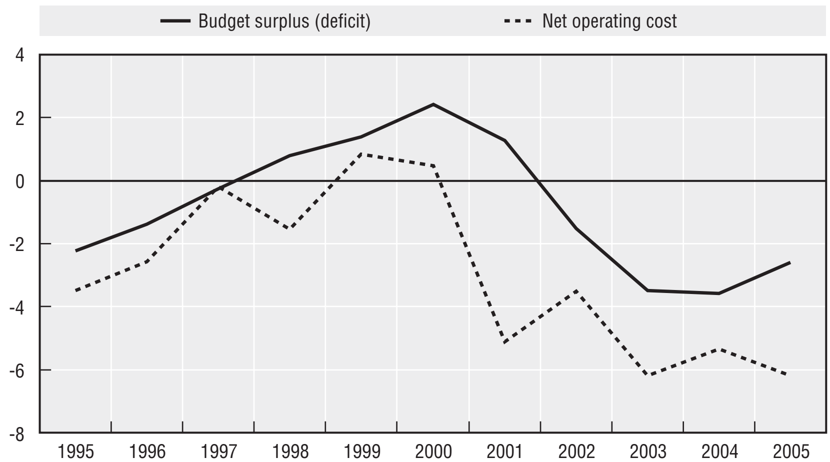
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Budget surplus or deficit (–)	–164	–107	–22	69	126	236	128	–158	–378	–413	–319
Net operating cost	–255	–198	–3	–110	101	53	–515	–365	–668	–616	–760
Difference	91	91	–19	179	25	183	643	207	290	203	441

Note: The Department of the Treasury published the first audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

Figure 1. **The budget surplus or deficit and net operating cost**

Percentage of gross domestic product

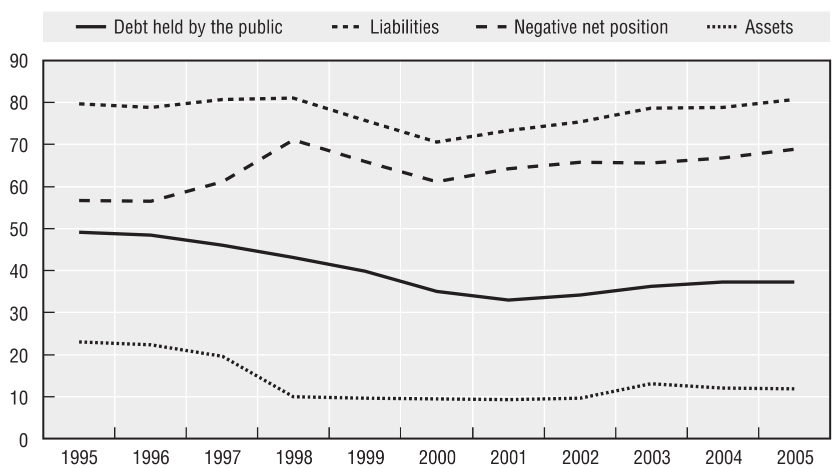


Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

Figure 2. **The federal government's debt, assets, liabilities, and net position**

Percentage of gross domestic product



Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005).

2.2. Long-term budget projections

To enable policy makers to see projected budgets over a longer planning horizon, both OMB and CBO prepare long-term budget projections, including some with 50 to 100-year spans.[13] Those projections are based on assumptions about the continuation of current laws and policies; long-run rates of productivity growth and growth of the labour force; and alternative paths for several variables, including health care costs, spending on Social Security, and defence spending.

Long-term projections help to illustrate the uncertainty about the budget because several factors that are difficult to predict – especially the growth of health spending relative to overall GDP – have major implications for the budget over time. Long-term projections can highlight that uncertainty by showing outcomes under various assumptions for those variables. Also, long-term budget projections show the path of potential future fiscal imbalances, which is useful in identifying the timing for remedial policies.

3. The federal government's financial statements

The *Financial Report of the United States Government* – like the financial statements of private companies – consists of a balance sheet, an income statement, a cash flow statement, and notes to those financial statements. The Department of the Treasury consolidates the financial reports of individual federal agencies and now issues the government-wide report each December.

In particular, the consolidated report includes a balance sheet showing assets, liabilities, and net position (assets minus liabilities), and statements of government operations and changes in net position, showing revenues, expenses, and net operating cost (tax revenues minus the net cost of government operations). Those statements follow accounting standards developed by the Federal Accounting Standards Advisory Board (FASAB) (see Box 1). The financial report also includes numerous notes and substantial supplementary information on long-term projections for social insurance programmes.[14]

3.1. The balance sheet

The Department of the Treasury's government-wide balance sheet indicates the government's financial position in terms of the assets it owns or controls as well as the liabilities it owes at the reporting date (see Table 2). The list of reportable assets and liabilities for the federal government depends on the federal financial accounting standards as issued by FASAB. As noted, those standards are still in the process of being developed and, in some cases, revised.

Currently, the balance sheet includes as assets these categories of holdings:

- **Property, plant, and equipment.** This category includes buildings, structures, computer software, and other assets used to provide goods and services. Items are reported at original cost minus accumulated

Box 1. **The role of the Federal Accounting Standards Board**

The Department of the Treasury, the Office of Management and Budget, and what is now the Government Accountability Office created the Federal Accounting Standards Advisory Board (FASAB) as a federal advisory committee in 1990 to develop federal accounting principles. FASAB's three sponsors have authority under various laws to establish accounting and financial reporting standards for the government.

Through a series of legislative acts, the Congress sought to improve the financial management and accountability of the federal government by requiring agencies to produce audited financial statements tied to performance reports. The Chief Financial Officers Act of 1990 required some agencies to produce audited financial statements, and the Government Management Reform Act of 1994 extended that requirement to all agencies and to government-wide, or consolidated, financial statements. In addition, the Government Performance and Results Act of 1993 required agencies to submit performance reports comparing performance measures and related costs.

FASAB promulgates what are termed generally accepted accounting principles (GAAP) for the federal government.[1] Its role is thus similar to that of the Financial Accounting Standards Board, which promulgates private-sector accounting standards, and the Governmental Accounting Standards Board, which promulgates standards for state and local governments. FASAB's standards and concepts affect only financial accounting and have no effect on budgetary accounting.

FASAB must follow certain procedures before issuing final accounting standards. Proposed standards typically are first issued as "exposure drafts" in order to solicit public comments, which come from the accounting community and federal agencies. (In some cases, proposals are first issued as "preliminary views" for public comment and then as exposure drafts.) Standards are issued only after a majority vote of the 10 members. Six of the 10 board members are now from outside the federal government because independence is a requirement of FASAB's status as a GAAP-setting body. Two of the three founding government members, the Office of Management and Budget and the Government Accountability Office, effectively retain veto power over standards because the heads of those agencies may prevent the issuance of a standard by objecting during a 90-day review period. The Department of the Treasury voluntarily gave up that power. In addition to the three founding government members, a representative from the Congressional Budget Office sits on the board.

FASAB continues to issue new accounting standards – most recently for fiduciary activities, which cover reporting on the Indian trust funds.[2] Its current projects include statements for federal oil and natural gas resources, and revisions to accounting for social insurance. FASAB also issues concept statements, which are lower in the GAAP hierarchy than standards. For example, FASAB recently issued a draft concept statement on proposed new definitions of assets and liabilities. Finally, FASAB issues interpretations and guidance on existing accounting standards, and white papers.

1. The American Institute of Certified Public Accountants designated FASAB as a GAAP-setting body in 1999.
2. See Federal Accounting Standards Advisory Board, *Accounting for Fiduciary Activities*, Statement of Federal Financial Accounting Standards 31, 24 October 2006, available at *www.fasab.gov/pdffiles/sffas_31.pdf*.

Table 2. **The federal government's balance sheet, 2004 and 2005**
Billions of US dollars

	2004	2005
Assets		
Property, plant, and equipment	653	678
Inventories and related property[1]	262	272
Loans[1]	221	222
Cash, securities, and other investments[2]	154	161
Other	108	123
Total assets	**1 397**	**1 456**
Liabilities		
Debt held by the public (and accrued interest)	4 329	4 624
Federal employees' and veterans' benefits[3]	4 062	4 492
Environmental and disposal liabilities	249	260
Social insurance and other benefits due and payable[4]	103	117
Insurance programme liabilities	62	93
Loan guarantee liabilities	43	48
Other liabilities	258	281
Total liabilities	**9 107**	**9 915**
Net position (assets minus liabilities)	–7 710	–8 459
Total liabilities and net position	**1 397**	**1 456**

Note: The balance sheets are figures as of 30 September, the end of the government's fiscal year.
1. Reported on a net basis.
2. Includes assets held by the Pension Benefit Guarantee Corporation and the National Railroad Retirement Investment Trust.
3. Includes federal civilian and military personnel's benefits.
4. The amounts that are "due and payable" are about one month of benefits for Social Security, and payments due to health care providers for services already provided.

Source: Congressional Budget Office based on the Department of the Treasury, *Financial Report of the United States Government* (2005), p. 40.

depreciation. Military equipment – ships, aircraft, combat vehicles, and weapons – is the biggest single component.

- **Inventories and related property.** This category encompasses tangible property either held for sale or held for use in the production of goods or services. Operating materials and supplies held by the Department of Defense are a major component.
- **Loans.** This category reports the face value of outstanding direct loans minus allowances for losses. For direct loans issued after 1991, the allowance recorded in the financial statements is the cumulative total of the subsidy cost, as calculated under the procedures of the Credit Reform Act and reported in the budget, and subsequent adjustments, such as loan modifications, re-estimates, and write-offs of uncollectible loans. The largest source of net loan receivables is outstanding direct student loans, valued at USD 96 billion in 2005.

- **Cash, securities, and other investments.** This category includes cash balances, international monetary assets (including official reserves of foreign currency and gold), and securities held by the Pension Benefit Guaranty Corporation and the National Railroad Retirement Investment Trust.[15]

The balance sheet currently excludes the government's vast holdings of public lands and other natural resources because FASAB has tentatively concluded that the value of those resources cannot be reliably estimated. However, FASAB will soon propose reporting the value of federally owned oil and gas resources on the balance sheet, as measured by the expected stream of royalty payments to the government, and will consider adding other federal resources.[16] The balance sheet also excludes the income expected from future taxes under current law. One consideration favouring that exclusion is the absence of a legally enforceable claim to taxes until the taxable income is earned.

Six main categories of liabilities are recognised on the balance sheet:

- **Debt held by the public (and accrued interest).** This is federal debt held outside the government and excludes debt held by government trust funds. The largest item on the balance sheet, this is a legal obligation of the government.
- **Federal employees' and veterans' benefits.** This category includes actuarial estimates of the present value of pension benefits and health care benefits earned to date that are to be provided to federal civilian employees and military personnel in their retirement and of compensation for disabled veterans and their survivors. Those benefits are the second largest liabilities on the balance sheet. Although those benefits are not legal obligations of the government and could be modified by future legislation, they are recognised because they are part of the compensation costs for federal personnel – a practice consistent with the private sector's.
- **Environmental and disposal liabilities.** This category includes the expected cleanup costs of hazardous and radioactive wastes that the government generated and is required to remediate by law or regulation. Only costs for remediable conditions that can be reasonably estimated and cleaned up using today's technology are reported. Most of the liabilities are attributable to the Department of Energy – which is responsible for managing the cleanup of contamination caused by the production, storage, and disposal of nuclear weapons – and to the Department of Defense – which is responsible for disposing of nuclear-powered vessels and cleaning up contamination at defence sites.
- **Social insurance and other benefits that are due and payable.** This category includes amounts for social insurance programmes, including Social Security and Medicare, and other mandatory benefit programmes, including grants to states for Medicaid. The amounts that are "due and payable" are about one

month of benefits for Social Security, and payments due to health care providers for services already provided. Those amounts are reported as liabilities because they are legal obligations of the government.

- **Insurance programme liabilities.** The balance sheet reports unpaid insurance claims that have already been incurred. At the end of 2005, the amounts included USD 70 billion in insurance liabilities for the Pension Benefit Guaranty Corporation and the Federal Emergency Management Agency's estimate of USD 23 billion for the National Flood Insurance Program, mostly for claims arising from Hurricane Katrina.
- **Loan guarantee liabilities.** The long-term cost of outstanding guaranteed loans is measured by the subsidy cost at disbursement, with adjustments for modifications, re-estimates, amortisation, and write-offs. Guaranteed student loans constitute an estimated USD 30 billion in liabilities.

The balance sheet does not include the present value of future benefit payments for Social Security and Medicare until they are due and payable because those anticipated payments for entitlements do not represent a current liability under existing accounting principles. Also excluded are future outlays for veterans' health services because those services are provided on an "as available" basis, that is, subject to space limitations and annual appropriations. Nor does the balance sheet report contingent liabilities for expected future losses on risks assumed in federal insurance programmes. Those amounts are disclosed in the notes to the financial statements.

At the end of fiscal year 2005 (30 September 2005), the government reported liabilities in excess of assets, or a negative net position, of USD 8.5 trillion (or 68.8 per cent of GDP), largely reflecting the government's borrowing to finance deficits and its liabilities for federal employees' and veterans' post-employment benefits.[17] That measure is about twice as large as the public debt. Both liabilities and the negative net position have been rising steadily as a percentage of GDP (and faster than debt as a percentage of GDP) since 2000.

The government's net position and the corresponding measure for a private firm, its net equity, differ significantly in meaning. A negative net position for the federal government provides an indication of the extent to which the cost of past government activities will have to be paid in the future. It is not a measure of solvency, however, because the government has the power to tax and can reduce spending. Moreover, the government can borrow to pay off its liabilities as they come due, even with a negative net position. Nevertheless, an ever-growing burden of federal debt – as indicated by the debt-to-GDP ratio – would have a detrimental and potentially contractionary effect on the economy. At some point, the economy would be unable to provide enough resources for the government to pay interest on the debt.[18]

3.2. Net operating cost

The "Statement of Net Cost" and "Statement of Operations and Changes in Net Position" depict the effect of operations during the reporting period on the government's financial position.[19] In 2005, the government's cost of operations exceeded revenues by USD 760 billion, resulting in a negative net operating cost of 6.2 per cent of GDP (see Table 1 and Figure 1).[20] Just as the budget deficit affects changes in the debt held by the public, the government's net operating cost for a particular year corresponds to the change in the government's net position.[21] A loss approximates the increase in liabilities minus the increase in assets.[22]

Net operating cost includes as current expenses the cost of deferred compensation for federal military and civilian employees earned during the reporting period, as well as interest on existing liabilities for federal pensions and retirement health benefits, increases in liabilities for federal insurance programmes and for environmental cleanup, and the depreciation of assets. However, net operating cost is not a comprehensive accrual measure. For example, it does not include revenues from taxes on income earned in the period that are not yet owed. Nor does it include costs for future expected losses on insurance programmes.[23]

4. Comparing the measures

The federal budget is used to plan and control the allocation of fiscal resources. Financial reporting – with its requirements for audited statements and internal accounting and administrative controls – imposes a different method of accountability. Such audits and controls may improve the reliability of the numbers in the budget. The financial report includes a more comprehensive list of liabilities than the budget. At the agency level, financial reporting is also used to support management by matching programmatic expenses with outputs.[24] For example, decisions such as whether to contract out work or to offer buyouts or early retirements require a full cost accounting of labour resources – including salaries, expenses for pensions and retirees' health care – that budgetary accounting is not as well designed to accomplish.[25]

4.1. Reconciling net operating cost and the budget deficit

The net operating cost reported in the financial statements for 2005 of USD 760 billion differs from the budget deficit of USD 319 billion largely because it reflects liabilities that the budget does not include (see Table 3). Those additional items in net cost include the following:

- **Accruals for federal civilian and military employees' benefits.** The difference between the accrued expenses in the financial statements and the payments of benefits recorded in the budget is the increase in estimated liabilities

Table 3. **Reconciling the federal government's budget deficit and net operating cost, 2004 and 2005**

Billions of US dollars

	2004	2005
Budget deficit (–)	**–412**	**–319**
Increase in retirement liabilities		
Military health and pension benefits	–143	–170
Veterans' compensation	30	–198
Federal civilian health and pension benefits	–69	–62
Increase in insurance liabilities	–37	–31
Increase in environmental liabilities	1	–11
Property, plant, and equipment		
Depreciation expense	–90	–80
Purchases of fixed assets	112	147
All other factors	–7	–37
Net operating cost	**–616**	**–760**

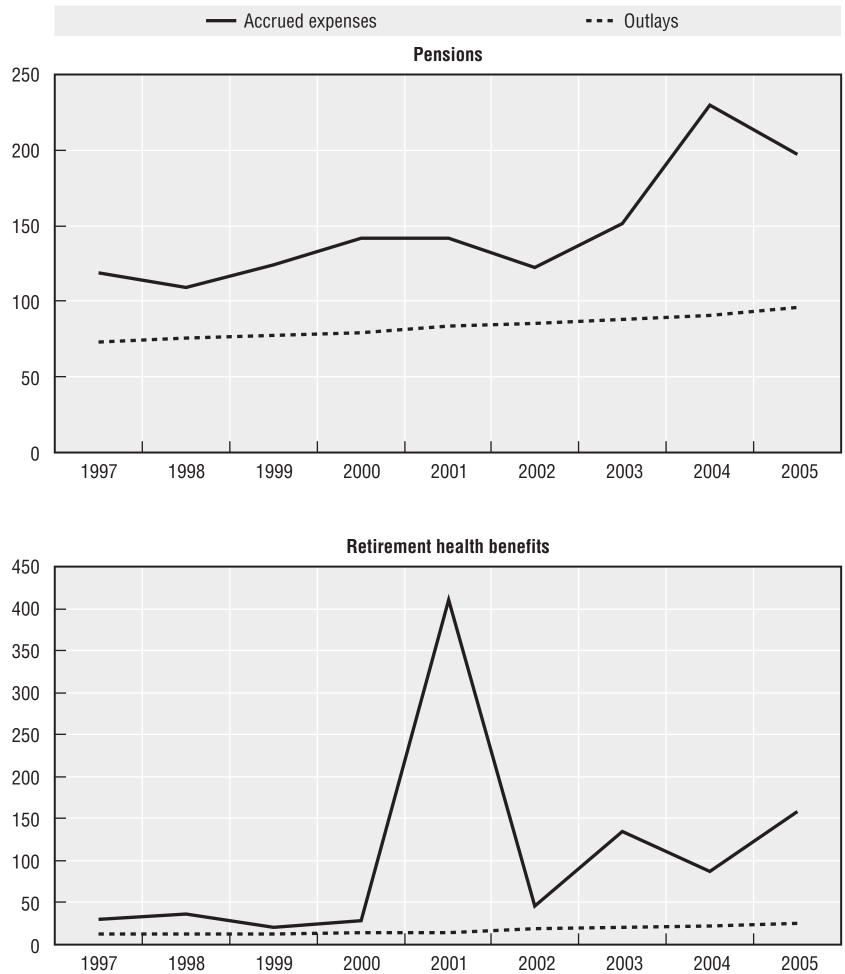
Source: Congressional Budget Office based on the Department of the Treasury, *Financial Report of the United States Government* (2005), p. 38.

incurred over the course of the fiscal year for veterans' compensation (USD 198 billion) and for military personnel's pensions and retirement health benefits (USD 170 billion) and federal civilian employees' pensions and retirement health benefits (USD 62 billion) (see Figure 3). Those factors account for USD 430 billion of the difference between the budget deficit and the net operating cost.

- **Accruals for insurance costs and environmental cleanup and disposal.** Environmental liabilities increased in 2005 by USD 11 billion, and insurance liabilities increased by USD 31 billion. The single biggest factor that year was the USD 22 billion jump in the National Flood Insurance Program's estimated unpaid claims resulting from Hurricanes Katrina and Rita. In contrast, the Pension Benefit Guaranty Corporation's net position (its assets minus its liabilities) improved by USD 430 million in 2005, while the budget reported net outlays of USD 94 million.[26] Those factors account for USD 42 billion of the difference between the budget deficit and the net operating cost.
- **Depreciation.** The budget reports the cost of property, plant, and equipment at the time of purchase, while the financial report's operating statement reports the cost as those items are consumed. Depreciation expenses – not counted in the budget – added USD 80 billion to the net operating cost, while purchases of fixed assets added USD 147 billion to the budget deficit. Those factors reduced the difference between the deficit and the net operating cost by USD 67 billion in 2005.

Figure 3. **Accrued expenses and outlays for federal employees' pensions and retirement health benefits**

Billions of US dollars



Note: Costs for pensions and retirement health benefits are for both federal civilian and military personnel. Those costs were accrued as expenses in the financial report beginning in 1997.

Source: Congressional Budget Office based on data from the Department of the Treasury, *Financial Report of the United States Government* (1997 to 2005); and *Budget of the US Government, Fiscal Year 2007: Historical Tables*, Table 11.3.

In general, the accruals left out of the budget make it likely that in most years, the shortfall in the financial report's statement of operations will be larger than the budget deficit.[27] In fact, the net loss in the financial statements has exceeded the budget deficit in all but one year since 1995 (see Table 1). The accrued expenses for federal employees' retirement, a big part of which is the increase in the present value of the liabilities as the date of the future payments nears, are likely to exceed the cash payments to retirees as long as the federal workforce is large relative to the number of retired federal employees.[28] That may not always be the case, however. Other factors could also narrow or reverse the gap between the net operating cost and the budget deficit. Capital expenditures depend on investment flows, so the treatment of capital assets can have varying effects over time. The extent of insurance liabilities depends on events – flood losses, bank and thrift failures, and bankruptcies of corporations with underfunded pension plans. Because of such contingencies, the budget deficit could exceed the net operating cost in the future.

4.2. Sources of change

Several factors must be taken into account in comparing the budget deficit with the net operating cost over time. Changes in accounting, policies, and actuarial assumptions can lead to big swings in any given year.

4.2.1. Accounting changes

Both the budget and the financial statements are subject to changes in accounting. For example, the Federal Credit Reform Act of 1990 significantly changed the budgetary accounting for direct loans and loan guarantees. However, major changes in budgetary accounting are infrequent. In contrast, financial accounting standards are still being developed and added. FASAB has recently proposed new definitions for assets and liabilities, which could affect what is reported on the balance sheet in the future.[29]

The government's net position depends on the comprehensiveness of the balance sheet. For example, the prototype financial statements issued before 1997 did not report the future cost of federal retirees' health benefits as an expense or a liability. In addition, USD 655 billion in national defence assets were taken off the balance sheet in 1998, causing a jump in the negative net position, before such assets were restored to the balance sheet in 2003 (see Figure 2).[30]

A number of new financial accounting initiatives will or could affect the balance sheet. FASAB recently issued a new interpretation of reporting for asbestos-related cleanup costs.[31] The board is currently debating whether to recognise greater liabilities for Social Security and Medicare and other social insurance programmes and whether to recognise federal oil and gas resources as an asset.[32] The outcome of those debates could have significant effects on the government's reported liabilities, assets, net position, and net operating cost, but changes in the balance sheet would not alter the budget's treatment of the federal programmes.

4.2.2. Policy changes

Policy changes can affect the budget and financial statements differently. For example, the National Defense Authorization Act of 2001 extended benefits from TRICARE – the Department of Defense's health insurance programme for the military – to military retirees and their survivors and dependents even if they were eligible for Medicare, enhanced drug benefits, and reduced the cap on participants' out-of-pocket payments. Financial statements recognised all of the increase in liabilities of USD 293 billion – the present value of the benefits earned to date and to be paid out over coming years – and a corresponding increase in net operating cost (see Figure 3).[33] However, for the cash-based budget, which recognises increased costs as they are paid, CBO estimated those costs as about USD 200 million in 2001, USD 1.8 billion in 2002, and USD 40 billion over 10 years.[34]

4.2.3. Changes in actuarial assumptions

Unlike the budget, the financial statements are sensitive to changes in actuarial assumptions. The divergence that occurred between the budget deficit and the net operating cost from 2004 to 2005 – as the former measure declined and the latter measure grew – was caused partly by changes in actuarial assumptions. Specifically, estimates of liabilities for veterans' compensation increased by USD 198 billion in 2005 following a USD 30 billion decline in 2004: changes in interest rates and other actuarial assumptions, including ones about the number of veterans and dependents receiving payments, did not affect the budget but did affect the net operating cost.[35] In addition, changes in assumptions about the costs of military retirees' health benefits increased that liability by over USD 50 billion in 2005.[36]

Notes

1. Numbers in the text and tables may not add up to totals because of rounding.
2. See Department of the Treasury, *Financial Report of the United States Government* (December 2005), available at *www.fms.treas.gov/fr/05frusg/05frusg.pdf*. See also Congressional Budget Office, *Measures of the US Government's Fiscal Position Under Current Law* (August 2004).
3. "Insurance programmes", as referred to in this paper, include ones providing deposit, flood, and pension insurance, for example, but not social insurance programmes such as Social Security and Medicare.
4. In 2006, the budget deficit declined to USD 248 billion. This paper uses 2005 numbers because the financial statements for 2006 are not yet available.
5. Significant amendments to that law were made by the Balanced Budget and Emergency Deficit Control Act of 1985, the Budget Enforcement Act of 1990, and the Unfunded Mandates Reform Act of 1995. See House Committee on the Budget, *Compilation of Laws and Rules Relating to the Congressional Budget Process*, Serial

No. CP-4 (May 2000). See also Senate Committee on the Budget, *The Congressional Budget Process: An Explanation*, S. Prt. 105-67 (Revised December 1998). A number of those provisions have expired in recent years.

6. For details on credit reform accounting, see Congressional Budget Office, *Estimating the Value of Subsidies for Federal Loans and Loan Guarantees* (August 2004) and *Credit Subsidy Reestimates, 1993-1999* (September 2000).

7. Zero-coupon bonds, which are sold at a discount to par value, provide a single payment at maturity. Interest payments are, therefore, implicit in the bonds' appreciation over time.

8. The Social Security trust funds and the cash flow of the Postal Service are designated "off budget" while the rest of the budget is "on budget". For many purposes, those two categories are combined to yield a total, or unified, surplus or deficit. In 2005, the unified budget deficit of USD 319 billion comprised an on-budget deficit of USD 494 billion and an off-budget surplus of USD 175 billion.

9. Another set of accounts – the national income and product accounts (NIPAs), which are maintained by the Department of Commerce's Bureau of Economic Analysis – also records the federal government's transactions but with different objectives. The NIPAs are intended to provide a comprehensive measure of current production and related income generated by the US economy. Because the aims of the NIPAs differ from those of the budget, the two accounting systems treat some government transactions differently. Receipts and expenditures in the NIPAs usually differ slightly from those in the budget. For details, see Congressional Budget Office, *The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts* (September 2006).

10. See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2007 to 2016* (January 2006).

11. In addition to borrowing from the public, the deficit is financed by some other means, including drawdowns of the government's holdings of coins, currency, and bank deposits and net cash inflows to credit-financing accounts.

12. Another measure that some analysts emphasise is gross federal debt, which is debt held by the public plus debt held by government accounts (including those for Social Security), some of which constitutes amounts that the government owes to itself. Gross federal debt was USD 7.9 trillion in 2005, or 64 per cent of GDP. Of that amount, USD 3.3 trillion was debt held by government accounts.

13. For the latest such projections, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005); and Office of Management and Budget, *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, pp. 184-194. See also Government Accountability Office, *The Nation's Long-Term Fiscal Outlook*, GAO-06-1077R (September 2006), available at *www.gao.gov/special.pubs/longterm/*.

14. Since 1997, the report has been subject to audit – by what is now the Government Accountability Office – but it has yet to receive an unqualified opinion because of a number of deficiencies. See Department of the Treasury, *Financial Report of the United States Government* (2005), pp. 135–154.

15. Federal gold holdings (258 713 310 troy ounces) are carried on the books at a price of USD 42.22 per ounce, as specified by statute, but the market price of gold is higher: USD 473 on 30 September 2005. See Department of the Treasury, *Financial Report of the United States Government* (2005), p. 85.

16. See Federal Accounting Standards Advisory Board, "Statement of Federal Financial Accounting Standards: Accounting for Federal Oil and Gas Resources" (exposure draft, forthcoming in 2007).
17. The Office of Management and Budget releases an unaudited statement of assets and liabilities that reports a smaller negative net position, of USD 5.7 trillion, mainly because it reports estimated values for federal land and mineral rights as assets. OMB's presentation does not follow all FASAB standards (see the Annex). See Office of Management and Budget, *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, pp. 181-183.
18. Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005), p. 2.
19. Agencies' statements of net cost arrive at that measure by starting with their gross costs and subtracting any earned revenues.
20. In years in which revenues exceed the net cost of government operations, such as 2000, a positive net cost is reported.
21. The government's net position at the beginning of 2005 was USD –7 710 billion and USD –8 459 billion at the end of the year – a change of USD 749 billion. The USD 11 billion difference between that change and the net operating cost of USD 760 billion results from USD 3.6 billion attributable to a change in accounting principles and USD 7.5 billion in adjustments for prior periods.
22. More generally, net operating cost is the change in assets minus the change in liabilities. Since the audited financial reports were first issued in 1997, liabilities have increased every year except 1999 and 2000. Assets declined only in 1998, but that decline derived solely from the removal of the Department of Defense's property, plant, and equipment from the balance sheet.
23. See Congressional Budget Office, *The Risk Exposure of the Pension Benefit Guaranty Corporation* (September 2005).
24. See Federal Accounting Standards Advisory Board, *FASAB's Strategic Directions: Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting* (November 2006), available at *www.fasab.gov/pdffiles/stratobjectivesnov2006.pdf*.
25. Federal agencies currently pay the accrual charges for federal pensions (but not for civilian employees' health care in retirement). The payments to the government's retirement accounts are intragovernmental and do not affect total budget outlays or, therefore, the budget surplus or deficit, but they do require appropriations and are recognised as agencies' obligations. See Congressional Budget Office, *The President's Proposal to Accrue Retirement Costs for Federal Employees* (June 2002).
26. The Pension Benefit Guaranty Corporation's assets increased more than its liabilities did in 2005, which resulted in an improvement in its net worth. Changes in interest rates had favourable effects on revaluations of assets and liabilities, and the agency's investment returns were strong. See Pension Benefit Guaranty Corporation, *Performance and Accountability Report: Fiscal Year 2005*, 15 November 2005, pp. 4 and 18-19, available at *www.pbgc.gov/docs/2005par.pdf*. See also Congressional Budget Office, *A Guide to Understanding the Pension Benefit Guaranty Corporation* (September 2005).
27. The shortfall in the statement of operations could be less than the budget deficit in years in which liabilities declined. Drops in liabilities could occur, for example, because of a rise in interest rates, which would reduce the present value of future benefit payments, or reductions in federal retirement benefits.

28. Accrued expenses include three main components: the accruing liabilities to workers derived from their current year's work, the effect of changes in benefit plans, and interest on pre-existing retirement liabilities for payment in future years. (The accrued expenses differ from the change in liabilities because the latter subtracts out benefits paid in the current year.) Interest costs arise because the pre-existing liabilities for payment in future years are one year closer to being paid than they were the previous year. The resulting change in their discounted present value is labeled "interest". In 2005, such interest amounted to USD 189 billion – just over half of the total accrued expense.

29. See Federal Accounting Standards Advisory Board, "Proposed Statement of Federal Financial Accounting Concepts: Definitions and Recognition of Elements of Accrual-Basis Financial Statements" (exposure draft, 7 June 2006), available at *www.fasab.gov/pdffiles/elementsed06072006.pdf*.

30. National defence assets, which had been reported as property, plant, and equipment, were taken off the balance sheet in 1998 and reported instead as "stewardship assets" in the notes to the statements. See Department of the Treasury, *Financial Report of the United States Government* (1998), pp. 68 and 75, available at *www.fms.treas.gov/fr/98frusg/98notes.pdf*. Beginning in 2003, FASAB required the Department of Defense to report the value of its military equipment, which added USD 325 billion to the amount of property, plant, and equipment reported that year.

31. Federal Accounting Standards Advisory Board, *Recognition and Measurement of Asbestos-Related Clean Up Costs*, Technical Bulletin 2006-1, 28 September 2006, available at *www.fasab.gov/pdffiles/techbulletin_2006.pdf*.

32. Federal Accounting Standards Advisory Board, "Accounting for Social Insurance" (revised preliminary view, 23 October 2006), available at *www.fasab.gov/pdffiles/socialinsurance_pv.pdf*.

33. Department of the Treasury, *Financial Report of the United States Government* (updated 30 March 2003), p. 110.

34. That estimate included the costs for the new benefit and increased costs in existing programmes, including Medicare. CBO also projected an increase of USD 59 billion over 10 years in intragovernmental accrual payments by the Department of Defense to a fund for retirees' health care. See the cost estimate of the Congressional Budget Office for H.R. 4205, National Defense Authorization Act for Fiscal Year 2001 (Health Care for Military Retirees), 11 October 2000.

35. See Department of the Treasury, *Financial Report of the United States Government* (2005), p. 101.

36. *Ibid.*, p. 96.

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ANNEX

Comparing the Department of the Treasury's Balance Sheet and OMB's Asset and Liability Presentation

The Office of Management and Budget (OMB) has issued an annual statement of federal assets and liabilities since 1993 (see Table A.1).[1] That presentation of assets and liabilities – which is not audited – includes "best estimates" that might not be reliable enough for an audited balance sheet. OMB does not call the presentation a balance sheet because its presentation does not exclusively use generally accepted accounting principles to measure assets and liabilities. The agency does not calculate the annual change in net assets, which would correspond to the net operating cost in the Department of the Treasury's *Financial Report of the United States Government*, but a general understanding of OMB's presentation helps illustrate the strengths and weaknesses of the government's official audited accounting report prepared in accordance with standards by the Federal Accounting Standards Advisory Board (FASAB).

For 2005, OMB reported federal assets of USD 3 736 billion, liabilities of USD 9 481 billion, and a negative net position (assets minus liabilities) of USD 5 745 billion. In contrast, the Treasury Department reported federal assets of USD 1 456 billion, liabilities of USD 9 915 billion, and a negative net position of USD 8 459 billion.

While there is much overlap in reporting in the two documents, OMB's presentation of assets and liabilities differs from the Treasury Department's presentation in several respects. Some of the differences relate to scope, but some relate to the use of different valuation measures. The differences are most apparent in the reporting of assets: OMB includes values for federal land (USD 729 billion) and mineral rights (USD 1 045 billion) that the Treasury Department does not report. Those estimates do not meet generally accepted accounting principles but indicate how important the items are to the asset

Table A.1. **OMB's presentation of the federal government's assets and liabilities, 2004 and 2005**

Billions of US dollars

	2004	2005
Assets		
Property, plant, and equipment	1 049	1 106
Mineral rights	800	1 045
Land	594	729
Cash, securities, and other investments	352	335
Inventories	262	272
Loans[1]	243	249
Total assets	**3 301**	**3 736**
Liabilities		
Debt held by the public	4 296	4 592
Federal employees' and veterans' benefits	3 984	4 416
Social insurance and other benefits due and payable	103	117
Insurance programme liabilities	105	99
Loan guarantee liabilities	43	48
Trade payables and miscellaneous[2]	195	208
Total liabilities	**8 725**	**9 481**
Net assets (assets minus liabilities)	–5 425	–5 745
Memorandum:		
Ratio of net assets to GDP (per cent)	–45.9	–45.6

OMB = Office of Management and Budget.
GDP = Gross domestic product.
1. Reported net of expected loan losses.
2. Trade payables include amounts owed for goods and property ordered and received and for services rendered by contractors.

Source: Congressional Budget Office based on *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182, and revised information from the Office of Management and Budget.

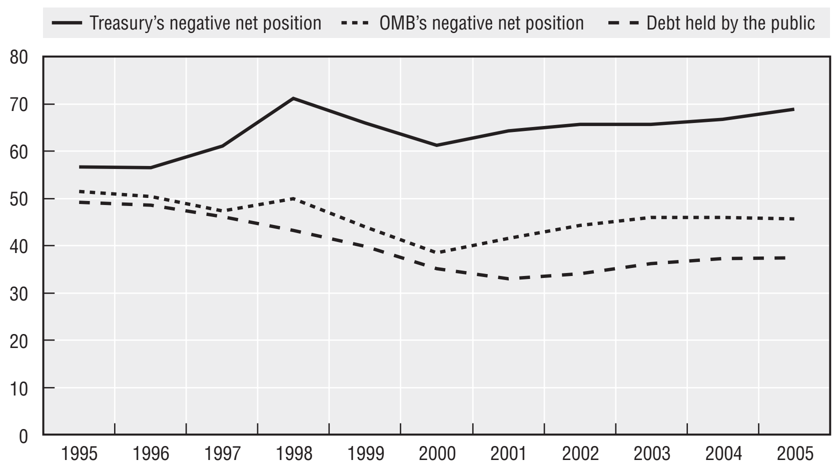
side of the balance sheet.[2] The difference illustrates the lack of comprehensiveness on the asset side of the Treasury Department's balance sheet and has motivated FASAB's work to develop new standards for valuing oil and natural gas. OMB also has an estimate of property, plant, and equipment that is more than USD 425 billion higher than the Treasury Department's because OMB bases its estimate on the current replacement value of the stock of plant and equipment rather than its original cost. In general, using a fair-market estimate of replacement value may provide a more relevant estimate but also one more subject to judgment than an estimate based on cost.

On the liability side, the biggest difference is that the Treasury Department reports USD 260 billion of environmental and disposal liabilities, while OMB reports no such liabilities. However, OMB may reconsider its treatment of those liabilities.[3] The two documents have similar estimates for federal employees' and veterans' benefits, insurance programmes, and social insurance and other benefits that are due and payable. The Treasury Department also includes USD 35 billion of accrued interest payable on debt held by the public, while OMB does not.

The reporting differences result in OMB's showing a smaller negative net position relative to GDP (45.6 per cent) than the Treasury Department does (68.8 per cent). That difference has persisted for several years (see Figure A.1).

Figure A.1. **Debt, Treasury's estimate of negative net position, and OMB's estimate of negative net position**

Percentage of gross domestic product



Note: The Department of the Treasury began publishing audited financial statements in 1997; data for 1995 and 1996 are from prototype reports. OMB = Office of Management and Budget.

Source: Congressional Budget Office based in part on data from the Department of the Treasury, *Financial Report of the United States Government* (1995 to 2005) and *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182, with revisions from OMB staff.

Notes

1. OMB does not, however, separately report operating costs on an accrual basis. See *Budget of the US Government, Fiscal Year 2007: Analytical Perspectives*, Table 13-1, p. 182.
2. Estimates for those two categories are based on earlier published estimates by researchers. The estimates are adjusted each year as market prices change for oil, natural gas, and land. The mineral rights include both proven and unproven reserves; however, OMB does not adjust quantities of those reserves either for depletion of existing stocks of reserves over time or new discoveries. Personal communication to the Congressional Budget Office by a staff member of the Office of Management and Budget, 11 July 2006. See Michael J. Boskin, Marc S. Robinson,

and Alan M. Huber, *Government Saving, Capital Formation and Wealth in the United States, 1947-1985*, Working Paper No. 2352, National Bureau of Economic Research, Cambridge, Massachusetts, August 1987, pp. 28-35.

3. When OMB originally set up its framework for reporting assets and liabilities – well before FASAB was established – there were no estimates of the federal government's environmental and disposal liabilities. OMB is considering adding FASAB's estimates in its future presentations of stewardship activities. Personal communication to the Congressional Budget Office by a staff member of the Office of Management and Budget, 11 July 2006.

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