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Comptroller General of the United States

Washington, D.C. 20548

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February 28, 1992

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The Honorable John Glenn
Chairman
The Honorable William V. Roth, Jr.
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

At our February 6, 1992 testimony before your committee, the Chairman asked for our reaction to the Administration's proposed accrual budget treatment of deposit insurance and pension guarantees. This letter provides our views.

In summary, we believe that the current, cash-based budget treatment of deposit insurance and pension guarantees does not disclose the true costs of those programs and that the concept of reporting accruals in the budget is sound and could result in improved disclosure of program costs. However, the accrual calculations of the Administration's current proposal go well beyond tested accrual accounting conventions and are suspect because of the uncertain assumptions and poor data that underlie the calculations. Therefore, we conclude that the Administration's current proposal is flawed and should be rejected by the Congress pending further study.

In a June 1991 report on the subject of budgeting accruals, the director of the Office of Management and Budget (OMB) discussed similar data limitations and the need to further develop and test the complex accrual projections models, concluding that another "two or three" years of study would be required, after which, "By then we should be able to see whether and how to bring these [accrual] estimates into the budget."[1] We fully agree with this earlier OMB assessment.

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[1]Office of Management and Budget, Budgeting for Federal Deposit Insurance, June 1991, p. 5.

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A number of factors have led many to suspect that the Administration has proposed to go forward with its proposal at this time in order to pursue certain policy objectives rather than to improve budget reporting. The proposal would include the use of questionable budget scoring procedures which would provide budgetary "savings" that could offset the revenue loss effects of the Administration's tax proposal. Further, the proposal was made without prior consultation with legislative officials and staff. The Administration's current proposal runs the danger of discrediting a good concept--accrual budgeting--by its premature application.

This letter sets forth certain steps that the Administration should take prior to seeking implementation of accrual budgeting for these programs.

BACKGROUND

For several years, GAO and others have reported that the cash-basis of recognizing costs in the budget--i.e., recognizing outlays and receipts essentially on a checks issued or received basis--distorts the true financial picture of the government, particularly in programs where the cash flows in a given year do not necessarily represent the costs incurred that year. For example, in the government's deposit insurance programs, it was apparent in 1988 that the government would be incurring substantial liabilities from the collapsing savings and loan industry. But the budget projections at that time failed to show the accruing liabilities, making those projections practically meaningless as indicators of future costs. Proper accruing of those liabilities could have provided an earlier alert to the developing crisis.

A similar problem existed in the government's military retirement program before accrual reform legislation in 1985. Decisions were being made on force levels and retirement benefits without budgetary recognition of the pensions' future costs.

This kind of distortion has led numerous blue-ribbon study commissions to recommend accrual budget reporting, wherein the budget would reflect the estimated costs being incurred in the year rather than simply the checks issued. At GAO, we also have recognized the limitations of cash-based budget reporting and have been a proponent of more accrual budget reporting.

GAO CONCERNS ABOUT ADMINISTRATION PROPOSAL

Notwithstanding our general support for more accrual budget reporting, we think that the Administration's current proposal is flawed for several reasons.

First, we question the appropriateness of the Administration's rush to implement such a major conceptual change in budget reporting, involving billions of dollars, in the absence of systematic consultation and analysis with legislative branch officials and staff. Absent such discussions concerning deposit insurance and pension guarantees, there inevitably will remain uncertainties about the policy and technical implications of the proposal.

A much better model was the way the Administration approached the issue of credit budgeting reform. In that case, the enactment of credit budgeting reform in 1990 followed years of study by legislative and executive branch offices and study groups. The act placed budget reporting for loans and loan guarantees on an accrual basis.

Second, we think that it is unfortunate that the proposal was made an integral part of the Administration's "pay-go" strategy under the budget enforcement provisions of the Budget Enforcement Act. Under pay-go, legislation that increases mandatory spending or decreases revenues must be offset by other budget savings so as to be at least deficit neutral in its impact on the budget baseline. On a cash basis, the Administration's proposed reforms of the deposit insurance and Pension Benefit Guaranty Corporation do not show a savings from the budget baseline until fiscal year 1994, according to OMB. By recording the reforms' effects on an accrual basis (moving forward in time the recognition of expected budget savings), and, more importantly, using questionable budget scoring for the reforms,[2] the Administration is able to show "savings" in fiscal years 1992 and 1993 thereby offsetting (as required by pay-go)

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[2]The enclosed CBO letter provides an excellent exposition of this scoring and related matters.

the revenue loss effects of the Administration's tax proposals.

This has understandably led observers to conclude that the accrual proposal was made mainly to provide pay-go "savings" to fund the Administration's tax change proposals.

Third, we are troubled by the Administration's selective application of the accrual concepts. For example, to be more consistent, the present partial accruing in the budget of civil service retirement system costs would have to be expanded and built into the unified budget's totals. And there are other entitlements where accruals could improve the budget's disclosure of future costs. The selective application of the accrual concept reinforces the notion that the change was proposed more for particular policy purposes rather than for improved financial management.

Finally, we are not convinced that there currently is sufficient basis of data and estimating procedures for making reasonably accurate accrual projections in the deposit insurance and pension guarantee areas. There are several potential problems.

-- Poor data. Our recent financial audits of several deposit insurance funds and the Pension Benefit Guaranty Corporation make us question the reliability of budget accruals based upon the financial management data currently available on these programs. We note that because of such data problems we were not able to audit the Resolution Trust Corporation's and the FSLIC Resolution Fund's 1990 financial statements. There are similarly severe problems concerning the Pension Benefit Guaranty Corporation, where the Corporation has not had reliable estimates of the costs of terminated plans that it has taken over.

-- Small errors and big effects. It is in the nature of accrual calculations, involving projections over several years and often tens of billions of dollars, that small changes in the underlying economic or technical assumptions can produce huge differences in calculated accrual amounts. The potential for widespread disagreement over calculated amounts is especially high in deposit insurance and pension guarantee programs given the data problems and uncertainties that affect these programs.

-- Insufficient test period. The OMB reported in June 1991 that the projection models used for calculating accruals in the deposit insurance field require further extensive testing. We also understand that the model for calculating Pension Benefit Guaranty Corporation accruals also requires further development and testing.

At GAO, we have long recognized the limitations of cash-based budget reporting and were an early proponent of budgeting for credit programs on an accrual basis. With respect to deposit insurance, we recently wrote that accrual budget reporting for such insurance ". . . is conceptually promising, although the practical difficulties in implementing such an approach must be carefully considered."[3] We went on to note the need for reliable safeguards to ensure that cost estimates are unbiased and realistic.

As required by the credit budgeting reform legislation in 1990, both OMB and the Congressional Budget Office (CBO) studied the possible application of accrual budget reporting to federal deposit insurance programs. The May 1991 CBO report concluded that accrual budget reporting for deposit insurance, as well as some other reporting alternatives, would represent an improvement over the current, cash-based reporting method.[4]

The June 1991 OMB report stated that accrual budget reporting for deposit insurance could be an improvement but, because of technical complexities, "Transition to a new system would require time: to gain experience with and confidence in the new cost measures; to expand the information provided by banks on their assets and liabilities; and to agree on further accounting and control reforms." The report added that the matter should be

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[3]1991 Budget Estimates: What Went Wrong (GAO/OCG-92-1, January 15, 1992), p. 43.

[4]See Congressional Budget Office, Budgeting Treatment of Deposit Insurance: A Framework for Reform, May 1991.

studied for another "two or three years," concluding that "By then we should be able to see whether and how to bring these [accrual] estimates into the budget."[5]

CONCLUSION AND OBSERVATIONS

The notion of reporting accruals in the budget is basically a very sound idea, but we strongly believe that the problems outlined above should be resolved before legislation is enacted requiring that the budget's totals reflect deposit insurance and pension guarantee costs on an accrual basis as proposed by the Administration. The same would also apply to the Administration's plans for incorporating into the budget's totals budget accruals for other insurance programs.

To resolve the problems, we believe that extensive discussions of the issues should take place between legislative and executive branch officials and staff. Accrual cost concepts should be studied for application to the entire budget where major liabilities are incurred requiring future payments, and, if appropriate, a set of principles, including budget scoring principles, should be developed for comprehensive application.

Also, principles for accruing costs in the budget should be developed in concert with accounting principles. For budgeting to effectively use actual data, the principles for accounting and budgeting need to be easily reconcilable. The Federal Accounting Standards Advisory Board is presently considering accounting principles for credit reform that would adopt budget accrual concepts and accomplish that objective.

Lastly, as the 1991 OMB report stated, the accrual concepts should be fully developed and tested before implementation. As part of the test process, the accrual amounts developed should be disclosed in future budgets as supplemental information.

I hope this letter clarifies the issues. We are sending copies to the Speaker of the House, the President of the

[5]Office of Management and Budget, Budgeting for Federal Deposit Insurance, June 1991, pp. 4-5.

Senate, interested congressional committees, the Director of CBO, the Director of OMB, and other interested parties.

My staff and I are available should you wish to discuss these issues further. Please contact Mr. Donald H. Chapin, Assistant Comptroller General for Accounting and Financial Management, at (202) 275-9461.

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

Enclosure

ENCLOSURE

CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Robert D. Reischauer
Director

February 18, 1992

The Honorable Jim Sasser
Chairman
Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of February 11 requesting CBO's views on the Administration's proposals to modify federal pension termination insurance and banking policy and to convert the budgetary basis of accounting for the Pension Benefit Guaranty Corporation (PBGC) and deposit insurance from cash to accrual. In response, I wish to emphasize four points:

- Federal budgetary accounting for these insurance programs needs to be improved;
- CBO does not believe, however, that the accrual accounting measures proposed by the Administration are suitable for use in the budget at this time;
- No PAYGO savings should be scored for the policy changes proposed by the Administration; and
- The Administration's proposal to provide mandatory appropriations for insurance costs could increase taxpayer liability for these programs.

Current Accounting. Cash-basis accounting for insurance programs fails to provide complete information about the cost of these activities. For deposit insurance, cash-basis includes in budget outlays and the deficit the distorting effects of outlays for the acquisition of assets and the proceeds of asset sales. These transactions distort trends in the deficit. Similarly, cash-basis accounting gives the false impression that the government is currently earning profits from pension insurance. The Budget Enforcement Act effectively removed the effects of most deposit insurance proposals from the provisions of PAYGO. Futhermore, CBO removes the deposit insurance cash flows from its budget projections to obtain a clearer picture of budgetary trends. Similar adjustments have not been made for pension insurance.

Proposed Budgetary Treatment. OMB's proposed accounting for deposit insurance is superior to present cash flow accounting for evaluating the financial condition of the insurance funds, and its market valuation techniques could be useful in setting insurance premiums. The accounting treatment proposed for PBGC is more problematic. Specifically, the effect of the Administration's proposals is to adopt inconsistent forms of accrual accounting for deposit insurance and the PBGC in the budget. For deposit insurance, the Administration's approach largely recognizes costs when economic insolvency occurs. For the PBGC, costs are recognized in the budget year they are forecast rather than when they are incurred. For example, the cost of an insured bank insolvency in 2010 that was first forecast in 1993 would be scored in the budget for 2010. By contrast, the cost of a pension plan termination in 2010 that was first forecast in 1993 would be scored in the 1993 budget.

While the Administration's methods for estimating accrued costs could be useful for some purposes, they are complicated, would be difficult to replicate and implement, and are not necessarily the best way to estimate costs. We would have no confidence in any comparable re-estimates that we could generate in the current budget cycle. Indeed, because of the uncertainty of the estimating procedures, we believe it would be imprudent to incorporate them into the budget without substantial study. If the Administration's--or alternative--reform measures are viewed as urgent, they can be introduced, analyzed, and enacted without changing current budget accounting.

PAYGO Scorekeeping. The Administration proposes to raise the minimum contributions required of sponsors of insured pension plans; to limit federal liability for increased benefits in underfunded plans; and to improve the status of PBGC claims against sponsors in bankruptcy. According to OMB, these changes would reduce the cost of federal pension insurance over the next 30 years by billions of dollars. However, if costs and cost savings are recognized only in the years they are incurred or achieved--rather than moved up to the year they are forecast--no significant budgetary or PAYGO savings would be achieved by these policy changes before 1997.

Even if the Administration's version of accrual accounting were accepted, it would be inappropriate to record PAYGO savings for costs that had never been recognized before in the budget. Under the Administration's accrual accounting proposal, significant costs would be estimated for the first time but not scored, while savings from proposals to reduce these costs would be credited to PAYGO. Thus savings designed to meet PBGC costs could be used to pay for other budgetary initiatives. Any savings should first be applied to the newly estimated insurance costs. Accordingly, CBO would score budgetary savings only when these insurance programs have income in excess of anticipated costs. The same point applies to the Administration's proposals involving bank reform legislation and the estimated impacts for deposit insurance.

Legislated changes in budgetary accounting, moreover, can run afoul of the existing prohibitions on directed scorekeeping. If legislation contains language that directs the budgetary accounting or scorekeeping treatment for that legislation, CBO disregards the directive in scoring that legislation until such time as the scorekeeping provisions become law. While the proposal is pending, we do not change our scoring practice. If this were not the case, any bill could evade all controls of the Budget Act by directing that a cost was not a cost. Therefore, at the present time, we would use cash-basis accounting for legislation mandating substantive changes in the deposit insurance and pension insurance programs for purposes of enforcing points of order on the House and Senate floors.

The Administration's reform proposals for PBGC would do much to make up the current PBGC shortfall and enhance the financial stability of pension termination insurance. Ironically, under the current cash basis of accounting, these reforms would add to the federal deficit in the near term and constitute a charge against PAYGO. This perverse outcome suggests a fundamental incompatibility of current accounting for PBGC and the PAYGO rules. The simplest remedy for the short-term is not to change the accounting, but to remove PBGC from the PAYGO scorecard as has been done for deposit insurance. The Congress should be held harmless in the budget for adopting policies to control the cost of pension insurance.

Taxpayer Liability. Under current law, the explicit federal liability is $100 million in borrowing authority for PBGC. Strong recent experience suggests, however, that a legal limit on federal liability that is not consistent with de facto liability is not likely to be an effective limitation. The legal limitation will be especially weak where the public presumes the existence of open-ended federal liability. The existing $100 million legal limit, therefore, may be a gross under-estimate of the actual federal liability.

The question of who is liable for PBGC and deposit insurance financial shortfalls, however, does lead to an additional, important reason that these proposals should not earn PAYGO credit. The proposals do not reduce claims on the federal general fund. Specifically, the CBO baseline does not contain any general fund appropriations (except for borrowing authority) for BIF or PBGC in the projection period. Rather, by CBO projections, all losses are fully funded by present and future insurance premiums. Adopting the Administration's policy reforms would reduce losses accruing to the BIF and PBGC and permit offsetting reductions in insurance premiums. These reforms leave the general fund unaffected. They, therefore, would not free federal monies for use in funding new budgetary initiatives.

The Administration's package of proposals for deposit insurance and PBGC also makes a subtle, but major, policy change in the primary source of funding for financial shortfalls in these two insurance programs. In the past, the first resort source of money to cover financial deficiencies in these funds has been to raise the level of premiums. A general fund appropriation, by contrast, has been regarded as a last resort, discretionary action taken by the Congress only to avoid the possibility of default.

The Administration proposes to replace this process with an annual mandatory appropriation that would be triggered by any shortfall between annual premium income on the one hand and annual total costs on the other. This changes fundamentally the priority of liability for the cost of these programs. The taxpayer's share increases; the insured's share decreases. This shift increases the general fund deficit unless the Congress acts to reduce program costs. An alternative approach would be to create a closer link between insurance fund losses and insurance premiums and, thereby, to maintain the self-financing nature of these insurance programs.

Conclusion. The Administration's accrual accounting proposal, while a step in the right direction for analyzing deposit and pension insurance, is not ready for incorporation in the budget. Under current Congressional scorekeeping practices, the savings from the Administration's policy changes should not be available to pay for other budgetary initiatives.

Sincerely yours,

Robert D. Reischauer
Director

cc: Honorable Pete V. Domenici