

# WebMemo



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## A Better Measure of Long-Term Spending: FASAB Proposes Changes in Accounting for Social Security, Medicare

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The Federal Accounting Standards Advisory Board issued a report on October 23 calling for changes in financial reporting for social insurance programs. This is an important step that will provide better financial information on the operations of the federal government. It will also help to begin a serious discussion of how the huge impact of future entitlement spending should be reflected in the federal budget. Social Security and Medicare represent a growing threat to the federal budget, one that bodes ill for future generations. Understanding and indicating their financial effect on the nation's fiscal burden is key to sound financial management.

### **What is FASAB and What the Report Did**

The Federal Accounting Standards Advisory Board (FASAB) is a rather obscure quasi-governmental organization that establishes the generally accepted accounting principles (GAAP) used to prepare the federal government's financial report. These standards are established through "Statements" issued by a joint public- and private-sector-member board. FASAB considers a broad array of viewpoints and input in establishing these standards, and its deliberations often take a few years before a final standard is issued. FASAB's new report aims to strengthen financial reporting for social insurance programs. Because there are two views that differ strongly on how best to accomplish this, the report establishes common ground and then discusses each view in depth. FASAB is

requesting public comment before it proceeds with a final standard.

### **Why Better Financial Information on Social Insurance Matters**

Social Security and Medicare will cause the total federal budget to more than double in 45 years, from nearly 21 percent of the economy today to 50 percent by 2050, according to projections by the Congressional Budget Office. This will leave a stunning gap between these exploding spending programs and revenues (also projected to increase as a percentage of the economy) and thus some very tough choices for Congress and the president. It is imperative that the nation better understand the full extent of the obligations and commitments of these programs.

The latest Financial Statement of the U.S. Government, prepared by the U.S. Treasury and audited by the Government Accountability Office, shows total liabilities of \$9.9 trillion, including Social Security and Medicare benefits due to current retirees at the end of last fiscal year under current law which have not yet been paid. This

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[www.heritage.org/research/budget/wm1242.cfm](http://www.heritage.org/research/budget/wm1242.cfm)

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measure is often referred to as “due and payable.” It also includes a large volume of information about these programs in a section called the Statements of Social Insurance (SOSI), much of which is meaningful to only a relatively small group of policy experts. Carefully culling through this information, one would find that the long-term unfunded obligations of these programs total \$35.6 trillion<sup>1</sup>, bringing the nation’s total fiscal burden to \$45.5<sup>2</sup> trillion, over 3 times the size of the U.S. economy.

According to David Walker, the U.S. Comptroller General and a long-time proponent of more transparent financial reporting of social insurance, this represents a debt of \$375,000 for every full-time worker in American. Like a mortgage—without the house. Walker is right, and such growing threats to the nation’s fiscal health deserve better disclosure in the financial statements, though there is vigorous debate about the best ways to accomplish this.

## Two Views on Needed Changes

FASAB members agree that financial statements should help Congress, the media, and the public make informed decisions about whether these social insurance programs are sustainable as they are designed today, whether the federal government’s financial position has improved or worsened due to these programs, and to what extent these programs will be able to provide benefits in the future. But there are two views on how to do this. Both—the “Primary” and the “Alternative”—agree that information on social insurance programs should:

- Be included in the basic federal financial statements,
- Be audited,
- Be readily understandable to a non-expert reader, and
- Clearly illustrate any projected long-range fiscal imbalance.

The views differ on how and what to include in the financial statements. According to David Mosso, FASAB Chairman, both views would include the present values of projected future program revenues and scheduled benefit payments, changes in present values during the period, and other disclosures on sustainability, though they differ on the details and the format of the statement. They would go about this in different ways, however. The biggest differences between the two views concern when a liability should actually be booked and how much of a liability to recognize.

## The Primary and Alternative Views

Currently, liabilities for social insurance programs are recorded when they are due and payable. “Due and payable” refers to a legal obligation to pay for a good or service that has been provided when payment is due but has not yet been remitted. This is like getting a bill for a doctor’s visit or legal services that were rendered but not paid. Since the bill is both payable *and* currently due, it would be accrued as a liability.

Under the Primary view, held by six of the ten board members, the federal government would change the way this liability is recognized to when “participants substantially meet eligibility requirements during their working lives.... The liability would be the accumulated unpaid expense as of the reporting date.”<sup>3</sup> For Social Security and Medicare, this would first occur when participants complete 40 quarters of work in covered employment.

Under this view, it is akin to an employer first booking a liability for an employee’s pension benefits once they are vested, even if the benefits will be paid far in the future, and then, for Social Security, increasing that liability each additional year the employee works and earns more future benefits. However, dedicated payroll taxes would not reduce this liability, unlike most discussions of Medicare and Social Security’s finances today.

1. Measured in net present value terms. This is the amount of money that would have to be invested in government bonds today in order to pay these future promises.
2. Adding in other commitments, like those to the Pension Benefit Guarantee Corporation, brings this total to \$46.4 trillion.
3. Federal Accounting Standards Advisory Board “Accounting for Social Insurance, Revised,” October 23, 2006, at [www.fasab.gov/pdffiles/elementsed06072006.pdf](http://www.fasab.gov/pdffiles/elementsed06072006.pdf).

The Primary view would also explain how these liabilities relate to the net present value of these programs' obligations and revenues reported in the SOSI so that readers could understand them and understand dedicated payroll taxes in the long-term context.

The Primary view members followed the private sector accounting model for developing this proposed treatment. They observed strong similarities, in their view, between these social insurance programs and private sector pension and retiree health benefits and cited the need for formally recognizing their financial commitments.

The Alternative view, held by three members (one member abstained), would continue the present practice of recording liabilities when they are due and payable. Last year's financial statement reported \$72.7 billion in such liabilities for Social Security and Medicare.<sup>4</sup> This due and payable liability model is a key feature of the Alternative view.

Additionally, the Alternative view would change the accounting for earmarked revenues like the payroll taxes for Social Security. Payroll taxes for Social Security currently exceed Social Security benefits, and these unused revenues are then spent on other federal programs. This is tracked as an IOU from one part of government, the Treasury, to another, the Social Security Trust fund, much as an individual might take \$10 from a piggy bank to pay for lunch and put in an IOU to pay it back in the future. These IOUs are not treated as liabilities in the financial statements. Instead, under today's way of financial reporting, these IOUs from the Treasury to the trust fund net out to zero. But excluding them from the financial statements, says the Alternative view, presents a misleading picture of the government's finances and further creates misunderstanding among lawmakers and the public.

The Alternative view would also include a report on changes in the net present value of social insurance commitments and explain the cause of these changes. Proponents of this view would also

include a statement of fiscal sustainability. These changes would show, in a clear way, whether the nation is fiscally better or worse off than in the preceding year and why.

Those who support this view feel strongly that there are *no* similarities between private sector pensions and retiree health care. They argue that social insurance programs can be changed by Congress at any time and do not constitute the same kind of contractual obligation as due and payable liabilities or private sector retirement programs.

## Conclusion

All Americans—Congress, the president, the media, and the public—should have sufficient information to evaluate the financial condition of the federal government. Steps to improve information on long-term obligations and the fiscal sustainability of social insurance programs are sorely needed. Today the nation is on an unsustainable fiscal path, but it is difficult to know this from reading the financial report. Moreover, long-term spending issues rarely make it into annual budget discussions. The budget process should also be fixed to include long-term measures of social insurance liabilities and associated policy changes in such a way that lawmakers can evaluate reforms over the short term and the long term.

There is disagreement about how best to proceed within the FASAB. But, more importantly, there is agreement on the need to do so. FASAB's proposals, and the discussion they will prompt on how to best measure entitlements, are welcome steps toward providing better information and deserve to be thoroughly evaluated by the government and the public. As the FASAB emphasizes, the nation must have better financial information that will force Congress and the President to address these programs before their crushing costs become due and payable.

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4. This consists of \$36.3 billion for Federal Old-Age and Survivors Insurance, \$16.8 billion for Medicare Part A, and \$16.6 billion for Medicare Part B.