

Truth and Transparency: Fiscal, Retirement Security, and Accounting Profession Update

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**The Honorable David M. Walker
Comptroller General of the United States**

- Today I'd like to speak the truth about three topics: (1) our nation's financial condition and fiscal outlook, (2) the state of our nation's retirement security model, and (3) the state of the accounting profession.
- I hope my comments will stimulate your thinking and provoke a number of questions about these and other topics.

Financial Condition and Fiscal Outlook

- Let's start with our nation's current and projected financial condition.
- Before I address the present and the future, it's important to understand the past and how we have gotten to where we are.
- From 1963-2003, the federal budget percentage for defense spending fell from 48% to 19%, with the reduction in defense spending going to Social Security, Medicare, and Medicaid. In addition, discretionary spending fell from 68% to 39% during the same 40-year period.
- One thing is for sure: The past is not prologue!
- According to the U.S. Government's September 30, 2002 balance sheet, we had an accumulated deficit of about \$7 trillion, or about \$24,000 for every man, woman, and child in the United States today.
- Interestingly, that accumulated deficit does not include a number of very important and very large items (e.g., the bonds in Social Security/Medicare trust funds, the difference between future Social Security and Medicare promised versus funded benefits, and veterans health care benefits).
- As a result, our real financial condition is much worse than advertised, and it's getting worse every day.
- In fact, if you were to estimate the cost of the items that were not included in the September 30, 2002 financial statements, the average burden per American would go from \$24,000 to more than \$124,000.
- This is multiple times the average annual wage and the average net worth of a typical American worker.
- From a budget perspective, we just ended fiscal year 2003 with a deficit of about \$375 billion, and the deficit for fiscal year 2004 is projected by CBO to be about \$480 billion.

- Interestingly, the cost of our global war against terrorism, IRAQ's reconstruction, and our additional homeland security costs amount to less than 25% of the projected fiscal year 2004 deficit.
- The current deficit is also due to a number of factors, including a lack of fiscal discipline and prudence on both the spending side and the tax side. This problem is growing and involves both political parties.
- In addition, while overall economic growth has not been what we would have liked during the past few years, we haven't been in a recession since November 2001.
- While there has been some recent good news about the economy, it's too early to tell whether it will continue.
- Looking forward, due largely to known demographic trends and rising health care costs, we face a large structural deficit that must be addressed.
- Much of this projected deficit is due to the impending and unprecedented demographic tidal wave that will begin to hit our country in fewer than 10 years.
- However, unlike most tidal waves, this demographic tidal wave will never recede! It will bring a fundamental and lasting change to the age profile of our nation.
- Frankly, budget deficits are not just numbers. If left unchecked, they can have an adverse effect on the national security of our nation and the economic security of Americans in the future.
- While additional economic growth can help, our future fiscal gap is simply too great to grow our way out of the problem!
- Tough choices will be required on both the spending and tax sides of the policy ledger, including tough choices in connection with national defense and homeland security issues.
- Given the size of the projected fiscal gap, we need to engage in nothing less than a fundamental review, reassessment, and reprioritization of the "base" of government policies, programs, functions, and activities.
- The simple truth is that the base of government is not "OK." Why? Because the current base of government represents an accumulation and amalgamation of programs, policies, functions, activities and entities that may have made sense at their inception, but may not make sense or represent as high a priority for today and/or tomorrow.
- Clearly, the longer we wait to make appropriate changes, the more dramatic the changes will have to be. In addition, delay may also increase the degree of difficulty in making the changes.
- This is a matter of significant concern for our country, our children, and our grandchildren.
- Unfortunately, public officials in Washington have yet to answer this fiscal wakeup call. In addition, despite the fact that we're in a deep fiscal hole, Washington is still digging, both on the spending and the tax side of the ledger.
- Most recently, the enactment of the new Medicare prescription drug benefit will help many seniors, including those with very high annual drug costs. However, it will also add trillions to our existing unfunded commitments and serves to dig our fiscal hole deeper. In fact, preliminary estimates are that this bill alone will add

another \$8 trillion to our existing unfunded commitments. That's an additional \$25,000 burden for every man, woman, and child in America today.

- There is also a real risk that attempts will be made to add to this drug benefit when seniors understand the contents of the bill.
- Looking forward, at the very least, we need to think about formulating new budget process controls to prompt more caution and discipline in the near term. We also need to think about new metrics to promote greater disclosure and deliberation over long-term costs of our commitments and the cost effectiveness of various government programs and policies.
- In my recent National Press Club speech, I suggested several specific actions that should be taken to help get us on track. I'd be happy to address these in the Q&A period. In addition, my Press Club speech is on the GAO website, and some copies are available here today.

State of the Nation's Retirement Security Model

- In my view, there are six legs to the modern retirement security stool:
 - Social Security
 - Medicare
 - Private pension/savings plans
 - Private health plans
 - Individual savings and investments
 - Earnings from continued employment, especially part-time employment.
- Candidly, the state of the nation's current retirement security model is also a matter of concern.
- As I previously noted, Social Security has a current funding gap of over \$3.6 trillion dollars for the next 75 years in DPV terms. That's the bad news.
- The good news is that with leadership and courage we can reform Social Security to make it both solvent and sustainable while exceeding the expectations of all generations of Americans. You can ask me how during the Q&A period if you want.
- Medicare is estimated to have a current funding gap of over \$24 trillion for the next 75 years in DPV terms after enactment of the new prescription drug benefit. Unfortunately, there isn't much good news relating to the longer-term outlook for the Medicare program. There are huge expectation gaps in connection with this program and it will ultimately have to undergo both dramatic and fundamental reforms.
- These reforms should be part of a comprehensive health care reform effort that will need to be addressed in installments over a number of years.
- In my opinion, health care clearly represents our largest domestic policy challenge, and this subject will be one of recurring interest and debate.
- The private pension and savings system has undergone a number of dramatic changes in recent years, including the continued movement to defined contribution plans, the emergence of certain hybrid plans, and the significant decline in the funding status of defined benefit plans.

- The overall decline in defined benefit plan funding levels was due to the “double whammy” that hit most plans - namely, declining asset values and declining annuity rates, the combination of which, served to dramatically reducing average funding levels.
- While asset values have recovered somewhat, annuity rates are still low in historical terms. The result is that many plan sponsors are now crying “poor mouth” and wanting relief from certain minimum funding requirements.
- In addressing any related concerns, Congress needs to take care to target any related relief in a manner that does not unduly compromise the retirement income security of American workers and retirees or further threaten the financial condition of the PBGC. As you may know, the PBGC’s single employer insurance program was recently added to GAO’s High Risk List.
- The state of the employer sponsored health care system is also a matter of great concern. Recent statistics show that we are now experiencing a decline in the percentage of active workers who are covered under an employer or union sponsored health plan. This is matter of particular concern given the importance and popularity of this benefit to workers.
- In addition, employers are continuing to seek ways to reduce or eliminate any retiree health plan arrangements they may have. Despite the incentives contained in the recently enacted Medicare prescription drug bill, this trend is likely to accelerate.
- Many employers are looking for a basis to dump these arrangements in the face of rising health costs and increasing global competition. It’s pretty clear that the new Medicare prescription drug benefit will provide many with a new basis to do so.
- With regard to personal savings and investments, the U.S. personal savings rate continues to trail most other industrialized nations. While increasing real estate values have helped homeowners recently, it’s unclear how long this trend will last. In addition, not everyone owns a home.
- The final leg of the stool is represented by earnings from employment after reaching retirement age. This leg is increasing in both size and importance, not necessarily because people want to work longer, but in part because it may be their only default option if the other legs aren’t strong enough.
- This is not all bad. After all, current workforce projections show that we need to encourage people to work longer, given longer life spans, the changes in the nature of the economy, and advanced medical technologies.
- In addition, many studies have shown that staying physically and mentally active for as long as possible can help to extend live and improve one’s quality of life. In this regard, the federal government needs to look for ways to allow people to phase into retirement, and to encourage people with needed skills and knowledge to stay in the workforce longer.
- Current government and employer policies aren’t keeping pace in this area, but both will eventually see the light.

State of the Accounting Profession

- Our profession has taken a number of hits in the last couple of years as a result of recent accountability failures in the private sector.
- Auditors were by no means the only responsible party for these failures and, in many cases, they weren't even the primary responsible party; however, the public expects much from our profession.
- After all, the "P" in CPA stands for public, which signifies that we hold a special public trust.
- All elements of our profession, including the AICPA, the firms and individual CPAs must get the message from Sarbanes-Oxley and seize upon the opportunity to modernize our profession for the future.
- In this regard, the AICPA's recent decision to establish quality centers for both the employee benefits and government areas is a very positive step.
- In my view, achieving meaningful corporate and other governance reforms will be a critical element for success. We also need to modernize the accounting/reporting and the attest/assurance models for the 21st Century.
- If we do our part and encourage others to theirs, we can regain the public's trust and position our profession for even greater heights in the future.
- We at GAO will continue to lead by example in connection with a range of accounting/reporting (e.g., performance, projection information) and attest/assurance (e.g., independence, reporting on internal controls) matters.
- We'll also continue to conduct various studies (e.g., consolidation of the Big 8 to the Big 4, mandatory audit firm rotation) to help the Congress and others make timely and informed judgments affecting our profession.
- I'll continue to try and do my best to make a difference - all that I ask is that each of you do your best as well. Working together we can make a great profession even greater.
- Thank you.