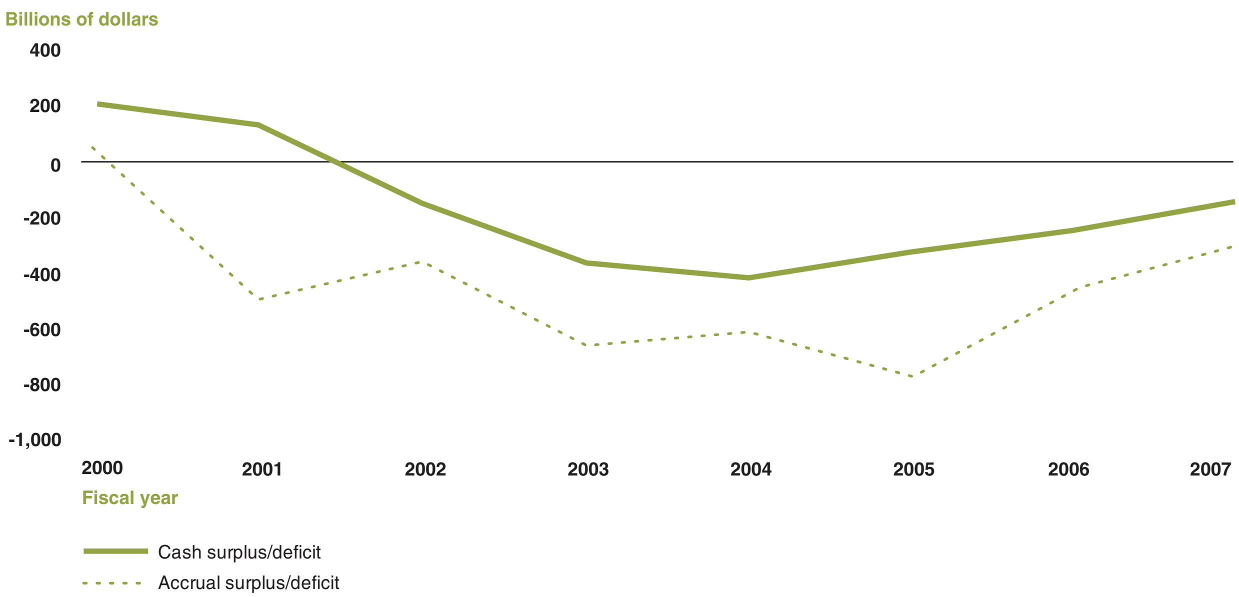
How Did the Accrual and Cash Measures Change in Fiscal Year 2007?

The unified budget deficit—sometimes called the "cash deficit"—and the net operating cost—sometimes called the "accrual deficit"—are two key measures of the government's annual fiscal position. The cash deficit provides information on the government's current cash flow and borrowing needs. The accrual deficit provides information on the current cost of government—the amount of resources used to produce goods or deliver services during the fiscal year—regardless of when cash is used.[1]

Both deficit measures improved in 2007, but the accrual deficit improved more than the cash deficit (see fig. 1). The cash deficit decreased by about $85 billion or 34.3 percent while the accrual deficit decreased by $174 billion or 38.7 percent.[2]

Figure 1: Cash and Accrual Surpluses/Deficits (Fiscal Years 2000–2007)



Source: Department of the Treasury.

Notes: Data reported in the *Financial Report of the United States Government*, hereafter referred to as the *Financial Report*, for fiscal years 2001 through 2007. GAO disclaimed an opinion on the U.S. government's consolidated financial statements for these years, other than the 2007 Statement of Social Insurance. As such, the reported amounts may not be reliable.

[1] The following pages update selected information in *Understanding Similarities and Differences between Accrual and Cash Deficits* (GAO-07-117SP) and should be read in conjunction with that document.

[2] Despite recent improvements in the budget deficit, the long-term outlook remains unsustainable. See *GAO*, *The Nation's Long-Term Fiscal Outlook: August 2007 Update*, GAO-07-1261R (Washington, D.C.: Sept. 28, 2007).

Importantly, emphasis should not be placed on the precise numbers for either a single year accrual deficit or the change from year to year. For the 11th consecutive year, the government was unable to demonstrate the reliability of significant portions of the 2007 *Financial Report*, from which the data in this update were taken.[3]

What Drove the Change in Cash and Accrual Deficits in Fiscal Year 2007?

The decrease in both cash and accrual deficits in 2007 was driven by growth in federal receipts and revenue that exceeded growth in outlays and accrual-based costs. Revenue and cash receipts each increased by around 7 percent. Total cash outlays increased by only 3 percent in 2007 and accrual-based costs remained relatively stable.

The difference between cash receipts that are reported in the budget and revenue, which is recorded on a modified cash basis in the consolidated financial statements, has typically been small—averaging 1.2 percent of revenue from fiscal years 2000 to 2006. Revenue exceeded cash receipts by about $25 billion on average in those years, but in 2007 the difference increased to almost $60 billion—more than 2 percent of revenue. This difference can not be explained. GAO has previously recommended that the Department of the Treasury explain and document the differences between the operating revenue reported in the consolidated financial statements and unified budget receipts.[4]

Traditionally, the significant differences between cash and accrual deficits have been on the spending side. Differences arise when a cost is accrued (and affects the accrual deficit) in one fiscal year but the cash outlay is paid (and affects the cash deficit) in a different fiscal year. In 2007, the largest increases in both cash outlays and accrual-based costs were at the Department of Defense (DOD), the Department of Health and Human Services, and the Social Security Administration.[5] Cash outlays and accrual-based costs decreased at a number of cabinet agencies, most notably at the Departments of Education, Agriculture, and Homeland Security. At the Department of Veterans Affairs (VA), cash-based outlays increased while accrual-based costs decreased. In fact, the decrease in VA's costs account for about one-third of the $174 billion improvement in the accrual deficit. This decrease was primarily driven by changes in assumptions that are the basis for actuarial estimates for certain accrued long-term liabilities. These and other significant changes that caused the accrual deficit to improve relative to the cash deficit are discussed below.

[3] For more information regarding the reliability of federal financial data, see GAO's auditor report in the 2007 *Financial Report of the United States Government* (Washington, D.C.: Dec. 10, 2007).

[4] GAO, *Financial Audit: Process for Preparing the Consolidated Financial Statements of the U.S. Government Needs Improvement*, GAO-04-45 (Washington, D.C.: Oct. 30, 2003).

[5] Amounts reported in the consolidated financial statements for agencies' net costs include allocations from the General Services Administration and Office of Personnel Management and thus do not match the costs reported in individual agencies' financial statements.

- Veterans compensation: Veterans compensation costs (in excess of cash outlays) declined by just over $57 billion in 2007. In the past, much of the volatility in the veterans compensation liability was caused by changes in the interest rate assumption. For 2007, the large change was primarily caused by changes in VA's inflation assumption. VA reduced the inflation rate used to calculate future benefits, which substantially reduced the present value estimate of future benefit payments and related accrual-based costs.
- Civilian employee benefits: Civilian employee benefit costs (in excess of cash outlays) declined by more than $25 billion in 2007. The decline is primarily because of an actuarial gain, which occurs when actual experience is better than assumed. In 2007, the actual cost-of-living allowance and general salary increase were lower than previously assumed for 2006 thereby reducing the accrual-based costs.

Because accrual deficits are highly sensitive to changes in inflation, interest, and other assumptions, any large change in the accrual deficit needs to be examined to evaluate whether it represents a fundamental change in the longer-term budgetary consequences of today's policy decisions. Cash deficits are also sensitive to factors unrelated to fundamental changes in policy, such as changes in dates when cash is scheduled to be paid or received. However, these types of technical changes have resulted in smaller effects on the cash deficit than the accrual deficit.

How Do You Get to the Cash Deficit from the Accrual Deficit?

The *Financial Report* includes a statement called Reconciliation of Net Operating Cost and Unified Budget Deficit that provides a crosswalk between the net operating cost (accrual deficit) and the unified budget deficit (cash budget deficit). Figure 2 summarizes this crosswalk. It shows components of the accrual deficit that are not in the cash deficit—costs incurred, but not yet paid—such as changes in liabilities for pensions and retiree health benefits for civilian and military employees and veterans compensation. The change in the liability is generally equal to accrual-based costs less cash payments made to cover costs. The figure also shows components of the cash deficit that are not in the accrual deficit—the largest of which are outlays to purchase various capital assets.

Figure 2: Crosswalk between Accrual and Cash Deficits

	Dollars in billions	
	2006	**2007**
Net operating cost (i.e., accrual deficit)	**–449.5**	**–275.5**
Components of accrual deficit not part of the cash budget deficit		
Changes in liability for military employee benefits	74.9	60.3
Changes in liability for veterans compensation	31.2	–26.1
Changes in liability for civilian employee benefits	81.3	55.9
Changes in environmental liabilities	45.4	36.8
Depreciation expense[a]	82.9	45.3
Changes in insurance liabilities	–20.4	–1.9
Increase in accounts and taxes receivable	–2.7	–19.0
Other	25.5	46.0
Total	**318.1**	**197.3**
Components of cash budget deficit not part of the accrual deficit		
Outlays for capitalized fixed assets[a]	–103.7	–58.8
Other	–11.1	–10.7
Total	**–114.8**	**– 69.5**
All other reconciling differences		
Net amount of all other reconciling differences	–1.5	–15.1
Unified budget deficit (i.e., cash deficit)	**–247.7[b]**	**–162.8**

Information available on www.fms.treas.gov/fr/index.html

Source: Department of the Treasury.

Notes: Data reported in the 2007 *Financial Report*. GAO disclaimed an opinion on the U.S. government's fiscal year 2006 and 2007 consolidated financial statements other than for the fiscal year 2007 Statement of Social Insurance. As such, the reported amounts may not be reliable.

[a] Nearly all of the decrease in the depreciation component and outlays for capitalized fixed assets was attributable to DOD. Because DOD's financial statements have been unauditable, it is unclear what exactly drove the large change. However, looking at depreciation and acquisition of capital assets together shows that they account for a small share of the difference between the net operating cost and unified budget deficit in fiscal year 2007.

[b] The final deficit number published in the *Budget of the United States Government* was slightly higher—$248.2 billion—because of subsequent adjustments. However, we use the numbers reported in the *Financial Report* since it contains the reconciliation between cash and accrual deficits.