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# **Budgeting for Federal Insurance and Retirement Programs: Cash or Accrual?**

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# What Is the Difference Between Cash and Accrual Accounting?

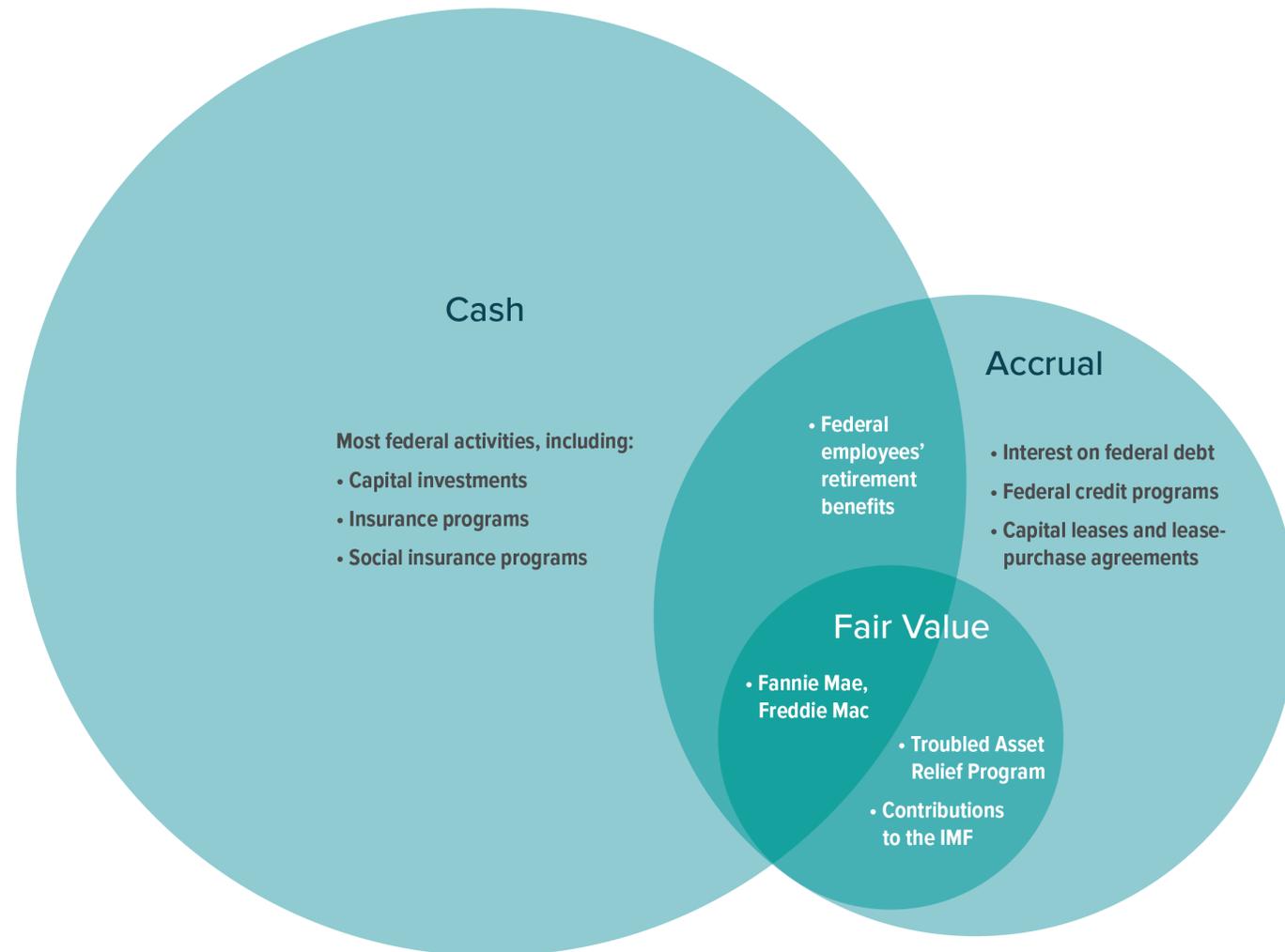
The principal difference is the time at which the commitment (or collection) of budgetary resources is recognized.

Transactions in cash-based accounting are recorded when payments are actually made or receipts collected.

By contrast, accrual measures summarize in a single number the anticipated net financial effects at a specific point in time of a commitment that will affect federal cash flows many years into the future.

- The costs of some federal commitments with long-term budgetary effects—primarily loans and loan guarantees—are reported in the budget totals on an accrual basis.
- A few programs are reported using a fair-value approach that reflects the market value of the federal government's obligations.

# Current Budgetary Treatment of Selected Federal Programs



# Why Does Budgetary Accounting Matter?

Whether programs are accounted for on a cash or an accrual basis can, in some cases, significantly affect the size and timing of their estimated deficit effects.

Cash-based estimates used in the budget process generally reflect costs over the 10-year period on which the process focuses, but that period may not be long enough to capture the full extent of some activities' effects.

Accrual-based estimates that consider long-term effects provide more complete information about programs that involve longer time frames.

But accrual estimates are less transparent and verifiable than cash-based estimates, they involve more uncertainty, and they can complicate budgetary reporting.

# Assessing Information Provided by Cash and Accrual Measures

Do accrual measures convey more complete and relevant information about a program's budgetary effects?

Can a program's underlying long-term cash flows be projected and discounted with enough accuracy and practicality to allow accrual measures to be used reliably in the budget process?

Is the government's commitment to providing future resources firm enough to justify recording future cash flows before they occur?

# **A Model for Accrual Measures: The Federal Credit Reform Act of 1990 (FCRA)**

FCRA moved federal direct and guaranteed loan programs from a cash to an accrual basis.

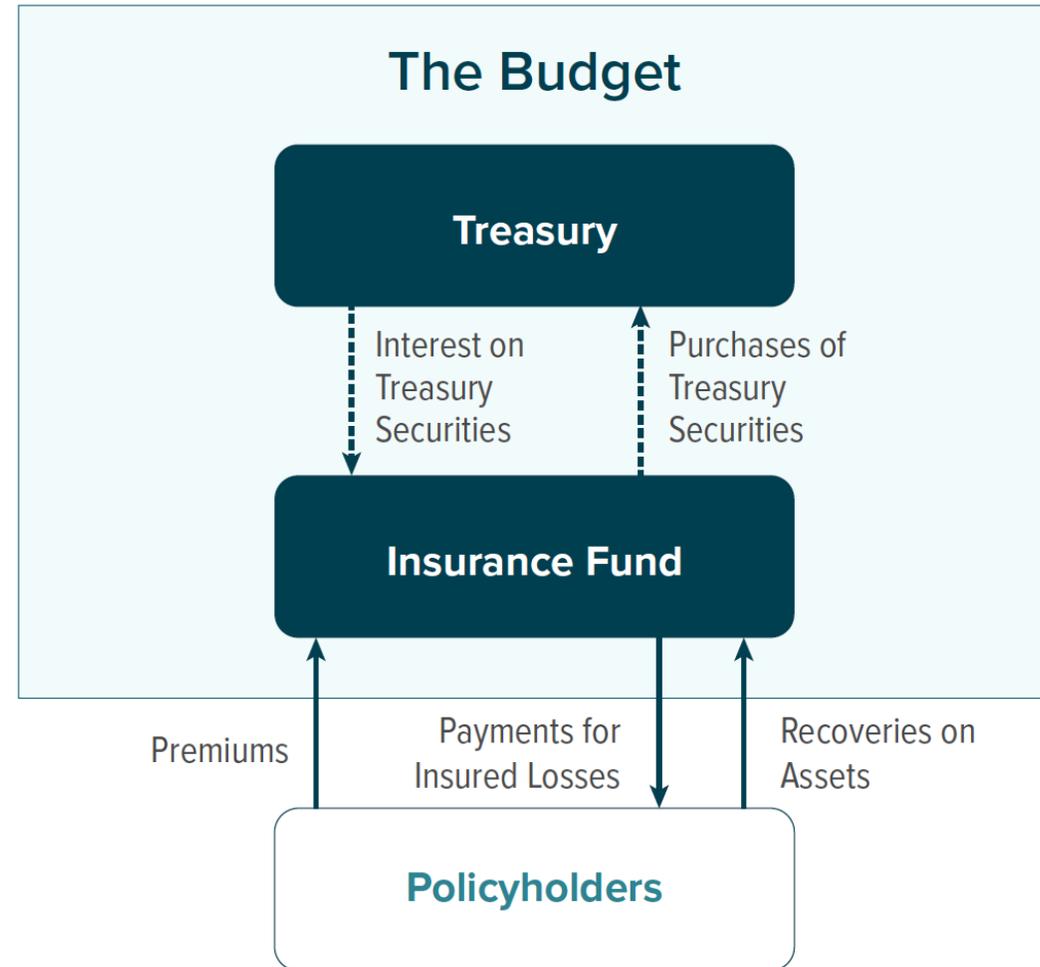
Its goals were to more accurately measure the net costs of credit programs; to facilitate comparisons of the net cost of direct loans, loan guarantees, grants, and other programs; and to improve the allocation of budgetary resources.

An accrual measure is the subsidy cost of a direct loan or guarantee. It is the discounted value of the expected net cash flows (using Treasury rates of similar maturity).

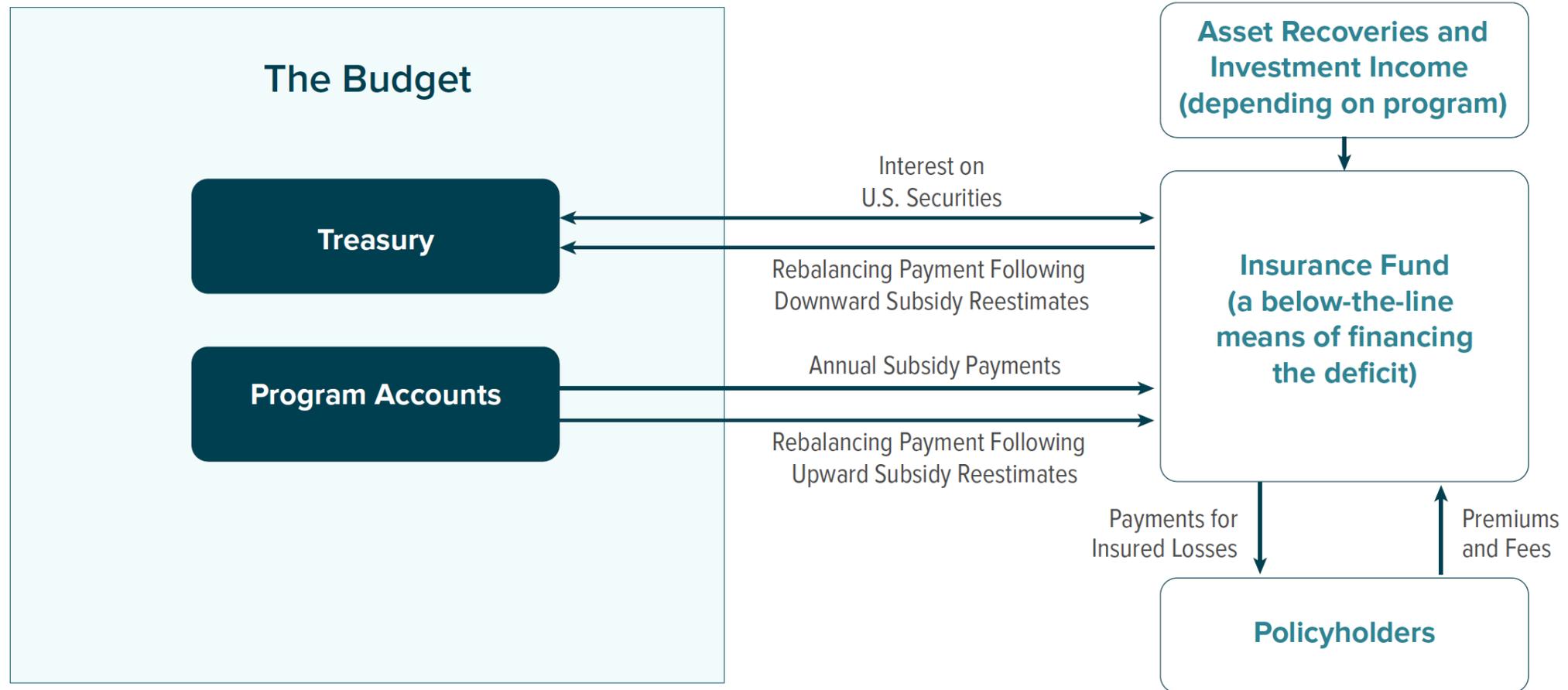
Periodic reestimates reported in the budget align accrual estimates with cash flows.

# **Accounting for Federal Insurance Programs**

# Current Budgetary Treatment of Insurance



# An Accrual Approach to Budgeting for Federal Insurance Programs With Positive Subsidy Costs



# Why Consider Accrual Accounting for Federal Insurance Programs?

Insurance programs are similar to federal credit programs in some ways, but FCRA exempted them from coverage.

Accruals would accelerate the recognition of long-term costs and any offsetting income and could clearly display the net costs of new commitments.

The clearer display of long-term net costs could allow for more meaningful comparisons of the costs of competing programs and a greater focus on risk when setting prices and reserve requirements.

However, the estimates would be more uncertain and would require judgments about which time horizon to cover.

Cash and accrual measures probably convey similar information for some insurance programs with relatively short timing lags, including crop and flood insurance.

# Why Consider Accrual Measures That Account for Market Risk?

Market risk is the element of financial risk that is correlated with overall economic conditions and therefore cannot be eliminated by diversifying a portfolio.

Investors require compensation for market risk in the form of higher expected returns.

Federal deposit and pension insurance programs are exposed to market risk because they experience significantly larger losses when economic conditions are weak.

To incorporate market risk, the fair-value approach generally entails using the discount rates that private financial institutions would use. Those discount rates are higher than Treasury rates; the difference reflects the market risk inherent in the cash flows.

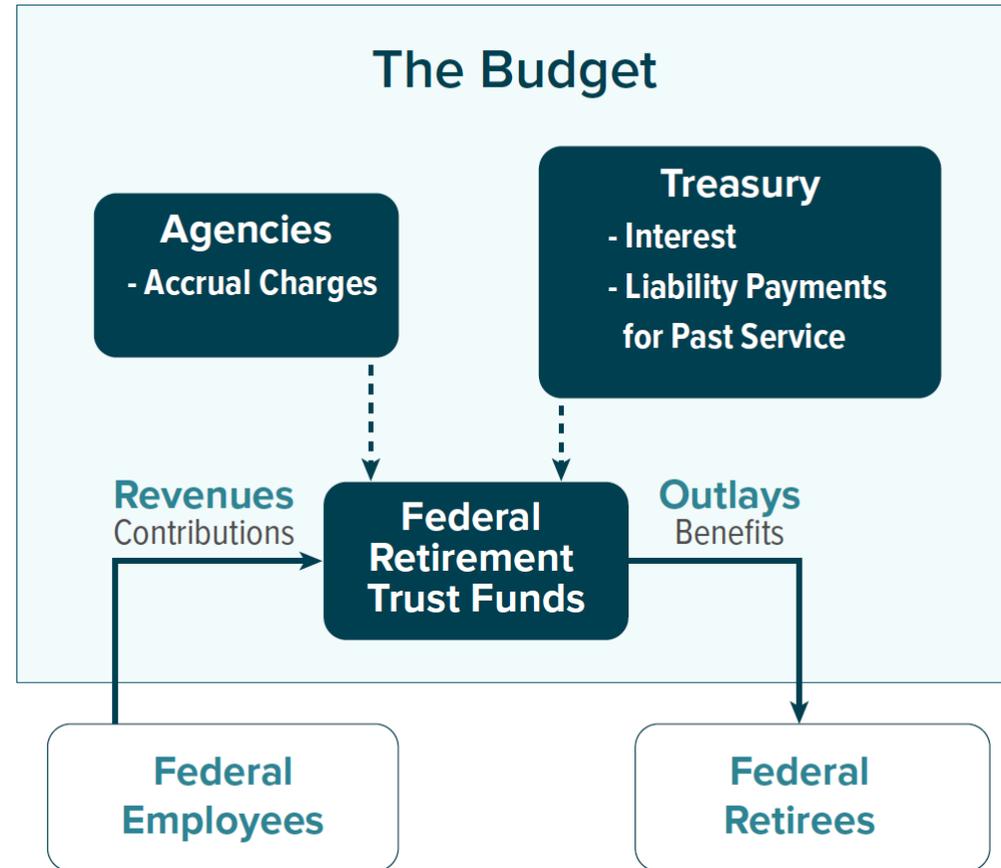
Accounting for market risk in fair-value estimates would result in more comprehensive information about long-term costs but would involve considerable analytical judgment and be harder to understand.

# Cash and Accrual Projections of Financial Assistance Claims and Premiums for PBGC's Multiemployer Program, 2019 to 2039

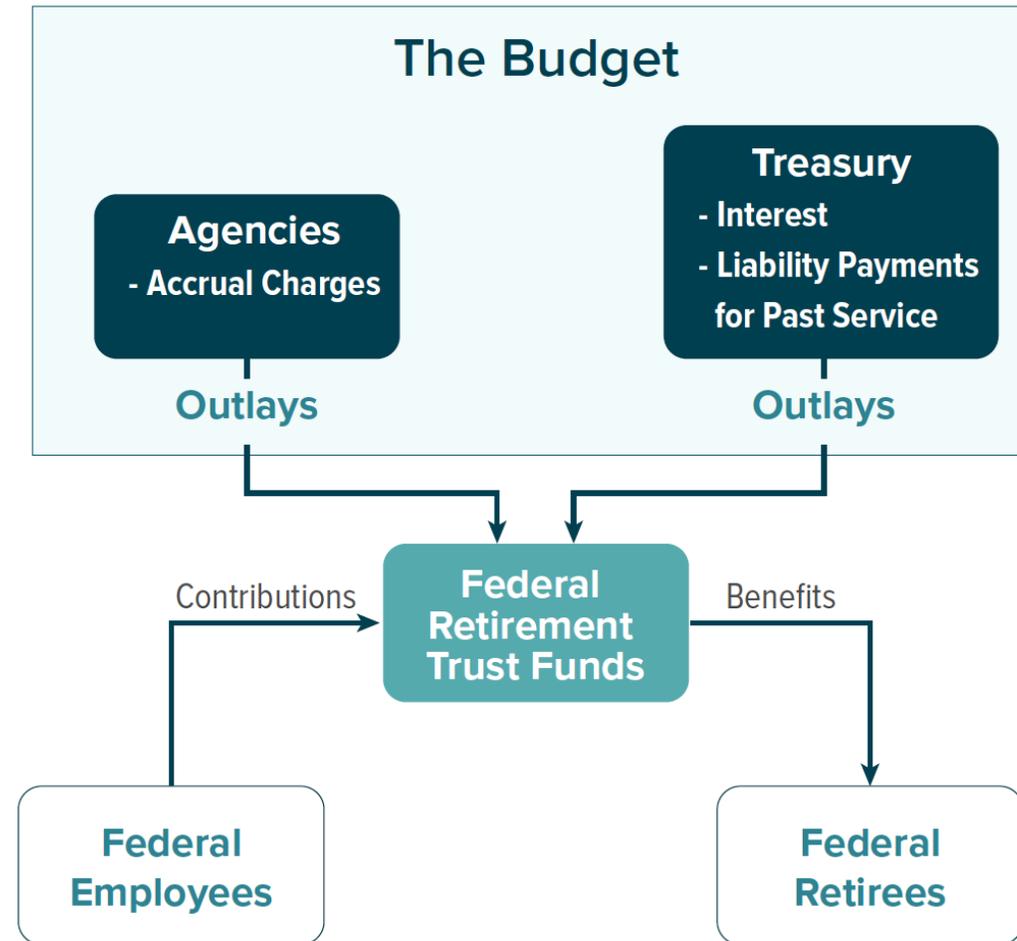
Billions of Dollars	Accrual-Based Estimates		
	Cash-Based Estimates	Net-Present-Value Estimates Without an Adjustment for Market Risk	Fair-Value Estimates
Total Claims for Financial Assistance	58	64	73
Premium Payments by Insured Plans	<u>-8</u>	<u>-6</u>	<u>-6</u>
<b>Claims Net of Premiums</b>	<b>50</b>	<b>58</b>	<b>67</b>

# **Accounting for Federal Retirement Programs**

# Current Budgetary Treatment of Federal Retirement Costs



# Potential Accrual Budgetary Treatment of Federal Retirement Costs



## **How Accrual Measures Can Provide More Complete Information: An Example**

Using estimates of the accrual costs of federal civilian and military retirement benefits and veterans' benefits, CBO found in 2015 that, on average, a civilian employee in the Department of Defense's commercial positions costs the federal government about 30 percent less than an active-duty service member (largely because the civilian worker would not be eligible for veterans' benefits).

## How Accrual Measures Can Provide More Complete Information: An Example (Continued)

- Accrual measures capture the cost of deferred compensation as it is earned (rather than when paid) and thus are more comprehensive than the cash-based measures used to estimate the cost of proposed legislation.
- The current approach to legislative cost estimates would not encompass all of the changes in the government's future long-term liabilities that could result from such proposals. For example, cost estimates for proposed changes to military end strength would not report the mandatory costs that could arise for future service-related benefits.
- Accrual measures are useful because the full budgetary effects would not be realized for a few decades, when new employees began to retire and collect benefits.

## Related Work by the Congressional Budget Office

In keeping with CBO's mandate to provide objective, impartial analysis, this presentation makes no recommendations.

The presentation draws on three of CBO's reports:

- *Cash and Accrual Measures in Federal Budgeting* (January 2018), [www.cbo.gov/publication/53461](https://www.cbo.gov/publication/53461).
- *Measuring the Costs of Federal Insurance Programs: Cash or Accrual?* (December 2018), [www.cbo.gov/publication/53921](https://www.cbo.gov/publication/53921).
- *Accounting for Federal Retirement and Veterans' Benefits: Cash and Accrual Measures* (September 2019), [www.cbo.gov/publication/55499](https://www.cbo.gov/publication/55499).