Answering the *Right Question* at the *Right Time:*

Why and How FASAB Added Fiscal Sustainability Information to Financial Reports

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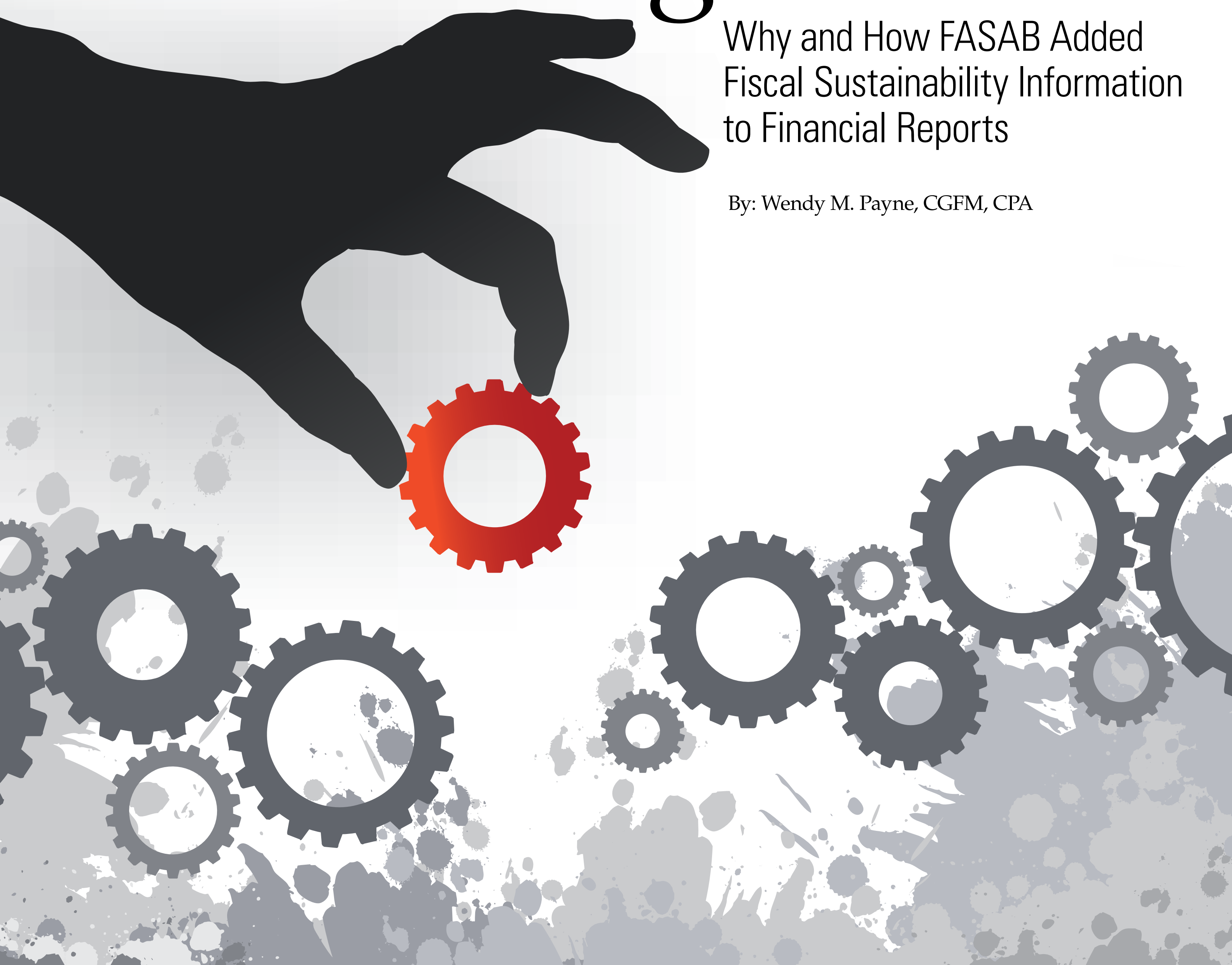

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Annual financial statements are commonly viewed as providing "all the relevant financial information, presented in a structured manner and in a form easy to understand."[1] So simple a goal and yet so elusive. How many financial statements does it take to capture all the relevant information in a manner understandable to citizens?

The federal government will soon add No. 7 to its suite of financial statements. In fiscal year (FY) 2013, a new financial statement will present "Long-Term Fiscal Projections for the U.S. Government." This statement, extensive disclosures and required supplementary information are collectively referred to as "fiscal sustainability information." Beginning with the most recent annual report, FY2010, fiscal sustainability information gets a trial run as required supplementary information (RSI) in the consolidated financial report of the U.S. government (CFR).

Understandability is often the greatest challenge for the preparer in presenting fiscal sustainability information. In considering how to help people understand this new financial statement, we ought to identify the questions financial statements help answer. This article explores the questions that a citizen can find answers to through federal financial statements, the challenges implicit in giving understandable answers, and features intended to make fiscal sustainability information more accessible to citizens.

Governments, 'Accountability' and the Financial Statements

Accountability is a high bar. One possible synonym for accountability is "answerable." But answerable for what? On any given day, parents may ask whether their children did what they were told, did all things well and consistently did the right things without being told. They also may wonder what their children think they will be doing when they are 30 years old but rarely ask. It's not so different with citizens and their government. Citizens can rightly demand information in their role as the ultimate overseers of government. However, I suspect they want their government to consistently do the right things without being told to do them. In this sense, accountability "is not only a reactive response to overseers but also a proactive one linked to ensuring that the public trust is served."[2]

The Federal Accounting Standards Advisory Board (FASAB) and its sponsors—the Office of Management and Budget, the U.S. Department of the Treasury and the U.S. Government Accountability Office—demonstrate proactive accountability by considering what questions citizens may have about the fiscal sustainability of their government. At a minimum, generally accepted accounting principles (GAAP) should align the scope of financial statements with the scope of citizens' expectations of an accountable government. This will ensure their government is prepared to be answerable.

The most visible form of accountability is the budget—the most often referenced federal financial information. It serves as a planning and control tool as well as a means of communicating public policy. Through highly aggregated budgetary information, citizens can monitor public policy; through more detailed budgetary information, they can monitor compliance with the budget. Financial statements reveal the budgetary surplus or deficit, and how it was financed. This type of information helps answer citizens' questions about the size of their government as well as how much of its cash needs were met through present collections rather than through borrowing.

To answer broader, complementary questions about the government's activities, financial statements on an accrual basis are provided. While cash transactions are still captured, additional information is also captured so financial effects can be comprehensively reported. The accrual basis statements are the balance sheet, the statement of net cost and the statement of changes in net position.

Proactive Accountability in Action

"Never before has the United States government attempted to assemble comprehensive financial statements covering all of its myriad activities and to subject those financial statements to an audit. I am confident that in future years, as the data used to prepare these financial statements continue to improve, these financial statements will prove to be an important management tool for policymakers and the public."

— Robert Rubin, then-Secretary of the Treasury, regarding the FY1997 consolidated financial report of the U.S. government issued in compliance with the Government Management Reform Act

The balance sheet extends accountability to resources ("assets") entrusted to elected officials, political appointees and career civil servants for use in providing goods and services. Information about the assets managed by federal officials is now routinely provided on a consistent basis. Citizens can find answers to questions about the magnitude of federal real property holdings used to support service delivery and even the assets held in trust for others.

The balance sheet also identifies and reports liabilities arising from operations. This makes officials accountable not just for budgetary resources consumed but also for present obligations that will require use of budgetary resources in the future. The largest of these are deferred compensation liabilities for military and civilian employees such as pensions and retiree health benefits. By agreeing to defer some portion of their compensation, federal employees finance present operations of the government. This reduces the budgetary outlays needed to deliver current goods and services but increases budgetary outlays in the future when the obligations are settled. Citizens can use the balance sheet to find out how much present debt—in whatever form—their government has incurred.

The statement of net cost provides accountability for the cost of delivering goods and services to citizens. Cost relates spending, consumption of resources and incurrence of new liabilities with the delivery of goods and services during the reporting period. It presents the costs incurred at the federal level to address issues of public concern.

Each financial statement answers different questions, each has limitations and there is no immediately apparent "bottom line" for the federal government. Since we cannot show what was "earned" through government operations in purely financial terms, many believe it is misleading to report a single number as the "result" of government operations. Therefore, the greatest remaining challenge is to use available accrual basis measures to evaluate the results of government programs as well as to assess how well cost-saving measures are functioning. Any such evaluation would need to consider the accrual-basis financial costs along with the perceived public benefits to determine the "result" of federal government operations.

The Biggest Question of All: Where Are We Headed?

It is rare to read the daily news without running across commentary regarding the risk of "excessive government borrowing." For example, see the quote from the chair of the Federal Deposit Insurance Corporation. These types of commentary provide evidence of an apparent consensus that citizens need to focus more attention on where their government is headed—long-term fiscal sustainability information is more important than ever.

From its earliest days, FASAB has focused on providing information to help the reader determine whether "future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due."[5] The annual report of the U.S. government has evolved in the last few years to include information intended to do just that. In particular, the Citizens Guide has provided clear and concise information on fiscal sustainability.

However, fiscal year 2010 was the first year that such information was required by GAAP. The report is available on the U.S. Department of the Treasury website at *www.fms.treas.gov/fr/index.html*. I encourage you to read it, share it with your friends and family, and help them understand its important message. Key features of the required fiscal sustainability information are described below along with some tips to help you explain its significance.

Context: Just What are These Projections?

The first thing we do when we think about where we will end up if we stay on our present course is make projections. For example, if we are driving down the highway, we think about where the road can take us and whether we need to make a turn. If we want to know about our financial future, we might start with asking, "Where will I end up if I just keep doing what I have been doing?"

Essentially, GAAP requires the preparer to respond to the question: "What if current policy without change regarding federal government public services and taxation are continued in the future?" The foundation for all the fiscal sustainability information required by GAAP is a projection based on continuing current policies without change. The preparer will have to use judgment in determining what current policy is. A key factor is that the objective is not a projection that anticipates future changes based on the policy goals of a particular administration. Rather, the projection should assume the present suite of goods and services continue along with the current tax policy.

The three most important things to know about projections are they:

- require assumptions about future events, conditions and trends; actual results may differ materially from those that are projected.

The Need for Integration Between Performance and Cost Information

"In a resource-constrained environment, it becomes even more important for policy-makers to have the needed information to know which programs are working and which ones are not to make tough decisions. One of the central themes of a December 2007 forum on financial management systems hosted by GAO was the importance of the integration of program and financial information so that CFOs were providing information of use to program management. This type of information is in line with what CFOs say they value when they question the investment in financial statements."

— Jeffrey C. Steinhoff, CGFM, CPA, CFE, and Robert F. Dacey, CGFM[3]

More Important Now than Ever

"The quiet confidence of the American public in the [Federal Deposit Insurance Corporation's] deposit insurance guarantee was one of the bulwarks that helped to stem the tide in the recent crisis and avert even greater economic calamity. But we must never take public or investor confidence for granted. ***In the end, that confidence is only as great as the resolve shown by our government in identifying emerging risks and taking concerted action to head them off. Excessive government borrowing poses a clear danger to our long-term fiscal stability.*** All of us must work together now as Americans, look beyond our narrow partisan interests and show the world that we are prepared to act boldly to secure our economic future. [Emphasis added.]

— Sheila Bair, chair, Federal Deposit Insurance Corporation[4]

- are not forecasts or predictions (in other words, they do not foretell the future).
- may also encompass hypothetical future trends or events that are not necessarily deemed probable (for example, the assumed ability to continue issuing new public debt indefinitely).[6]

Fiscal projections are not predictions or prophesies—they are mathematical models that depict fiscal results if current policies are extended into the future. In some cases, the math will depict something that economists generally do not believe can come to pass. For example, models do not adjust for uncertain market reactions to policies and it is possible that the market would refuse to provide the debt financing needed for the projections to play out as modeled.

So, why do we need projections? As Yogi Berra said, "If you don't know where you're going, you'll wind up somewhere else." Rather than ending up "somewhere else," we need to look ahead based on the best information we have. Some aspects of the projections have a more solid foundation than others but in aggregate they should reasonably depict the trajectory of federal spending and receipts as well as the resulting debt.

Typically, projections look ahead 75 years because that period of time covers the lifetime of all present workers. A 75-year time period is not required by the accounting standards. Instead, the accounting standards require "a finite projection period sufficient to illustrate long-term sustainability."[7]

How Are the Results of Fiscal Projections Presented in Financial Reports?

Projections, and the significance of them, will be presented and explained in a variety of ways. GAAP requires tabular presentations of amounts through financial statements as well as graphic presentations of trends. Narrative is required to help citizens understand the fiscal sustainability information. The most important presentations are described below.

The presentation most familiar to accountants and auditors is a financial statement illustrated in *Figure 1*: Long-term Fiscal Projections of the United States Government.[9] The new financial statement will provide the present value of receipts and noninterest spending for the projection period. Amounts will be presented for the two most recent reporting periods as well as for the change between these two years. The amounts will be in the trillions of dollars—most citizens will have a difficult time imagining trillions.[8]

Because even $1 trillion is hard to fathom, the financial statement will also provide the relationship of each amount to the present value of gross domestic product (GDP) during the projection period. GDP is an indicator of the size of the economy.

By presenting the relationship of future spending and receipts to the future size of the economy, readers will be able to assess projections against the nation's future capacity to support those projected amounts.

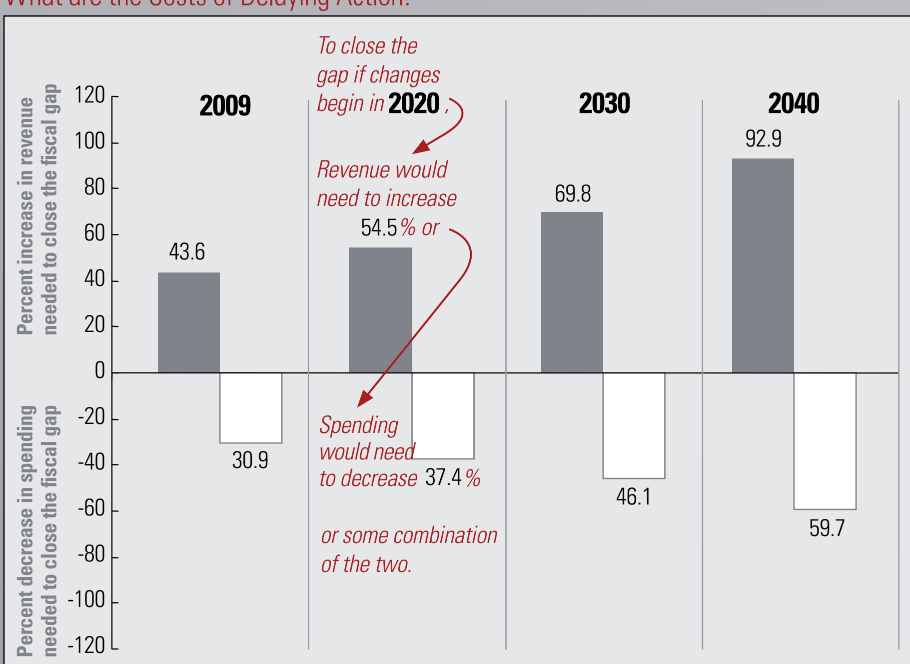
Figure 1: Tabular Presentation
Long-Term Fiscal Projections for the U.S. Government

Amounts projected to 75 years

	As of XXXX XX, 20XX (Current Year)		As of XXXX XX, 20XX (Prior Year)		Change from Prior Year	
	PV Dollars in trillions	% of the PV of GDP	PV Dollars in trillions	% of the PV of GDP	PV Dollars in trillions	% of the PV of GDP
RECEIPTS						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
All Other Receipts	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Receipts	**$ XXX.X**	**X.X%**	**$ XX.X**	**X.X%**	**$ X.X**	**X.X%**
NON-INTEREST SPENDING						
Medicare	$ XX.X	X.X%	$ XX.X	X.X%	$ X.X	X.X%
Medicaid	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Social Security	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program A	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Major Program B	X.X	X.X%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	XX.X	X.X%	XX.X	X.X%	X.X	X.X%
Total Non-Interest Spending	**$ XXX.X**	**X.X.%**	**$ XX.X**	**X.X%**	**$ X.X**	**X.X%**
Non-Interest Spending in Excess of Receipts	**$ XX.X**	**X.X%**	**$ XX.X**	**X.X%**	**$ X.X**	**X.X%**

To maintain the current [or date] level of U.S. Treasury debt held by the public to GDP, actions would need to be taken to increase receipts or decrease non-interest spending by a net present value of $XX.X trillion or X percent of GDP.

Figure 2: Impact of Delaying Action
What are the Costs of Delaying Action?



Source: GAO's March 2009 Alternative simulation.

For example, the cost of raising a child from birth to age 18 is often projected to exceed $150,000 and may be daunting to those just starting a career. However, comparing this to the present value of expected income—including raises—during those 18 years may reveal that this is 25 percent of your projected earnings. This information provides important context.

Additional context is provided by comparing the present and prior year reported amounts. An explanation of reasons for the change from year to year is required and should highlight the amounts resulting from the passage of time, updates to assumptions, and policy changes. It's especially important for citizens to know how changes in law affect fiscal projections. This will help them answer the question, "Did policy changes improve our fiscal future?"

The bottom line of the statement of long-term fiscal projections is the excess of noninterest spending over receipts during the projection period. This measure does not reveal what happens to the debt level as a result of these future cash flows. Debt levels are a critical factor in assessing fiscal sustainability. While general consensus is that high levels of debt lead to greater risks and costs, the right level of debt is yet to be decided.[10]

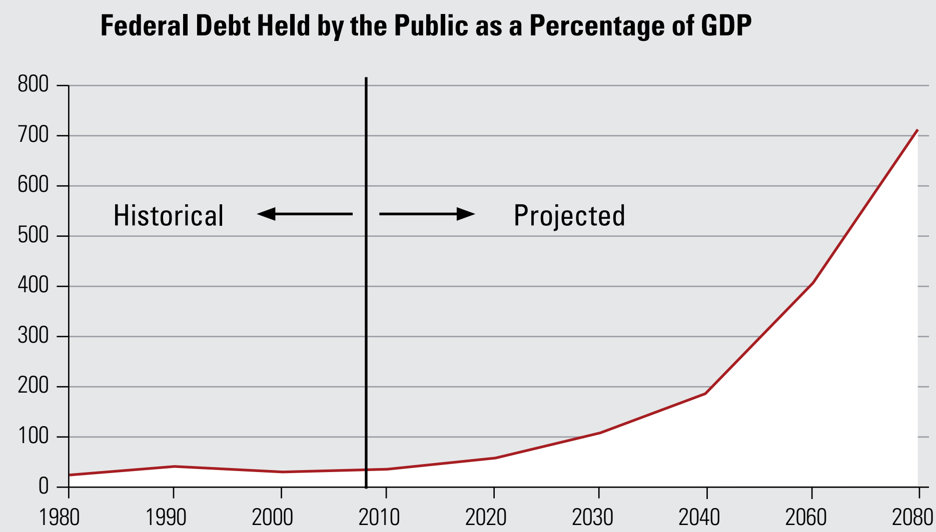
Once a target level of debt is selected, fiscal projections allow one to measure "fiscal gap." The fiscal gap is the change in noninterest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of GDP.[11] Fiscal gap is a required component of fiscal sustainability information. The fiscal gap may be expressed as a summary amount in present value dollars, a share of the present value of the GDP for the projection period and/or a share of the present value of projected receipts or projected noninterest spending.

Presenting fiscal gap in relation to projected receipts or noninterest spending reveals the amount that either would have to change in order to attain the target debt level. This is an important amount because it puts the information in terms citizens can easily understand. For example, if we are told that someone has to increase their income by $100,000 to meet their personal goals, we would view this differently if it represents a 10 percent versus 100 percent increase.

It matters a great deal when the fiscal gap is addressed. Because deficits add to the debt over time, changes in the first year of the projection period have greater impact than the same change in later years. This concept—the impact of delaying actions to resolve deficits—is sometimes referred to as "the cost of delay." This cost is revealed by comparing the magnitude of change needed assuming change originates in different years.

Information about this cost can be presented in a variety of ways and *Figure 2*: Impact of Delaying Action illustrates one way. The chart shows, for each of the years presented, how much the government would have to immediately and permanently either raise receipts or cut noninterest spending—or some combination of the two—to close the fiscal gap if action began in that year. For example, using the projections referenced, if action is taken in 2040, noninterest spending would have to be permanently reduced by 59.7 percent or

Figure 3: Increase in Federal Debt Held by the Public



DATA SOURCES:
Historical: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives,* FY 2008 Budget
Projections: Government Accountability Office, Long-Term Fiscal Simulation Data, Alternative Scenario.
Available at: *www.gao.gov/special.pubs/longterm/data.html* (accessed May 7, 2009).

receipts (revenue) increased by 92.9 percent (or some combination of the two) relative to 2009 levels of spending and receipts.[12]

Timing of receipts and spending is important as well. Fiscal sustainability information will include graphs that reveal the timing of the flows underlying the present value amounts already discussed. This information complements the present value information by showing the relationships between receipts and expenditures during the projection period. In addition, the trend in debt will also be provided. *Figure 3:* Increase in Federal Debt Held by the Public illustrates this key trend. Such information helps the public assess when debt may rise above a level with which they are comfortable.

Perhaps most important of all the information, an explanation of the factors driving increases in spending, is required. Demographic factors such as an aging population and economic factors such as excess health care cost growth must be explained for citizens to consider the implications of policy changes needed to resolve fiscal challenges. Such implications may influence their expectations and plans.

Challenges Ahead

The requirement for comprehensive long-term fiscal projections is significant. With the addition of this information, the CFR will provide information that helps citizens answer questions about the future of their government's finances as well as the budgetary and accrual results of operations during the period, the present assets available to support future operations, and the present liabilities to be settled in the future.

Challenges remain though. This information is difficult to prepare and to understand. Implementation of the requirements may lead to further technical questions for FASAB. Also, some have called for measures focusing on intergenerational equity as well as intergovernmental dependency. Much remains to be done to help citizens understand the finances of their government. As knowledgeable government finance professionals, please consider how you can contribute to greater understanding of this important annual report from our government to its citizens. It is imperative that all of us support FASAB and its sponsors as we seek to help citizens find answers to their questions about government fiscal performance and sustainability in ways that are understandable and readily accessible.

FASAB will continue to seek public comment on further improvements to federal financial reports. The quality of the outcome depends on your contributions—either through AGA or individual efforts. The AGA Financial Management Standards Board routinely provides excellent comments on FASAB proposals. However, FASAB rarely hears from individual citizens. As AGA members you are well prepared to influence how your government reports, and I encourage you to offer suggestions for improvement and to respond to proposals.

End Notes

1. Wikipedia. Accessed Oct. 15, 2010 at *http://en.wikipedia.org/wiki/Financial_statement#Government_financial_statements.*

2. Ebrahim, A., "Making Sense of Accountability: Conceptual Perspectives for Northern and Southern Nonprofits," *Nonprofit Management and Leadership*, 2003, 14: pp. 191–212.

3. Steinhoff, Jeffrey C., and Robert F. Dacey, The Government Management Reform Act of 1994: A Retrospective of Achievements and Remaining Challenges and a Look to the Future, *The Journal of Government Financial Management*, Winter 2008, p. 10.

4. Bair, Sheila (chair of the Federal Deposit Insurance Corporation), "Will the Next Fiscal Crisis Start in Washington?" *The Washington Post*, Nov. 26, 2010.

5. Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, June 1993.

6. Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards (SFFAS) 36, *Comprehensive Long-Term Fiscal Projections*. Par. 39.

7. SFFAS 36, Par. 35.

8. Accessed on Dec. 10, 2010 at *www.cnbc.com/id/30108264/What_Does_1_Trillion_Look_Like?slide=10*. "This stack of cash—in $1 bills—would measure 67,866 miles, stretching approximately 2.72 times around the Earth's equator." Paul Toscano, Posted April 8, 2009 on *CNBC.com*.

9. Each chart provides the relevant illustration from SFFAS 36. Readers are encouraged to access the fiscal year 2010 amounts in the CFR.

10. Commission of the European Communities. *Communication from the Commission to the Council and the European Parliament: The Long-term Sustainability of Public Finances in the EU*, Brussels, December 2006.

11. SFFAS 36, Par. 13. (More specifically, the fiscal gap is the net present value of projected spending minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at or below the target percentage of GDP for the stated projection period.)

12. SFFAS 36, Appendix B.

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