



June 6, 2008

Memorandum

To: Members of the Board  
From: Eileen W. Parlow, Assistant Director  
Through: Wendy M. Payne, Executive Director  
Subj: Fiscal Sustainability Reporting – Tab B<sup>1</sup>

### **MEETING OBJECTIVES**

To review draft exposure draft (ED), *Comprehensive Long-Term Projections for the U.S. Government*, and to provide staff direction regarding the following:

1. The concept of “fiscal imbalance” versus “fiscal gap” in relation to proposed reporting in the consolidated financial report of the U.S. Government (CFR), and
2. Treasury Department proposal (Tab B-1)

With respect to the Treasury proposal, members should consider (1) whether they wish to focus their efforts on developing the proposal in lieu of the ED developed through Board deliberations to date (found at Tabs B-4 and 5), or (2) continue deliberations on the draft ED with Alternative Views in the Basis for Conclusions as members desire. Selected aspects of the Treasury proposal might influence decisions on specific provisions of the draft ED even if the Treasury proposal is not adopted as the preferred approach.

The timing of the next preballot draft will depend upon the nature of the Board’s decisions at the June 2008 meeting. The attached revised timeline for project milestones (Tab B-2) illustrates what staff believes to be the most aggressive schedule possible to reflect the Board’s stated priorities at previous Board meetings as to the urgency of this project.

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<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

## **BRIEFING MATERIAL**

This memorandum includes a discussion of issue (1) above, beginning on page 6. In addition, the following items are attached:

1. Treasury Department proposal (sent to members directly from Treasury on 5/23/2008 and attached for your convenience)
2. Revised milestones- project plan
3. History of recent Board decisions
4. Draft ED- marked copy with revisions based upon the April 2008 Board meeting and proposed revision for discussion at the June 2008 meeting.
5. Draft ED- clean copy per above
6. Handout from February 2008 Board meeting: Option A, which included both fiscal imbalance and fiscal gap in the primary summary display

## **BACKGROUND**

At the April 2008 Board meeting, a majority of members approved the following staff-proposed edits to the draft ED:

- (a) Add a requirement to identify (in the narrative section) the major causes of high/low variances that significantly impact the projections.
- (b) Add a footnote clarifying that projections calculated using per capita estimates for spending should consider the characteristics of the population for expenditures that benefit identifiable subgroups.
- (c) Add a footnote explaining the limitations of displaying ratios of projected fiscal imbalance relative to projected receipts and projected spending.
- (d) Add a requirement to disclose significant departures from current law in the spending assumptions- such as allowing for exceeding the statutory limit on total Federal debt held by the public.
- (e) Add a discussion of “current levels” and “current policy” to the Basis for Conclusions section of the ED.

In addition, the Board asked staff to develop an educational session on the concepts of fiscal imbalance and fiscal gap, and how those concepts relate to the proposed reporting in the draft ED, particularly the primary summary display.

## **ISSUE FOR DISCUSSION: TREASURY PROPOSAL**

At the April 2008 meeting, the Board member representing the Treasury Department indicated that prior to the June 2008 Board meeting Treasury would provide an alternative proposal for Board review and discussion. This proposal is attached at Tab B-1.

To facilitate the Board’s discussion of the Treasury proposal, staff has prepared a recap of the major features of the two draft EDs: the current FASAB draft ED and the Treasury proposal.

The two drafts have the following features in common:

- (a) both drafts contains a requirement that assumptions be explained,
- (b) both drafts require that assumptions should reflect current levels of benefits, services and taxation, and
- (c) both drafts allow that assumptions may depart from current law under certain circumstances.

There are many differences between the two options. Staff believes some of the differences may pose technical challenges – for example, the combined effect of interaction among the assumptions is complex and input from the task force would be helpful in assessing the reliability of—and the cost-benefit of making—such estimates. If the Board wishes to pursue the Treasury proposal, staff believes further analysis of technical aspects is needed. At the Board meeting, we hope to obtain your views regarding the options before proceeding.

<b>Current Draft FASAB ED (June 2008 Version, Attached at Tabs B-4 and 5)</b>	
	<b>Paragraph</b>
<b>Summary of Objectives</b>	<b>References</b>
<p>Assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due is important not only because such an assessment has financial implications but also because it has social and political implications. Users of financial reports should be provided with information that is helpful in assessing the likelihood that the government will continue to provide the current level of benefits and services to constituent groups and to assess whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits.<sup>2</sup> Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.</p> <p>Fiscal Sustainability Reporting should be understandable to the intended users of the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the media, public interest and advocacy groups, and others). The CFR should be easily understandable to the “average citizen” who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence.</p>	Paragraphs 7-8
<b>Summary of Major Requirements</b>	
Scope: the CFR only	Par. 17
An integrated report on fiscal sustainability including key measures, graphs and discussion. Phased implementation provides for eventual principal financial statement and notes.	Par. 35-48
<b>Projections showing where our current policies would take us if continued:</b>	
A primary summary display with a bottom-line <b>summary measure(s)</b> that allows readers to assess the magnitude of the problem and changes regarding fiscal sustainability from period to period.	Par. 35-39
Information that explains the changes in the key measure(s) from period to period.	Par. 31
Narrative and graphics that convey trend information about receipts, spending, deficits, and debt including both historical and projected information.	Par. 47
<b>Information that helps the reader understand the projections:</b>	
Limitations of projections.	Par. 41-43
Explanation of assumptions underlying the projections.	Par. 42
A range (high and low) for projections including factors that cause the projections to be uncertain.	Par. 45
Optional information about range for individual programs (or related groups of programs).	Par. 45
Major causes of the projected trends.	Par. 46
<b>Information that helps the reader understand the likely impact of delaying action:</b>	
The relative magnitude of the change in receipts or spending needed if made at various points in the future.	Par. 48

<sup>2</sup> The latter notion is sometimes referred to as “interperiod equity.”

<b>Treasury Proposal, Attached at Tab B-1</b>	
	<b>Paragraph References</b>
<b>Summary of Objectives</b>	
Broad Objective: "Provide information to help the reader to determine whether current policy is likely to produce future revenues sufficient to sustain current levels of public services and to meet obligations as they come due. At a minimum, it should address projected revenues and costs, and the significant resulting fiscal imbalances, assuming that current levels of benefits, services, and taxation are continued."	Paragraph 4
Objective Clarifier: The intent is <b>not</b> to enable the Board to require or specify the parameters for policy decisions. It is to provide for the reporting of reliable information and analysis about the future sustainability of pre-existing revenue and spending decisions, as well as changes to the programs for which decisions have been made that could potentially reduce the imbalances between total revenues and spending.	Par. 3
<b>Summary of Major Requirements</b>	
Scope of requirements - the CFR, other government-wide reports, and agency reports as deemed appropriate.	Par. 17
Reporting would be RSI for agencies and "government-wide reports" beginning in 2010.	Par. 13
Broad requirement: "Provide information to help the reader to determine whether current policy is likely to produce future revenues sufficient to sustain current levels of public services and to meet obligations as they come due. At a minimum, it should address projected revenues and costs, and the significant resulting fiscal imbalances."	Par. 18
Inter-generational equity measures required (broad requirement)	Par. 20
OMB and Treasury will assess sustainability from a government-wide perspective. Based on that assessment, they will request additional reporting from relevant government sources as they deem appropriate. OMB and Treasury will issue reporting format guidance.	Par. 21 and 22
Critical elements of sustainability reporting: <ul style="list-style-type: none"> <li>• to quantify the degree to which the individual programs contribute to the governmentwide imbalance,</li> <li>• to identify the program elements that have the greatest impact on the imbalance; and</li> <li>• to offer potential changes having sufficient financial impact to reduce the fiscal imbalance.</li> </ul>	Par. 23
Assumptions and their impact on the analysis must be identified.	Par. 25
Assumptions must be consistent with current levels of benefits, services and taxation; departure from current law permitted if it does not provide an adequate basis.	Par. 26
Assumptions can have reflective and mutual effects on each other and the resulting analysis. Sustainability reporting should include identification and explanation of significant assumption inter-relationships and their estimated combined effect on projections.	Par. 27

## ISSUE FOR DISCUSSION: FISCAL IMBALANCE AND FISCAL GAP

At the April 2008 Board meeting, staff noted that neither the fiscal imbalance nor the fiscal gap is a perfect measure, because both measures have shortcomings-- in particular when a finite projection period, rather than an infinite projection period, is being displayed. Staff said that several of the Task Force technical experts noted that when the fiscal imbalance is reported for a finite time horizon, some have argued that the fiscal imbalance measure overstates the size of the fiscal adjustment needed because it assumes that public debt will be zero at the end of the projection period. Others have argued that the fiscal gap measure (which assumes a selected level of debt at the end of the projection period) may understate the fiscal adjustment needed, because the selected level of debt may be unacceptably high.

For an infinite projection period, the fiscal imbalance and the fiscal gap produce identical results because of the impact of adjusting amounts in the very distant future to present value dollars or share of GDP for the projection period. However, since the Board previously decided to allow either a finite or an infinite projection period for the primary summary display, the Board asked staff to provide briefing materials to support an in-depth discussion of the two measures at the June 2008 Board meeting. This memorandum includes a discussion of the following:

1. Definition and characteristics of fiscal imbalance and fiscal gap .....	6
2. Similarities and differences between fiscal imbalance and fiscal gap .....	8
3. Pros and cons of the fiscal imbalance and fiscal gap measures .....	9
4. Options for displaying fiscal imbalance and/or fiscal gap in the primary summary display .	10
5. Background: .....	14
(a) Analysis of how the ED's proposed additional graphics and narrative relate to the concepts of fiscal imbalance and fiscal gap, and .....	14
(b) Comments on fiscal imbalance and fiscal gap by Task Force technical experts.....	14

### 1. Definition and characteristics of fiscal imbalance and fiscal gap

#### Fiscal imbalance: definition

The fiscal imbalance is the net present value of existing federal debt plus projected noninterest spending<sup>3</sup> minus projected receipts. The fiscal imbalance is the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt over a selected time horizon. The fiscal imbalance as of a stated valuation date<sup>4</sup> may be expressed as:

- (a) a summary amount in present value dollars,
- (b) a share of the present value of the GDP<sup>5</sup> for the projection period, and/or
- (c) a share of the present value of projected receipts or projected spending.<sup>6</sup>

<sup>3</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 in Appendix C of the draft ED.

<sup>4</sup> See requirement for valuation date in paragraph 32 of the draft ED.

<sup>5</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

### Fiscal imbalance: characteristics

The fiscal imbalance is based upon a conceptual standard that is well known to economists. This conceptual standard is called the “intertemporal budget constraint.” The intertemporal budget constraint is the assumption that an entity’s spending will ultimately be paid for by the entity’s revenues and that any initial debt will be repaid over the infinite horizon.<sup>7</sup> In the case of a government, the intertemporal budget constraint assumes that budget deficits and any outstanding debt must ultimately be offset by budget surpluses. The intertemporal budget constraint assumes that an entity such as a government is and will continue to be a going concern and will not go bankrupt or default on its obligations.<sup>8</sup>

### Note:

The fiscal imbalance could be described as the first step in calculating the fiscal gap. The fiscal gap is calculated by first calculating the fiscal imbalance and then inserting a target ending debt-to-GDP ratio in the calculation. The fiscal imbalance could also be described as a fiscal gap with “zero” as the target ending debt level.

### Fiscal gap: definition

The fiscal gap is the change in spending and/or revenue that would be necessary to maintain public debt as a constant percentage of GDP.

### Fiscal gap: characteristics

The fiscal gap calculates the change needed to achieve a particular debt level target. The fiscal gap is calculated as a three-step process:

- (a) calculate the fiscal imbalance
- (b) select a target level of debt-to-GDP<sup>9</sup>
- (c) calculate the change that would be required in either revenue or spending that would be necessary to achieve the target level of debt to GDP.

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<sup>6</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

<sup>7</sup> The infinite horizon introduces complexity to these calculations that may not be readily apparent. For example, it is not necessary for a government over any finite interval to repay its debt in full. At the end of any specified time period, there may still be debt outstanding. Furthermore, the government can continue to add to the debt provided that the debt does not grow faster than the rate of growth in GDP.

<sup>8</sup> Some have argued that the intertemporal budget constraint can include a target debt-to-GDP level because they believe that all spending must be either paid for or financed. Additional background on the concepts of the intertemporal budget constraint, fiscal imbalance and fiscal gap is available in a paper, “Long-term fiscal projections and their relationship with the intertemporal budget constraint: An application to New Zealand.” The paper is available at the New Zealand government website at <http://www.treasury.govt.nz/publications/research-policy/wp/2002/02-04>.

<sup>9</sup> The “target level” of debt to GDP could be a constant percentage that would not change- such as a specific percentage, or the debt-to-GDP level of a specific historical point in time, or it could be a flexible target that would be adjusted each year- for example, the debt-to-GDP level at the beginning of the current reporting period.

## 2. Similarities and differences between fiscal imbalance and fiscal gap

### Similarities between fiscal imbalance and fiscal gap

- Both measures require the calculation of projected future receipts and noninterest spending that are intended to reflect current levels<sup>10</sup> of receipts and (noninterest) spending.
- Both measures can be expressed as either present-value dollars or as a percentage of GDP for the selected projections period.
- Both measures contain information that is likely to be useful to readers in assessing the long-term fiscal outlook of the U.S. Government.
- If an infinite-horizon projection period is selected, the fiscal imbalance and fiscal gap measures will yield identical results.<sup>11</sup>
- For both the fiscal imbalance and the fiscal gap, it is important to remember that either could become infinitely large when calculated for the infinite horizon under certain conditions.<sup>12</sup> Under those conditions, an infinite fiscal imbalance or fiscal gap would not be a very useful concept; for example, it would likely perplex readers to see “infinity” as a line item amount in a primary summary display.

### Differences between fiscal imbalance and fiscal gap

- Calculating the fiscal imbalance measure is a necessary first step in calculating the fiscal gap.
- The fiscal imbalance can be displayed as the total of disaggregated projections of current levels of receipts and spending and existing debt. In contrast, the fiscal gap is not simply the sum of these understandable components. Arriving at the fiscal gap requires an additional adjustment because (assuming a target debt to GDP ratio greater than zero) the existing balance of debt will not be eliminated in its entirety. This can be displayed as an adjustment to the fiscal imbalance or as an adjustment to the net amount of projected receipts and spending. An understandable label must be applied to the adjustment line. Generally, the adjustment line represents the amount of any deficit that can be financed without exceeding the target ratio.

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<sup>10</sup> “Current levels” is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base). See note 3 for an explanation of why noninterest spending is used in the calculation of fiscal imbalance and fiscal gap.

<sup>11</sup> This is because an infinite horizon projection would reduce the present value of the ending balance of Treasury debt to an amount so immaterial as to be immeasurably small (except under certain conditions, such as the conditions described in note 12 below, under which the amount would be immeasurably large.). Said differently, the infinite horizon would allow an infinite amount of time to repay initial debt, and accordingly, the measures of fiscal imbalance and fiscal gap would be virtually identical. Since there is no effective difference between fiscal imbalance and fiscal gap for an infinite horizon, the calculations for both measures are the same.

<sup>12</sup> For example, if the interest rate is less than the rate of growth in GDP, or if rapidly growing parts of the budget such as Medicare do not eventually stop growing at rate that exceeds the growth of GDP, the fiscal imbalance or fiscal gap measured over the infinite horizon would be infinitely large amounts.

- The fiscal imbalance does not require the selection of a target debt-to-GDP level because it assumes compliance with the intertemporal budget constraint, which assumes zero debt at the end of the projection period.

### 3. Pros and cons of the fiscal imbalance and fiscal gap measures

#### Fiscal Imbalance Pros and Cons

<i>Pro</i>	<i>Con</i>
Can be displayed simply as the sum of disaggregated projections of current debt plus disaggregated projections of current levels of receipts and spending.	Since most economists believe that some level of public debt is reasonable or even desirable, an assumption of an ending debt level of zero (the intertemporal budget constraint) may <b>overstate</b> the severity of the long-term fiscal outlook for finite projection periods. The shorter the projection period, the greater the overstatement, because less time would be allocated for the repayment of the beginning balance of public debt. (For an infinite horizon projection period, the fiscal imbalance and fiscal gap are virtually identical.)
Does not require the selection of a target debt-to-GDP level. In the absence of a legislated target, the selection of a target debt-to-GDP level could be viewed as arbitrary. The selection of a moving debt-to-GDP level (such as the beginning of the reporting period) would make period-to-period comparison difficult or misleading.	If a finite horizon is used, it could be argued that the preparer is arbitrarily selecting a target date to reach zero debt.
Displays compliance with the intertemporal budget constraint, which is a commonly accepted concept and the most conservative conceptual treatment of public debt. (See the “con” column for a qualification for this “pro.”)	However, the intertemporal budget constraint is most commonly associated with an infinite projection period.
It can be viewed as a more stand-alone, independent measure. The fiscal imbalance can be calculated without calculating fiscal gap, but the fiscal gap cannot be calculated independently of the fiscal imbalance measure. Some have argued that the fiscal imbalance is an easier concept for readers to grasp than the fiscal gap concept.	Some argue that the fiscal imbalance could be viewed a fiscal gap measure with a selected ending debt level of “zero.”

### Fiscal gap pros and cons

<i>Pro</i>	<i>Con</i>
The fiscal gap does not overstate the severity of the long-term fiscal outlook by requiring a zero debt level at the end of a finite projection period.	If a flexible debt-to-GDP target is selected, such as “beginning of year” level, the fiscal gap measure may <b>understate</b> the severity of the long-term fiscal outlook because it implies that the selected target level is sustainable or acceptable.
	An inflexible/constant debt-to-GDP target could be viewed as arbitrary and/or as a recommendation by FASAB for budget rules or legislation.
	The fiscal gap is typically presented as a total bottom-line amount. Because the fiscal gap requires an adjustment to force a balance to a selected debt-to-GDP level, a disaggregated presentation (projecting current levels of benefits, services, and taxation with an adjustment to force a balance with the selected debt-to-GDP level) - or a reconciliation with the fiscal imbalance measure- is potentially confusing for readers who are not familiar with the concepts being presented.

#### 4. Options for displaying fiscal imbalance and/or fiscal gap in the primary summary display

Previous versions of the draft ED (as recently as the ED in the February 2008 briefing materials and handout) included both the fiscal imbalance and the fiscal gap in the primary summary display. The fiscal gap was displayed at the bottom of Option A (attached at Tab B-6).

At the February 2008 Board meeting, a majority of members decided that instead of selecting one of the display options A through D, it would be preferable to come up with a list of essential elements for the primary summary display, and allow the preparer flexibility in how to format those essential elements. At the February 2008 meeting, a majority of the members did not believe that the fiscal gap should be a required element in the primary summary display. However, a majority of the members approved a requirement that the primary summary display should include a display of the fiscal imbalance as a percentage of projected receipts and as a percentage of projected spending. If the primary summary display includes an infinite horizon projection period,

this display would be identical to a display of fiscal gap. However, for finite projection periods, this display would not be identical to a display of fiscal gap.<sup>13</sup>

At the April 2008 Board meeting, a majority of members indicated that they would like to review the concept of fiscal gap in more depth and re-consider whether to require it as a part of the primary summary display. As noted above, if an infinite horizon is used for the projection period, the fiscal imbalance as a percentage of projected receipts and as a percentage of projected spending would be identical to the fiscal gap calculation.

#### Staff recommendation

- (a) If a **finite** projection period is used for the primary summary display (which would cause fiscal gap to be different from fiscal imbalance), staff recommends that the primary summary display should include fiscal gap, and not fiscal imbalance, as a percentage of projected receipts and as a percentage of projected receipts.
- (b) If an **infinite** projection period is used for the primary summary display, there would be essentially no difference between the fiscal imbalance and the fiscal gap. Staff believes that since it would not be necessary to introduce an additional technical term, it might be less confusing for readers to retain the term “fiscal imbalance” for this display, perhaps with a footnote explaining that this display is identical to the fiscal gap.

The following edit to the ED would incorporate staff recommendation:

- [37] The primary summary display, *Long-Term Fiscal Projections for the U.S. Government*, should state the projection period and display the following projected amounts as both present value dollars and as a percentage of the present value of GDP as of the required valuation date(s) for the projection period indicated:
- (a) receipts, disaggregated by Medicare, Social Security, and all other receipts, and total receipts;<sup>14</sup>
  - (b) spending, disaggregated by Medicare, Medicaid, Social Security, and all other spending, subtotal of spending before debt held by the public, and total spending plus repayment of debt;<sup>15</sup> and
  - (c) fiscal Imbalance (the net amount needed to balance receipts and total spending plus repayment of debt)-<sup>16</sup> and
  - (d) fiscal imbalance as a percentage of total projected receipts and as a percentage of total projected spending. If a finite projection period is displayed, the fiscal gap, rather than the fiscal imbalance, should be

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<sup>13</sup> As a separate issue, a majority of members declined to require either an infinite horizon or a finite horizon for the primary summary display.

<sup>14</sup> Full payment of amounts due to Social Security and Medicare HI Trust Funds must be shown as revenue for Medicare and Social Security, and outlays for “rest of government.”

<sup>15</sup> See note 14.

<sup>16</sup> A positive fiscal imbalance indicates a shortfall; a negative fiscal imbalance indicates a surplus situation.

displayed below the disaggregated display of fiscal imbalance as a percentage of total projected receipts and as a percentage of total projected spending. The fiscal gap should use the beginning debt-to-GDP level as of [Month, Day Year] as a permanent \* target debt-to-GDP level.

[38] After the initial year of implementation, ~~the~~ primary summary display should also present

- ~~(a) fiscal imbalance as a percentage of total projected receipts and as a percentage of total projected spending and~~
- ~~(b) after the initial year of implementation,~~  
comparative amounts for the current year and prior year, and the net change for each of the above line items from the prior year.

\* See below for discussion of target debt-to-GDP level.

#### Target debt-to-GDP level for fiscal gap calculation

If the Board decides that the ED should propose a requirement to display fiscal gap, the ED should also propose a target debt-to-GDP level, which is a necessary component of the fiscal gap measure.

Options for a target debt-to-GDP level include:

- (a) a permanent target of:
  - a specific percentage of debt-to-GDP, or
  - the level of debt-to-GDP that existed or will exist at a specific date (such as the beginning of the initial year of implementation, or an average debt-to-GDP level for a selected historical time period), or
- (b) a flexible target that resets each year (such as the beginning of each new reporting year).

The advantage of a permanent target is that a permanent target debt-to-GDP level would provide the greatest degree of comparability of the current year with the prior year. The disadvantage is that a permanent target might appear to imply a recommendation from the Board regarding future legislation or budget rules. This disadvantage might be lessened if the Board proposes the selection of an unknown future target, such as the initial year of implementation. A disadvantage of this approach is that the debt-to-GDP level in that future year may not be a level that the Board would have wished- for example, it may be unacceptably high.

The advantage of a flexible target that resets each year is that it would avoid the appearance of a recommendation from the Board regarding future legislation or budget rules. The disadvantages are that this would impair comparability from one period to the next, and also that future debt-to-GDP levels may not be suitable targets because they are too high (or in other situations, too low).

The most important caveat is that there will always be a possibility that either legislation or an administration's budget rules may someday establish a target debt-to-GDP level, which ideally the requirements would accommodate. This could be accomplished by inserting language that the reporting should comply with target levels set by law or by budget rules.

***Staff recommendation:***

If the Board wishes to display the fiscal gap, staff believes that the most objective debt-to-GDP level would be the level at the beginning of the first year of implementation (this is likely to be fiscal year 2011) or an average for a long historical period, for example 1945-2010. If the Board wishes to establish a cap in case the debt-to-GDP level in that future year is extremely high, perhaps a prudent cap might be 100%.

***Questions for the Board:***

1. Does the Board wish to add a display of fiscal gap in instances where the primary summary display uses a finite horizon projection period? (In an infinite horizon is used, the fiscal gap is identical to the fiscal imbalance.)
2. If so, does the Board agree with staff recommendation above, to establish a fixed target debt-to-GDP level?
2. If a required target debt-to-GDP level is based upon future events, does the Board wish to establish a specific cap that would apply only if the debt-to-GDP level in that future year is extremely high?

The illustration on the following page displays how the fiscal gap might be included in the primary summary display.

**Long-Term Fiscal Projections for the U.S. Government**  
**Amounts projected to 75 years**

	As of January 1, 2008 (Current Year)		As of January 1, 20XX (Prior Year)		Change from Prior Year	
	PV Dollars (in trillions)	% GDP*	PV Dollars (in trillions)	% GDP*	PV Dollars (in trillions)	% GDP*
<b>Receipts</b>						
Medicare	\$ 10.7	1.5%	\$ XX.X	X.X%	\$ X.X	X.X%
Social Security	36.3	5.1%	XX.X	X.X%	X.X	X.X%
All Other Receipts	<u>91.0</u>	<u>12.8%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Total Receipts</b>	\$ 137.9	19.4%	\$ XX.X	X.X%	\$ X.X	X.X%
<b>Spending</b>						
Medicare	\$ 44.8	6.3%	\$ XX.X	X.X%	\$ X.X	X.X%
Medicaid	15.6	2.2%	XX.X	X.X%	X.X	X.X%
Social Security	40.5	5.7%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	<u>73.9</u>	<u>10.4%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Subtotal- Spending</b>	\$ 174.9	24.6%	\$ XX.X	X.X%	\$ X.X	X.X%
Add: Debt Held by the Public	<u>5.0</u>	<u>.7%</u>	<u>X.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Total Projected Spending plus Repayment of Debt</b>	\$ 179.9	25.3%	\$ XX.X	XX.X%	\$ XX.X	XX.X%
<b>Fiscal Imbalance***</b>	\$ 41.9	5.9%	\$ XX.X	X.X%	\$ X.X	X.X%
<b>Less: Portion of Fiscal Imbalance that can be financed within target Debt to GDP</b>						
	5.0	0.7%				
<b>Fiscal Gap</b>	\$36.9	5.2%				

**5. Background:**

- (a) **Analysis of how the ED's proposed additional graphics and narrative relate to the concepts of fiscal imbalance and fiscal gap, and**
- (b) **Comments on fiscal imbalance and fiscal gap by Task Force technical experts**

(a) Analysis of how the ED's proposed additional graphics and narrative relate to the concepts of fiscal imbalance and fiscal gap

The proposed additional graphics and narrative do not conflict with either fiscal imbalance or fiscal gap. All but one of the proposed graphics display future cash flows without any reference to inherited (beginning balance) of public debt, nor do they force a balance to any particular debt level. One of the proposed graphics, Illustration 6, “Impact of Delaying Action” illustrates the fiscal gap concept, using the current year debt-to-GDP level and shows how changes in spending would need to be more severe in the future if action is delayed. (A similar graph or narrative would report the same trend for changes in future receipts.) Staff believes that this requirement could work with either the fiscal imbalance or the fiscal gap concept.

(b) Comments on fiscal imbalance and fiscal gap by Task Force technical experts

The Task Force technical experts were not asked to reach a consensus, and did not reach a consensus regarding a preference for the fiscal imbalance or fiscal gap. The terms fiscal imbalance and fiscal gap are similar, and accordingly were often used interchangeably rather than contrasted with each other, except in a discussion at the April 5, 2007 Task Force meeting of a concept known to economists as the intertemporal budget constraint (IBC). At that meeting, some of the technical experts argued that the IBC requires all expenses and debt to be eventually paid (fiscal imbalance concept), while others argued that all expenses need only to be financed and that the IBC can be calculated as a requirement to achieve a selected target debt level.

Questions for the technical experts from Treasury, OMB, GAO and CBO:

A draft of this memorandum was circulated to the technical experts representing the Treasury Department, the OMB, the GAO and the CBO requesting their comments, specifically regarding the following questions. In addition, Bob Murphy forwarded responses from the CBO’s Chief of the Long-Term Modeling Group, whose comments are included in the recap below.

1. Is the discussion of fiscal imbalance versus fiscal gap in this paper technically accurate?
2. Should the primary summary display use the infinite horizon in order to resolve the issue of fiscal imbalance versus fiscal gap, since it would remove the distinction between fiscal imbalance and fiscal gap, or would an infinite horizon present other disadvantages?
3. Should fiscal gap be required, per the example on the following page? Why or why not?
4. Should the target debt-to-GDP level be fixed or movable? Why?

Recap of technical experts’ responses to the above questions

1. The technical experts believe that the discussion of fiscal imbalance versus fiscal gap is technically accurate in substance. Several of the technical experts provided editorial recommendations to improve the clarity or focus of the discussion, many of which were incorporated into this document.

2. There was no consensus on whether to require an infinite horizon projection period (in lieu of a finite horizon) for the primary summary display. Some of the technical experts believe that the disadvantages of an infinite horizon would outweigh the benefits of getting the fiscal imbalance and the fiscal gap to be equal.

3. There was no consensus on whether to require the fiscal gap for a finite horizon. Several of the technical experts suggested that this might be left to the judgment of the preparer,

4. There was no consensus on whether a target debt-to-GDP level should be fixed or movable. One expert emphasized that using a fixed target would ensure comparability from one year to the next, and that using a movable target such as the current year's debt-to-GDP level would effectively soften the discipline associated with the fiscal gap measure at exactly the time that the fiscal stance is deteriorating. That expert said that if the Board insists on a nonzero target for the debt-to-GDP ratio in the fiscal gap, the target should be relatively low, on the order of 30 percent,<sup>17</sup> but that it is critical that the target level not change over time, because the point is to instill pressure to move the policy toward fiscal discipline.

**Attachments:**

1. Treasury Department proposal (sent to members directly from Treasury on 5/23/2008 and attached for your convenience)
2. Revised milestones- project plan
3. History of recent Board decisions
4. Draft ED- marked copy with revisions based upon the April 2008 Board meeting and proposed revision for discussion at the June 2008 meeting.
5. Draft ED- clean copy per above
6. Handout from February 2008 Board meeting: Option A, which included both fiscal imbalance and fiscal gap in the primary summary display

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<sup>17</sup>The U.S. debt held by the public was at 37 percent of GDP in 2006.



Federal Accounting Standards Advisory Board

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**Reporting Comprehensive Long-Term Fiscal Projections for the  
U.S. Government**

**Statement of Federal Financial Accounting Standards **XX****

*TREASURY DRAFT – June XX, 2008*

Written comments are requested by **October XX, 2008**

**June XX, 2008**

**Staff draft- Do Not Circulate**

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## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- “Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”
- “Mission Statement: Federal Accounting Standards Advisory Board”, Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB’s website at: [www.fasab.gov](http://www.fasab.gov).

Federal Accounting Standards Advisory Board  
441 G Street, NW, Suite 6814  
Mail stop 6K17V  
Washington, DC 20548  
Telephone 202-512-7350  
FAX – 202-512-7366  
[www.fasab.gov](http://www.fasab.gov)

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Federal Accounting Standards Advisory Board

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July 10, 2008

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. Specific questions for your consideration appear on page 7 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by **October 10, 2008**.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. A public hearing for this exposure draft has been scheduled at 9:00 AM on October 22, 2008, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.

Notice of the date and location of this public hearing also will be published in the *Federal Register* and in the FASAB's newsletter.

Tom L. Allen  
Chairman

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**Executive Summary****What is the Board proposing?**

Treasury is proposing a reporting framework that will enable financial report users, including citizens and citizen intermediaries, Congress, and the President, to evaluate the extent to which the government can sustain the funding of critical programs, services, and benefits in the future.

The intent is **not** to enable the Board to require or specify the parameters for policy decisions, but to provide for the reporting of reliable information and analysis about the future sustainability of pre-existing revenue and spending decisions and changes to the programs for which the decisions have been made that could have sufficient financial impact to reduce the imbalances between total revenues and spending. Such information should enable the public, including citizens and citizen intermediaries, government agencies, Congress, and the President to draw conclusions concerning the fiscal sustainability of government programs, services, and benefits.

The standard would require individual agencies that fund, operate, and/or administer programs deemed to potentially contribute to the governmentwide fiscal imbalance to quantify the effects and conduct sensitivity analyses of varying the most significant features of those programs having the greatest financial impact. The critical elements of agency and governmentwide sustainability analysis are: 1) to quantify the degree to which the individual programs contribute to the governmentwide imbalance, 2) to identify the program elements that have the greatest impact on the imbalance; and 3) to offer potential changes having sufficient financial impact to reduce the fiscal imbalance.

Discussion and analysis of federal program sustainability should be easily understandable to the 'average citizen' who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence.

The Office of Management and Budget (OMB) and Treasury conduct their own analysis to assess the overall, long-run sustainability of the federal government, drawing on existing government projections of the long-run fiscal outlook prepared by Social Security and Medicare trustees. They will request additional information from relevant government sources as deemed necessary or appropriate.

The Department of the Treasury and OMB will issue guidance on reporting format and the minimum number and types of programs that should be covered

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in agency sustainability reporting. Such guidance will not preclude agencies from reporting on additional programs. Reporting format at the agency level should facilitate comparative analysis at the governmentwide level.

This standard requires that fiscal sustainability reporting and analysis be implemented as Required Supplementary Information (RSI) for the period ending September 30, 2010 and beyond.

### **How would this proposal contribute to meeting the federal financial reporting objectives?**

This proposal supports the Stewardship Objective (Objective 3):

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>1</sup>

In particular, this proposal directly addresses sub-objective 3B:

Federal financial reporting should provide information that helps the reader to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>2</sup>

This proposal would provide reporting requirements that the Board believes will be useful to readers in assessing the potential future impact of current levels of benefits, services, and taxation.

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<sup>1</sup> Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraph 134.

<sup>2</sup> SFFAC 1, paragraphs 135 and 139.

**Table of Contents**

**Executive Summary** ..... **4**  
 What is the Board proposing? ..... 4  
 How would this proposal contribute to meeting the federal financial reporting objectives? ..... 5  
**Questions for Respondents** ..... **7**  
**Introduction** ..... **13**  
 Purpose ..... 13  
 Objectives of Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative (“Fiscal Sustainability Reporting”) ..... 13  
 Materiality ..... 15  
 Effective Date ..... 15  
**Accounting Standard** ..... **16**  
 Definitions ..... 16  
 Scope ..... 16  
     Policy, Economic, and Demographic Assumptions ..... **Error! Bookmark not defined.**  
     Changes in Assumptions ..... **Error! Bookmark not defined.**  
     Projection Periods ..... 18  
 Primary Summary Display ..... **Error! Bookmark not defined.**  
 Requirements for Narrative and Graphics ..... **Error! Bookmark not defined.**  
 Supporting Data (Other Accompanying Information) ..... **Error! Bookmark not defined.**  
 Effective Date ..... **Error! Bookmark not defined.**  
**Appendix A: Basis for Conclusions** ..... **20**  
 Project History ..... **Error! Bookmark not defined.**  
 Financial Position versus Financial Condition ..... **Error! Bookmark not defined.**  
 Existing Required Sustainability Reporting ..... **Error! Bookmark not defined.**  
     Management’s Discussion and Analysis (MD&A) ..... **Error! Bookmark not defined.**  
     Statement of Social Insurance (SOSI) ..... **Error! Bookmark not defined.**  
     What would this proposal add to existing reporting? ..... **Error! Bookmark not defined.**  
 Assumptions ..... **Error! Bookmark not defined.**  
 International Perspective ..... **Error! Bookmark not defined.**  
 Primary Summary Display ..... **Error! Bookmark not defined.**  
     Per Capita Measures ..... **Error! Bookmark not defined.**  
     Time Horizon for Projections ..... **Error! Bookmark not defined.**  
     The Concept of Fiscal Imbalance ..... **Error! Bookmark not defined.**  
**Appendix B: Example Formats and Illustrations** ..... **Error! Bookmark not defined.**  
 Primary Summary Display ..... **Error! Bookmark not defined.**  
 Additional Information ..... **Error! Bookmark not defined.**  
     1. Rising Cost of Health Care ..... **Error! Bookmark not defined.**  
     2. Demographic Trends ..... **Error! Bookmark not defined.**  
     3. Relationship of Projected Receipts and Spending ..... **Error! Bookmark not defined.**  
     4. Trends in Deficit Spending ..... **Error! Bookmark not defined.**  
     5. Trends in Treasury Debt ..... **Error! Bookmark not defined.**  
     6. Impact of Delaying Action ..... **Error! Bookmark not defined.**  
**Appendix C: FAQs** ..... **Error! Bookmark not defined.**  
**Appendix D: Abbreviations** ..... **Error! Bookmark not defined.**  
**Appendix E: Glossary** ..... **Error! Bookmark not defined.**

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## Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at [www.fasab.gov/exposure.html](http://www.fasab.gov/exposure.html). Your responses to the Questions for Respondents should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

All responses are requested by August 15, 2008.

### QUESTIONS ABOUT OBJECTIVES

Q1. This exposure draft proposes that fiscal sustainability reporting should help the reader determine whether current policy is likely to produce future revenues sufficient to sustain current levels of public services and to meet obligations as they come due. Do you believe that sustainability reporting is appropriate for achieving this objective?

**QUESTION 1:** Do you believe that this is the primary objective? If not, what is the primary objective?

Q2. This exposure draft proposes that sustainability reporting would support FASAB

Objective 3, Stewardship, and in particular, Sub-Objective 3B:

Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>3</sup>

Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>4</sup>

**QUESTION 2:** Do you believe that the 'primary' objective as written also satisfies FASAB's Stewardship objective? If not, how should it be revised so as to satisfy the FASAB Stewardship objective?

Q3. The Board's mission is to issue reporting requirements for the federal government's general purpose financial statements. The intent of this exposure draft is **not** to enable the Board to formulate policy decisions and/or recommendations, but to provide for the reporting of reliable information and analysis about the fiscal impacts of possible changes to programs that have sufficient financial impact to reduce the fiscal imbalance.

**QUESTION 3:** Do you agree with the intent of the standard? If not, what should the intent of the standard be?

Q4. This exposure draft proposes that fiscal sustainability analysis and reporting should enable and facilitate the identification of those programs having the greatest fiscal impact on governmentwide imbalances. Sustainability analysis would require the quantification of the effects of varying the most significant features of those programs having the greatest financial impact. Agency information and reporting should aggregate to and support governmentwide information and reporting.

**QUESTION 4(a):** Do you think that sustainability analysis at the agency level has value? If not, why not?

**QUESTION 4(b):** Should sustainability reporting in general be initiated by agency level reporting on programs initially deemed to contribute to the governmentwide fiscal imbalance?

Q5. This exposure draft proposes that sustainability analysis is important for its

<sup>3</sup> SFFAC 1, par. 134.

<sup>4</sup> SFFAC 1, par. 139.

financial, social, and political implications, e.g.,:

- (a) the likelihood that the government can continue to provide the current level of benefits and services to constituent groups; and
- (b) the extent to which financial burdens will be passed on by current-year taxpayers to future-year taxpayers without related benefits (i.e., intergenerational equity).

**QUESTION 5:** Do you agree that sustainability reporting is important for its financial, social, and political implications? Are there other implications?

- Q6. This exposure draft proposes that sustainability reporting should provide for the sensitivity analysis and discussion of the key features of the programs that potentially contribute to the governmentwide fiscal imbalance which, if varied, would produce the largest financial impact. No policy implications or conclusions should be drawn. The analysis should provide for information that would lead to attaining fiscal balance.

This exposure draft proposes that the critical elements of agency and governmentwide sustainability analysis are: to quantify the degree to which the individual programs contribute to the governmentwide imbalance, 2) to identify the elements within the programs that have the greatest impact on the imbalance, and 3) to offer potential changes having sufficient financial impact to reduce the fiscal imbalance.

**QUESTION 6(a)** Do you believe that sensitivity analysis is critical to sustainability reporting for its financial, social, and political implications?

**QUESTION 6(b):** Do you agree with the three critical elements of sustainability reporting as listed above?

#### QUESTIONS ABOUT CONTEXT

- Q7. This exposure draft proposes that fiscal sustainability reporting should be understandable to the 'average' citizen and citizen intermediaries, government agencies, Congress, and the President. Reporting therefore may take many non-traditional forms.

**QUESTION 7:** Do you believe that the 'average citizen' is the primary audience and the minimum audience to whom sustainability reporting should be targeted? If not, who is the primary audience?

- Q8. This exposure draft proposes that sustainability reporting should address projected revenues and costs and the significant resulting fiscal imbalances in a

format that the preparer, OMB, and Treasury agree best communicates the information (e.g., present value dollars, gross domestic product, present value share of projected receipts / spending).

**QUESTION 8:** Do you agree that Treasury and OMB should establish the format of sustainability reporting?

## QUESTIONS ABOUT PROCESS

### Governmentwide Sustainability Analysis and Reporting

Q9. This exposure draft proposes that OMB and Treasury will conduct their own analysis to assess the overall, long-run sustainability of the federal government, drawing on existing government projections of the long-run fiscal outlook prepared by Social Security and Medicare trustees. They will request additional information from relevant government sources as deemed necessary or appropriate.

**QUESTION 9(a):** Do you think OMB and Treasury should be responsible for assessing the government's long-run fiscal position is sustainable? If not, what information about the government's long-run fiscal position should be presented? Should a sustainability determination be made by an alternative individual, organization, or agency? If so, which?

**QUESTION 9(b):** Other than Social Security and Medicare, which programs, if any, should be required to make long-run fiscal sustainability projections?

**QUESTION 9(c):** In addition to Social Security and Medicare, which additional programs should be expected to report on sustainability?

### Agency Sustainability Analysis and Reporting

Q10. This exposure draft proposes that sustainability reporting should include: 1) governmentwide results in the FR; 2) the anticipated results of changes to key features demonstrating the largest financial sustainability impact; and 3) an analysis of the causes of annual changes to the sustainability calculations.

Sustainability reporting detail should correlate with and be based upon the identified programs and 'key' elements, and should include an explicit presentation of the significant assumptions used and their individual and combined effect on the analysis.

**QUESTION 10(a):** Do you think it is useful and relevant to identify and report

on the 'key' elements affecting sustainability?

**QUESTION 10(b):** Do you agree that sustainability analysis and reporting should include a presentation of the significant assumptions used and their individual and combined effect on the results?

Q11. This exposure draft proposes that the preparer should identify 'key' elements, the existence of or changes in which substantially or significantly impact fiscal sustainability information and/or analysis. The preparer should identify all significant assumptions and discuss reasons for changes

**QUESTION 11(a):** Do you think it is useful and relevant to identify and report on the 'key' elements affecting sustainability?

**QUESTION 11(b):** Do you think that a clear distinction exists between 'key element' and 'assumption'? How would you articulate that distinction?

**QUESTION 11(c):** Do you believe that these 'key' elements and their impact on sustainability analysis are / can be / should be reported separately and distinctly from the underlying 'assumptions'?

Q12. OMB and Treasury shall issue guidance on reporting format, the minimum programs that should be covered, and the minimum assumptions to be used in agency sustainability reporting. Such guidance will not preclude agencies from reporting on additional programs or using additional assumptions.

**QUESTION 12(a):** Do you think that OMB and Treasury should determine and issue guidance on reporting format to include guidance on minimum programs and minimum assumptions to be addressed?

**QUESTION 12(b):** Do you think that agencies should be permitted to report on additional programs and/or use additional assumptions? Should approval from OMB and/or Treasury be required for any additional reporting?

Q13. This exposure draft proposes that projections and estimates should be prepared over a period sufficient to illustrate fiscal sustainability. Preparers should identify where finite periods (i.e., period begins and ends at explicit dates) versus infinite periods are used. For finite projection periods, preparers should disclose the beginning, end, and duration of those periods.

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All projections and estimates should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on (“current year”) as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

**QUESTION 13:** Do you agree that preparers should distinguish between those analyses occurring over a finite (date- or year-certain) period or infinite periods?

#### EFFECTIVE DATE

Q14. This standard requires that fiscal sustainability reporting and analysis be implemented as Required Supplementary Information (RSI) for the period ending September 30, 2010 and beyond. After the initial year of implementation, sustainability reporting should include comparative analysis for the current year and prior year, and a discussion of the reasons for the annual change.

**QUESTION 14(a):** Do you agree that sustainability information and analysis be reported as Required Supplementary Information (RSI)?

**QUESTION 14(b):** Do you agree that sustainability reporting should include comparative analysis after the initial year of implementation.

## Introduction

### Purpose

1. The Board believes that providing a framework for fiscal sustainability reporting as described in this standard in the consolidated financial report of the U.S. Government (CFR), as well as other governmentwide and agency financial reports as deemed appropriate, should help the reader determine whether current policy is likely to produce future revenues sufficient to sustain current levels of public services and to meet obligations as they come due.<sup>5</sup>
2. A fiscal sustainability reporting framework should support FASAB Objective 3, Stewardship, and in particular Sub Objective 3B:
 

Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>6</sup>

Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>7</sup>
3. The intent is **not** to enable the Board to require or specify the parameters for policy decisions, but to provide for the reporting of reliable information and analysis about the future sustainability of pre-existing revenue and spending decisions and changes to the programs for which the decisions have been made that could have sufficient financial impact to reduce the imbalances between total revenues and spending. . Such information should enable the public, including citizens and citizen intermediaries, government agencies, Congress, and the President, to draw conclusions concerning the fiscal sustainability of government programs, services, and benefits.

### Objectives of “Fiscal Sustainability Reporting”

4. In this Statement, “Fiscal Sustainability Reporting” refers to the reporting of results of comprehensive long-term fiscal projections and analysis that can help readers of agency and governmentwide reports to assess whether future U.S. Government revenues will likely be sufficient to sustain public services and to meet obligations as

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<sup>5</sup> SFFAC 1, par. 139.

<sup>6</sup> SFFAC 1, par. 134.

<sup>7</sup> SFFAC 1, par. 139.

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they come due, assuming that current levels of benefits, services, and taxation are continued.<sup>8</sup>

5. A fiscal sustainability reporting framework should enable and compel the preparer to analyze projections of agency and governmentwide revenue, expenses, and any resulting imbalances to determine if the financial condition of the government as a whole is sustainable under the present set of assumptions.
6. A fiscal sustainability reporting framework would facilitate the identification of those programs demonstrating the greatest financial impact on governmentwide imbalances. Further, it would require individual agencies that fund, operate, and/or administer the programs that substantially contribute to the imbalance, to quantify the effects of varying the elements of the programs having the greatest financial impact.
7. Assessing whether future revenues will likely be sufficient to sustain public services and to meet obligations as they come due is important due not only for its financial implications but also for its social and political implications. For example, users of financial reports should be provided with information that is helpful in assessing: (1) the likelihood that the government will continue to provide the current level of benefits and services to constituent groups and (2) the extent to which financial burdens will be passed on by current-year taxpayers to future-year taxpayers without related benefits (i.e., intergenerational equity).<sup>9</sup> Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.
8. Sustainability reporting should provide for the sensitivity analysis and discussion of the key features of the programs that potentially contribute to the governmentwide fiscal imbalance which, if varied, would produce the largest financial impact on overall results. No policy implications or conclusions need be drawn. The analysis should provide for information that would lead to attaining or at least approaching fiscal balance. The critical elements of agency and governmentwide sustainability analysis are: 1) to quantify the degree to which the individual programs contribute to the governmentwide imbalance, 2) to identify the program elements that have the greatest impact on the imbalance, and 3) to offer potential changes having sufficient financial impact to reduce the fiscal imbalance.

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<sup>8</sup> Note that fiscal sustainability reporting does not extend to supporting a detailed assessment of whether current levels of benefits, services, and taxation are optimal; rather, it addresses the fiscal outlook if current levels are continued.

<sup>9</sup> The latter notion is sometimes referred to as "interperiod equity."

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9. Fiscal Sustainability Reporting should be understandable to the intended users of agency financial reports and the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the media, public interest and advocacy groups, and others), as well as government agencies, Congress, and the President.
  10. Discussion and analysis of sustainability issues and information should be easily understandable to the “average citizen” who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence. A sustainability reporting framework should also inform users as to where to find additional information in other reports and publications, for example, reports issued by the Department of the Treasury, the Government Accountability Office (GAO), the Office of Management and Budget (OMB), and the Congressional Budget Office (CBO) and other agencies.<sup>10</sup>
  11. The Frequently Asked Questions (FAQs) at Appendix C provide a “Plain English” explanation of terms and concepts used in this Statement. (necessary?)

## Materiality

12. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

## Effective Date

13. This proposal provides for the reporting of fiscal sustainability information in annual agency and governmentwide reports as Required Supplementary Information (RSI) beginning with reports covering the government fiscal year ending September 30, 2010.

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<sup>10</sup> See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, paragraphs 6-7 and 15-20.

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## Accounting Standard

### Definitions

#### 14. Fiscal Imbalance

The fiscal imbalance is the net present value of existing federal debt plus projected spending<sup>11</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period

#### 15. Intergenerational Equity

In this standard, intergenerational equity refers to the extent to which costs attributed to current programs, services, and benefits, are expected to be transferred future generations of taxpayers...

#### 16. Current Policy

In this standard, current policy refers to current levels of federal government services and benefits (for example, current reimbursement rates for Medicare and scheduled benefits for Social Security) combined with current levels of taxation and other receipts.<sup>12</sup>

### Scope

17. The reporting requirements in this Statement apply to the consolidated financial report of the U.S. Government, as well as other governmentwide and agency reports as deemed appropriate. They do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose type of report and are not intended to address the policy-making process.

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<sup>11</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 on page **Error! Bookmark not defined.**

<sup>12</sup> "Current levels" is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

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## Framework for Fiscal Sustainability Reporting and Analysis

18. Fiscal Sustainability Reporting for the U.S. Government should provide information that helps the reader to determine whether current policy is likely to produce future revenues sufficient to sustain current levels of public services and to meet obligations as they come due. At a minimum, it should address projected revenues and costs, and the significant resulting fiscal imbalances.
19. The 'fiscal imbalance' as of a stated valuation date<sup>13</sup> may be expressed as:
- a summary amount in present value dollars,
  - a share of the present value of the gross domestic product (GDP)<sup>14</sup> for the projection period' and/or
  - a share of the present value of projected receipts or projected spending.<sup>15</sup>
- This does not preclude agencies from expressing fiscal imbalance by other means or in alternate formats.
20. Fiscal sustainability reporting should provide information that helps the reader assess the extent to which the costs of current government programs, services, and benefits are projected to be borne by future generations, and the extent to which correlating benefits will be available to those generations (i.e., intergenerational equity).
21. The Office of Management and Budget (OMB) and Treasury conduct their own analysis to assess the overall, long-run sustainability of the federal government, drawing on existing government projections of the long-run fiscal outlook prepared by Social Security and Medicare trustees. They will request additional information from relevant government sources as deemed necessary or appropriate..
22. The Department of the Treasury and OMB will issue guidance on reporting format and the minimum number and types of programs that should be covered in agency sustainability reporting. Such guidance will not preclude agencies from reporting on additional programs. Reporting format at the agency level should facilitate comparative analysis at the governmentwide level.

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<sup>13</sup> See requirement for valuation date in paragraph 28.

<sup>14</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

<sup>15</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

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### 'Key' Elements

23. Any fiscal sustainability reporting model should provide for the identification of 'key' program elements or features, requiring preparers to quantify the effects of varying those that have the most significant financial impact on a perceived imbalance. Preparers should quantify the extent to which individual programs contribute to the governmentwide fiscal imbalance, identify the elements within the programs that have the greatest impact on the imbalance, and offer potential changes having sufficient financial impact to reduce the fiscal imbalance..
24. This standard provides a framework and guidelines for presenting readily viewable comparisons of these 'key' elements or features and the resulting analysis under multiple assumptions (e.g., economic, demographic, policy) and/or conditions.
25. The level of sustainability reporting detail should correlate with and be based upon the identified 'key' elements and should include an explicit presentation of the significant assumptions used and their individual and combined impact on the analysis.
26. The selection and use of policy assumptions should generally be consistent with current policies (e.g., current levels of federal benefits, services, and taxation) and current law. Where "current law" will not provide an adequate basis for long-term projections under current policies (e.g., where the preparer can reasonably assume the discontinuation or emergence of that assumption), the preparer should use judgment in selecting policy assumptions consistent with current policies
27. Assumptions can have reflective and mutual effects on each other and the resulting analysis. Sustainability reporting should include identification and explanation of significant assumption inter-relationships and their estimated combined effect on projections.

### Valuation Date

28. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

### Projection Periods

29. Projections should be based on a projection period sufficient to illustrate fiscal sustainability. Preparers should indicate where projection periods used are finite (i.e., projections period begins and ends at explicit dates) versus infinite. Where

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finite projection periods are used, preparers should disclose the beginning, end, and duration of those periods.

**Effective Date**

- 30. This standard requires that fiscal sustainability reporting and analysis be implemented as Required Supplementary Information (RSI) for the period ending September 30, 2010 and beyond.
- 31. After the initial year of implementation, sustainability reporting should include comparative amounts for the current year and prior year, and the net change in those amounts.

The provisions of this Statement need not be applied to immaterial items.

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**Appendix A: Basis for Conclusions**

NOTE - - A more detailed BfC will be prepared pending discussion of the proposed alternative standard.

The goal of this alternative standard was to provide concepts- or objective-based guidance that enabled OMB and Treasury to provide oversight and direction as well as a minimum level of reporting, while providing the preparer flexibility as to the content. The focus is more on clarifying the message that we are trying to communicate, built upon sensitivity analysis of 'key elements and features', and less on how, specifically it should be communicated.

Given the amount of flexibility afforded in this proposed statement, it is appropriate to provide for 'experimentation' at least in the short run, and as such, to limit reporting to RSI until further notice, to allow the Board and the community to evaluate one or more approaches / methods developed within the standard's parameters.



## Attachment 2:

### Revised Milestones - Fiscal Sustainability Reporting

April 5, 2007	Task Force Meeting: Technical Experts
May 24, 2007	Board meeting: Recap of results of April 2007 task force meeting
June 19, 2007	Task Force Meeting: Financial Statement Users/Communications Experts
July 25-26, 2007	Board meeting: Survey of international reporting; recap of results of June 2007 task force meeting
September 19-20, 2007	Board meeting: Present options and proposals for reporting
December 4-5, 2007 *	Board meeting: Present draft ED for discussion
February 13-14, 2008 *	Board meeting: Continue discussion of draft ED
April 16-17, 2008	Board meeting: Discuss preballot draft ED
June 18-19, 2008 *	Board meeting: Discuss fiscal imbalance and fiscal gap
June 30, 2008	Finalize ballot draft ED
July 11, 2008	Issue ED: Comments due October 13, 2008
October 22-23, 2008	Board meeting: Public Hearing
December 17-18, 2008	Board meeting: Discuss ED comments and staff proposal(s)
February 25-26, 2009	Board meeting: Continue discussion of comments/proposal(s)
April 22-23, 2009	Board meeting: Continue discussion of comments/proposal(s)
June 17-18, 2009	Board meeting: Continue discussion/preballot draft SFFAS
August 26-27, 2009	Board meeting: Ballot draft SFFAS
September 10, 2009	Transmittal to principals; Begin 90-day review period
December 10, 2009	End 90-day review period and issue SFFAS

\* If desired, Task Force members may be invited to meet with the Board.

Note: If the Board is unable to issue an ED mid-July of 2008, the Public Hearing would need to be postponed until the February 2009 Board meeting in order to reasonably accommodate the preparation of testimony for the public hearing by the preparers of the CFR, which is due to be issued only two days before the December board meeting.

This, in turn, would likely postpone the completion of a ballot draft SFFAS until December 2009 with a 90-day review period ending in March or April of 2010.

### Attachment 3: History of Board Decisions on Fiscal Sustainability Reporting

Board Meeting Date	Question/Item for Discussion	Board View
May 2006	Staff presented a proposal to form a task force to address fiscal sustainability reporting, with technical experts from think tanks, social insurance actuaries, and members of the user community. The Board discussed providing task force representation and/or staff support from the FASAB's sponsoring agencies (OMB, GAO, CBO and Treasury).	Board concurred that staff should begin to form a task force and draft a project plan.
July 2006	Board reviewed: <ol style="list-style-type: none"> <li>1. Outline of draft briefing package for the "technical experts" task force members, and</li> <li>2. List and bios for proposed task force members (technical experts and financial statement users/communication experts)</li> </ol>	Board approved, with minor changes: <ol style="list-style-type: none"> <li>1. Outline for the briefing package for the "technical expert" task force members and</li> <li>2. List of proposed task force members.</li> </ol>
January 2007	Board reviewed: <ol style="list-style-type: none"> <li>1. Draft briefing package for Task Force technical members, and</li> <li>2. Updated list of outside technical members who accepted invitations and Federal members who would serve as technical experts for the April 4, 2007 Task Force meeting</li> </ol>	Board approved the briefing package for the task force technical members and asked that a copy of the PV Alternative View document also be sent to them.
March 2007	Board was briefed on: <ol style="list-style-type: none"> <li>1. Results of the April 5, 2007 meeting with technical members of the task force.</li> <li>2. Results of February 22, 2007 meeting with Allen Schick, who could not attend April meeting.</li> <li>3. Staff meeting with OMB, CBO, GAO and Treasury technical representatives.</li> </ol>	N/A
May 2007	Handout for the Board: update on April 2007 Task Force meeting	N/A

Board Meeting Date	Question/Item for Discussion	Board View
July 2007	<p>1. Board was briefed on results of the June 19, 2007 “Communications Group” Task Force meeting.</p> <p>2. Topics addressed at the July Board meeting:</p> <ul style="list-style-type: none"> <li>(a) Whether to develop reporting objectives versus a definition of “fiscal sustainability”, and</li> <li>(b) Need for user feedback.</li> </ul> <p>3. The Board was also provided with an international survey of fiscal sustainability reporting and a draft project plan for this project, including milestone target dates.</p>	<p>Board concurred that:</p> <ul style="list-style-type: none"> <li>(a) Staff should draft objectives that would be based upon Stewardship objective, and</li> <li>(b) Staff should continue to explore potential avenues for user feedback.</li> </ul>
September 2007	<p>Board discussed</p> <ul style="list-style-type: none"> <li>1. objectives and</li> <li>2. assumptions</li> </ul> <p>for fiscal sustainability reporting</p>	<ul style="list-style-type: none"> <li>1. Board expressed general agreement on the draft objectives, with some revisions.</li> <li>2. Board concurred that: <ul style="list-style-type: none"> <li>(a) Staff should develop broad guidelines for assumptions rather than detailed rules, and</li> <li>(b) Assumptions should be based upon current law, except when current law does not provide for continuance of current levels of spending and taxation.</li> </ul> </li> </ul>
December 2007	<p>Board reviewed draft ED with focus on:</p> <ul style="list-style-type: none"> <li>1. Revised guidance for objectives and assumptions</li> <li>2. “Per capita” issue</li> <li>3. Initial discussion of: <ul style="list-style-type: none"> <li>(a) Draft summary displays</li> <li>(b) Draft requirements for additional narrative</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>1. Board approved objections and assumptions in substance; staff will incorporate edits.</li> <li>2. Board decided against including per capita measures.</li> <li>3. Board requested that actual data be developed for all pro forma displays.</li> </ul>

	and graphics.	
February 2008	<p>Board reviewed draft ED with focus on:</p> <ol style="list-style-type: none"> <li>1. Time horizon</li> <li>2. Minimum required level of disaggregation</li> <li>3. Options for primary summary display</li> <li>4. Initial placement within the CFR and phased implementation</li> <li>5. Other required information, especially "impact of delay"</li> </ol>	<p>Board decisions:</p> <ol style="list-style-type: none"> <li>1. Both finite and infinite projections will be required. Summary data for the time horizon not presented in the primary display will be presented in the narrative section.</li> <li>2. Minimum disaggregation: <ol style="list-style-type: none"> <li>a. Receipts: Social Security, Medicare and rest of government</li> <li>b. Spending: Social Security, Medicare, Medicaid, rest of government</li> </ol> </li> <li>3. Reached consensus on list of items required to be included in the primary summary display. <b>[Staff note: this list of required items did not include fiscal gap, which appeared at the bottom of Option A.]</b></li> <li>4. Phased implementation: Primary summary display and required narrative and graphics will be RSI for 3 years starting in FY 2010. Starting in FY 2013, principal financial statement and notes.</li> <li>5. Added a requirement to address the likely impact of delay (if remedial action is indicated) with illustrative CBO graphic.</li> </ol>
April 2008	<p>Board reviewed comments from the Task Force technical experts with a focus on the distinction between fiscal imbalance and fiscal gap.</p>	<ol style="list-style-type: none"> <li>1. Staff will develop briefing materials to facilitate an in-depth discussion of fiscal imbalance and fiscal gap.</li> <li>2. Treasury Dept. will provide an alternative proposal for the Board prior to the June 2008 meeting.</li> <li>3. OMB will review the ED's guidance on assumptions and report if problems are anticipated.</li> </ol>



Federal Accounting Standards Advisory Board



**Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government**

**Statement of Federal Financial Accounting Standards **XX****

***Exposure Draft***

Written comments are requested by **October 13, 2008**

Deleted: **August 15**

**July 11, 2008**

Deleted: **May 9**

**Staff draft- Do Not Circulate**



## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: [www.fasab.gov](http://www.fasab.gov).

Federal Accounting Standards Advisory Board  
441 G Street, NW, Suite 6814  
Mail stop 6K17V  
Washington, DC 20548  
Telephone 202-512-7350  
FAX – 202-512-7366  
[www.fasab.gov](http://www.fasab.gov)

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July 10, 2008

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. Specific questions for your consideration appear on page 8, but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by October 10, 2008.

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All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. A public hearing for this exposure draft has been scheduled at 9:00 AM on October 22, 2008, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.

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Notice of the date and location of this public hearing also will be published in the *Federal Register* and in the FASAB's newsletter.

Tom L. Allen  
Chairman

Executive Summary

What is the Board proposing?

The Board is proposing to require that the consolidated financial report of the United States Government (CFR) present information addressing the fundamental question of whether the Government can sustain public services and meet its obligations as they come due. Answering this question requires analyzing current and projected levels of federal spending, federal receipts and federal debt in relation to the economy. Such an analysis is complex and the result is challenging to communicate. Nonetheless, it is the most significant fiscal question regarding the U.S. government and of concern to all citizens.

The Board believes that a comprehensive package is needed, consisting of a narrative that integrates and explains the information that is provided through a primary summary display and graphic presentations. The overall package should:

- 1. convey key projected fiscal measures such as projected receipts, spending, deficits and debt;
2. provide context for the measures such as how they relate to the overall economy;
3. highlight the major factors contributing to trends;
4. help readers understand the projections and their inherent uncertainty as well as possible alternative projections; and
5. include information regarding the implications of inaction.

Clear communication of such a complex analysis is critical. The Board recognizes that accounting standards alone will not guarantee success and that the standards must be flexible to facilitate alternative approaches. However, certain information is consistently found in reports published by U.S. entities and many other countries, and supports an understanding of the underlying issue. For example,

- 1. Information on the present value of receipts and spending conveys the magnitude of policy changes that would be required to sustain delivery of goods and services. Presenting this information in relation to a meaningful base (e.g., total projected spending, total projected receipts or the gross domestic product (GDP)) assists in understanding large dollar amounts.

2 Note that the fiscal year 2007 CFR included certain voluntary presentation of information relevant to this question. The due process relied upon by the Board would ensure the general acceptance of the underlying principles and the continued reporting of this important information.

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A primary summary display would present fiscal projections for all activities of the federal government and calculate a "bottom line" fiscal imbalance (the amount necessary to balance future spending and repay existing debt).

The narrative and graphics would serve a critical role of making economic concepts and projections accessible to a variety of audience segments, and in helping readers understand long-term projections by illustrating trends graphically and by providing context for the information provided.

The narrative would provide a "plain English" explanation of present value and interest rates used to calculate present value.

Narrative and graphics would explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. Current examples of major factors are the rising cost of health care and demographic trends.

Narrative and graphics would explain and illustrate historical and projected trends for a succession of years for: the relationship between projected receipts and spending; projected deficits or surpluses, and; projected Treasury debt as a share of gross domestic product.

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- 2. The trajectory of spending and receipts shows the timing of the government’s need for financing and allows for comparison to historic financing needs on an annual basis.
- 3. Presenting the trend in debt-to-GDP ratios in graphic form facilitates an understanding of when the rising drain on financial markets might constrain borrowing. If the debt-to-GDP ratio is rising uncontrollably then there will come a time when the Government cannot pay its bills because it is unable to finance deficit spending.
- 4. Most projections are based on maintaining the current level of effort devoted to federal programs and the current framework for taxation. This supports an understanding of where the government is headed if it maintains its current course.

The proposed standards would require:

- 1. A primary summary display presenting the present value of projected receipts and spending for all activities of the federal government, how those amounts relate to projected GDP, and the summary measures “fiscal imbalance” and/or “fiscal gap.”
- 2. Narrative and graphics would explain and illustrate the projected trends in:
  - a. The relationship between receipts and spending,
  - b. Deficits or surpluses, and
  - c. Treasury debt as a share of GDP.
- 3. Narrative and graphics also would explain and illustrate:
  - a. The assumptions underlying the projections,
  - b. Factors influencing trends,
  - c. The range of possible results using alternative assumptions, and
  - d. The likely impact of delaying corrective action when a fiscal imbalance exists.

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The Board believes that these projections—although inherently uncertain—will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

**How would this proposal contribute to meeting the federal financial reporting objectives?**

This proposal supports the Stewardship Objective (Objective 3):

Federal financial reporting should assist report users in assessing the impact on the country of the government’s operations and investments for

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July 11, 2008

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the period and how, as a result, the government’s and the nation’s financial condition has changed and may change in the future.<sup>3</sup>

In particular, this proposal directly addresses sub-objective 3B:

Federal financial reporting should provide information that helps the reader to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>4</sup>

This proposal would provide specific reporting requirements that the Board believes will be useful to readers in assessing the potential future impact of current levels of benefits, services, and taxation.

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<sup>3</sup> Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraph 134.

<sup>4</sup> SFFAC 1, paragraphs 135 and 139.

Table of Contents

**Executive Summary** ..... **4**  
 What is the Board proposing? ..... 4  
 How would this proposal contribute to meeting the federal financial reporting objectives? ..... 5  
**Questions for Respondents** ..... **8**  
**Introduction** ..... **13**  
 Purpose ..... 13  
 Objectives of Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative (“Fiscal Sustainability Reporting”) ..... 14  
 Materiality ..... 15  
 Effective Date ..... 15  
**Accounting Standard** ..... **16**  
 Definitions ..... 16  
 Scope ..... 17  
     Policy, Economic, and Demographic Assumptions ..... 17  
     Changes in Assumptions ..... 20  
     Projection Periods ..... 21  
 Primary Summary Display ..... 21  
 Requirements for Narrative and Graphics ..... 22  
 Supporting Data (Other Accompanying Information) ..... 25  
 Effective Date ..... 25  
**Appendix A: Basis for Conclusions** ..... **26**  
 Project History ..... 26  
 Financial Position versus Financial Condition ..... 27  
 Existing Required Sustainability Reporting ..... 29  
     Management’s Discussion and Analysis (MD&A) ..... 29  
     Statement of Social Insurance (SOSI) ..... 31  
     What would this proposal add to existing reporting? ..... 33  
 Assumptions ..... 33  
 International Perspective ..... 40  
 Primary Summary Display ..... 41  
     Per Capita Measures ..... 41  
     Time Horizon for Projections ..... 42  
     The Concept of Fiscal Imbalance ..... 44  
**Appendix B: Example Formats and Illustrations** ..... **46**  
 Primary Summary Display ..... 46  
 Additional Information ..... 48  
     1. Rising Cost of Health Care ..... 48  
     2. Demographic Trends ..... 51  
     3. Relationship of Projected Receipts and Spending ..... 53  
     4. Trends in Deficit Spending ..... 54  
     5. Trends in Treasury Debt ..... 55  
     6. Impact of Delaying Action ..... 56  
**Appendix C: FAQs** ..... **58**  
**Appendix D: Abbreviations** ..... **61**  
**Appendix E: Glossary** ..... **62**

- Deleted: 7
- Deleted: 12
- Deleted: 12
- Deleted: 13
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- Deleted: May 9

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 Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government  
 July 11, 2008  
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Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses to the Questions for Respondents should be sent by e-mail to fasab@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by October 13, 2008. Deleted: August 15

Q1. This exposure draft proposes reporting that would support FASAB Objective 3, Stewardship, and in particular, Sub-Objective 3B:

Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

5 SFFAC 1, par. 134. Deleted: May 9

Federal Accounting Standards Advisory Board
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government
July 11, 2008
Staff Draft Exposure Draft- Do Not Circulate

Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>6</sup>

More detailed discussion of the reporting objective and the objectives of fiscal sustainability reporting can be found in paragraphs 1 through 8.

Do you believe that the proposed reporting supports the above objectives? If not, please explain why you disagree.

Q2. In this proposed Statement, projections are prepared not to predict the future, but rather to depict results that may occur under various conditions. Accordingly, projections require assumptions to be made about the future. This exposure draft proposes broad and general guidance for selecting policy, economic, and demographic assumptions for long-term projections with a primary focus on the future implications of the continuation of current levels of benefits, services, and taxation. The guidance begins at paragraph 18.

Do you believe that the guidance for assumptions is appropriate? If not, please suggest alternative guidance. Please provide the rationale for your response.

Q3. This exposure draft proposes a primary summary display,<sup>7</sup> in addition to narrative and graphics. (Description begins at paragraph 35 and an illustrative example of the primary summary display is provided in Appendix B.) The Board has indicated that the primary audiences for the consolidated financial report of the U.S. Government (CFR) are citizens and citizen intermediaries such as journalists and public policy analysts.

Do you believe that this display would be understandable and meaningful for the primary audiences of the CFR? Please note any changes that you believe should be made to the requirements for a primary summary display.

Q4. Finite and infinite time horizons for fiscal projections are discussed in the Basis for Conclusions, paragraphs A54 through A59. This exposure draft proposes the following requirements regarding time horizons for projections: (a) the projections presented in the primary summary display should be “sufficient to illustrate long-term sustainability” (for example, traditionally the Social Security program has used a projection period of 75 years for long-term projections); (b)

<sup>6</sup> SFFAC 1, par. 139.

<sup>7</sup> The primary summary display will be presented as RSI for a period of three years and subsequently as a basic financial statement.

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Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

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projections for both a finite and an infinite horizon should be provided, one in the primary summary display and the other in the narrative section; and (c) either the primary display or the narrative section should include projections for Social Security and Medicare based on the time horizon used for long-term projections for Social Security and Medicare in the Statement of Social Insurance (SOSI).

- a. Do you believe that the above requirements for time horizons are appropriate to meet the reporting objectives of Fiscal Sustainability Reporting? If not, please explain.
- b. Do you believe that there should be a specific time horizon requirement (for example, 75 years) for the primary summary display for Fiscal Sustainability Reporting and/or the SOSI? If so, what time horizon do you believe should be required?

Q5. The Board’s mission is to issue reporting requirements for the federal government’s general purpose financial statements, and not to recommend budget policy. This exposure draft proposes a title for the primary summary display: “Long-Term Fiscal Projections for the U.S. Government.” An alternative title, “Statement of Fiscal Sustainability,” might imply to some that the Board has established or plans to establish specific rules that define “fiscal sustainability” and/or budget rules that would result in fiscal sustainability. However, others have indicated that the “plain English” meaning of the words “fiscal” and “sustainability” should be adequate, and that the title “Statement of Fiscal Sustainability” might be more appropriate.

The Board’s working definition of “fiscal sustainability reporting” is explained in the Basis for Conclusions, paragraph A3. The concept of “Financial Condition” is explained in the Basis for Conclusions, paragraphs A7 and A8.

Do you believe that the primary summary display should be titled:

- a. “Long-Term Fiscal Projections for the U.S. Government,”
- b. “Statement of Fiscal Sustainability,”
- c. “Statement of Financial Condition,” or
- d. A title not listed above (please specify).

Please explain the reasons for your choice.

Q6. This exposure draft proposes a minimum level of disaggregation for the primary summary display. For projected receipts, Medicare and Social Security would be shown separately from the rest of government. For projected spending, Medicare, Social Security, and Medicaid would be shown separately from the rest of government.

- a. Do you believe that the above projections should be disaggregated in the primary summary display? Please explain the basis for your views.

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b. Do you believe that additional line items should be disaggregated in the primary summary display? If so, please identify the line items and explain your reasoning.

Q7. This exposure draft proposes that a range (high and low) be required in the narrative section for each line item in the primary summary display. It also proposes that a range might optionally be displayed in the narrative for major factors impacting projected receipts and spending (such as the rising cost of health care), (see paragraph 45 and illustrative examples in Appendix B on pages 47 - 50.

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Do you believe that a range of possible results for some of all of the line items should be displayed on the face the primary summary display? If so, which line item(s) should display a range of results?

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Q8. This exposure draft proposes narrative and graphic displays to effectively communicate to the reader historical and projected trends and to help the reader understand the major drivers influencing projected receipts and spending. The requirements begin at paragraph 40 and illustrations begin on page 48.

- a. Do you believe that the required narrative and graphics would be useful in helping the reader to understand the information that is reported in the primary summary display?
- b. Are there any items that you believe should be added to, or deleted from, the requirements for narrative and graphics? If so, please explain.

Q9. The Frequently Asked Questions (FAQs) at Appendix C provide a "plain English" explanation of terms and concepts used in long-term projections.

- a. Do you find the FAQs helpful?
- b. Should the Treasury Department be encouraged to include any of the FAQs in the CFR to promote understandability of the terms and concepts? If so, please specify the FAQs that should be considered for inclusion (and/or exclusion).

Q10. Effective Date and Phased Implementation: This proposed Statement would be effective for periods beginning after September 30, 2009 with earlier implementation encouraged. This proposed Statement would require that the Primary Summary Display and the additional required information including graphics and narrative be included in Required Supplementary Information (RSI) for the first three years of implementation, and basic information (i.e., principal financial statement and notes) for all subsequent years.

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a. Do you believe that this implementation date is reasonable and appropriate?

- b. Do you agree with the phased implementation period (3 years)?
- c. Do you believe that some or all of the required information should remain as RSI after the 3-year implementation period? If so, please explain the basis for your view.

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Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government  
July 11, 2008  
**Staff Draft Exposure Draft– Do Not Circulate**

Introduction

Purpose

- 1. In Statement of Federal Financial Accounting Concepts (SFFAC) 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.<sup>8</sup> The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.
- 2. Objective 3, Stewardship, is the primary focus for this Statement. Objective 3 states that:  
Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>9</sup>
- 3. Sub-objective 3B states that:  
Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>10</sup>
- 4. While federal financial reporting is not expected by itself to accomplish the stewardship reporting objective, it can contribute to meeting the objective.<sup>11</sup> Sub-objective 3B is concerned with the future and with the resources expected to be consumed through programs of the federal government in the future.
- 5. The Board believes that including comprehensive long-term fiscal **projections**<sup>12</sup> and accompanying narrative and graphics in the consolidated financial report of the U.S. Government (CFR) will

<sup>8</sup> SFFAC 1, par. 109.

<sup>9</sup> SFFAC 1, par. 134.

<sup>10</sup> SFFAC 1, par. 139.

<sup>11</sup> SFFAC 1, par. 235.

<sup>12</sup> Terms defined in the Glossary are shown in **bold-face** the first time they appear.

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Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

July 11, 2008

**Staff Draft Exposure Draft– Do Not Circulate**

contribute to meeting the stewardship objective and especially sub-objective 3B. The more detailed objectives presented below were developed as one means of guiding the Board in selecting from a variety of possible summary display formats as well as in identifying the most important areas to be addressed in narrative and/or graphic format.

**Objectives of Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative (“Fiscal Sustainability Reporting”)**

- 6. In this Statement, “**Fiscal Sustainability Reporting**” is the short term for the comprehensive long-term fiscal projections and accompanying narrative and graphics required by this Statement to be provided in the CFR. Fiscal Sustainability Reporting should provide information to assist readers of the CFR in assessing whether future budgetary resources of the U.S. Government will likely be sufficient to sustain public services and to meet obligations as they come due,<sup>13</sup> assuming that current levels of benefits, services, and taxation are continued.<sup>14</sup>
- 7. Assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due is important not only because such an assessment has financial implications but also because it has social and political implications. For example, users of financial reports should be provided with information that is helpful in assessing the likelihood that the government will continue to provide the current level of benefits and services to constituent groups and to assess whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits.<sup>15</sup> Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.
- 8. Fiscal Sustainability Reporting should be understandable to the intended users of the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the

<sup>13</sup> SFFAC 1, par. 139.

<sup>14</sup> Note that fiscal sustainability reporting does not extend to supporting a detailed assessment of whether current levels of benefits, services, and taxation are optimal; rather, it addresses the fiscal outlook if current levels are continued.

<sup>15</sup> The latter notion is sometimes referred to as “interperiod equity.”

Deleted: May 9

Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

July 11, 2008

**Staff Draft Exposure Draft– Do Not Circulate**

media, public interest and advocacy groups, and others). The CFR should be easily understandable to the “average citizen” who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence. Moreover, the CFR is a high-level summary report; it tells users where to find additional information in other reports and publications, for example, reports issued by the Department of the Treasury, the Government Accountability Office (GAO), the Office of Management and Budget (OMB), and the Congressional Budget Office (CBO) and other agencies.<sup>16</sup>

- 9. The Frequently Asked Questions (FAQs) at Appendix C provide a “Plain English” explanation of terms and concepts used in this Statement.

Materiality

- 10. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

- 11. This proposal provides for a phased-in implementation, but earlier implementation is encouraged. Information would be reported as Required Supplementary Information (RSI) for the first three years of implementation (fiscal years 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information would be presented as a basic financial statement and related disclosures.

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<sup>16</sup> See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, paragraphs 6-7 and 15-20.

Accounting Standard

Definitions

12. **Fiscal Imbalance**

The fiscal imbalance is the net **present value** of existing federal debt plus projected spending<sup>17</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period. The fiscal imbalance as of a stated valuation date<sup>18</sup> may be expressed as:

- (a) a summary amount in present value dollars,
- (b) a share of the present value of the **gross domestic product** (GDP)<sup>19</sup> for the projection period, and/or
- (c) a share of the present value of projected receipts or projected spending.<sup>20</sup>

13. **Policy Assumptions**

Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees. Policy assumptions address projected spending rules for both **mandatory** and **discretionary spending** as well as the framework for assessing taxes and fees.

14. **Current Policy**

In this standard, current policy refers to current levels of federal government services and benefits (for example, current reimbursement rates for Medicare and scheduled benefits for Social Security) combined with current levels of taxation and other receipts.<sup>21</sup>

<sup>17</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 on page 58.

<sup>18</sup> See requirement for valuation date in paragraph 32.

<sup>19</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

<sup>20</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

<sup>21</sup> "Current levels" is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to

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15. **Economic Assumptions**

Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

16. **Demographic Assumptions**

Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Scope

17. The reporting requirements in this Statement apply to the consolidated financial report of the U.S. Government. They do not apply to financial statements prepared at the component entity level. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose type of report.

Policy, Economic, and Demographic Assumptions

18. Fiscal Sustainability Reporting for the U.S. Government should provide information that helps the reader to determine whether current policy is likely to produce future budgetary resources sufficient to sustain current levels of public services and to meet obligations as they come due. Long-term projections of current levels of federal benefits and services and current levels of taxes and other revenues should help the reader to understand the implications of current levels of benefits, services, and taxation and other factors such as demographic trends.

19. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions—for example, what if current levels of benefits, services, and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

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Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

July 11, 2008

**Staff Draft Exposure Draft– Do Not Circulate**

- 20. Long-term projections are derived from models that rely heavily on assumptions. There is an expectation that such models will evolve over time. Therefore, this Statement provides guiding principles for making choices among alternative assumptions. The guiding principles address three types of assumptions: policy, economic, and demographic.
- 21. Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees.
- 22. Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).
- 23. Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).
- 24. When combined with policy assumptions, economic, and demographic assumptions determine the level of future projected receipts and spending.
- 25. To illustrate the distinction between policy, economic and demographic assumptions: the Social Security program provides benefits. Assumptions relating to future Social Security eligibility and benefit formulas represent policy assumptions. Assumptions about productivity growth, inflation, and other factors represent economic assumptions. Assumptions about the future population represent demographic assumptions.
- 26. The guiding principle for selecting policy assumptions is to base selections on assumptions consistent with current policies (current levels of federal benefits, services, and taxation). With some exceptions, projections of future receipts and spending should be based upon policy assumptions consistent with current law. However, in **certain** instances a simple assumption of "current law" will not provide an adequate basis for long-term projections under current policies. For example, in some cases current law may expire almost immediately, or not fully support current levels of benefits or services, or produce levels of taxation that are significantly different from current levels of taxation. In these cases, the preparer should use judgment in applying the

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general guidelines presented below for selecting policy assumptions that are consistent with current policies.

27. When a simple assumption of current law does not provide a basis for projections of future receipts and spending that is consistent with current policies, assumptions should reflect “current policies” as defined in this standard.<sup>22</sup> Following are examples:

- (a) Legislation providing for **discretionary spending**<sup>23</sup> provides funding that extends at most a few years into the future. Therefore, assumptions will be required in order to prepare a long-range projection. A current-law policy assumption would show discretionary spending falling to zero within a few years. Such a projection would not be meaningful or useful, since it would not reflect current levels of benefits or services.
- (b) Some provisions of tax law (for example the Alternative Minimum Tax (AMT), which is not indexed) do not provide for future taxation at current levels. Current law would result in the AMT negatively impacting many more taxpayers in the future. A current-law policy assumption would show large increases in future receipts as the AMT eventually impacts 100 percent of taxpayers. Such a projection would not realistically reflect current levels of taxation.
- (c) Current law also may include provisions that have been changed in a consistent direction over a period of time. For example, the statutory limit on federal debt has been consistently raised. A current-law policy assumption would assume that Treasury borrowing will never increase beyond the dollar amount of the current statutory limit. Such an assumption would not support a projection of current levels of benefits, services, or taxation.

<sup>22</sup> See paragraph 14.

<sup>23</sup> In the federal budget process, “discretionary spending” refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not “mandatory.” “Mandatory spending” includes entitlement authority such as Social Security and Medicare and payment of interest on the national debt. Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP. Available at: <http://gaoweb.gao.gov/gaoproducts.php>.

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- 28. In those cases where simple assumptions of current law do not provide a basis for projections that is consistent with “current policies” as defined in this standard, assumption of a uniform growth rate for all types of revenues and spending is not required. Assumptions may be based on, but are not limited to, the notion that spending or revenues are likely to:
  - (a) maintain a constant share of GDP,
  - (b) grow with inflation,<sup>24</sup> or
  - (c) maintain a constant real<sup>25</sup> per capita level<sup>26</sup>
  
- 29. Judgment should be applied in selecting assumptions. Policy assumptions representing the worst case scenario are not required. Rather, the assumptions should be viewed as a whole and individual selections made which result in a reasonable overall projection. The preparer’s objective should be to produce unbiased projections.
  
- 30. The same economic and demographic assumptions should be used for the primary summary display for Fiscal Sustainability Reporting and for Social Security and Medicare in the Statement of Social Insurance.

Changes in Assumptions

- 31. When year-by-year comparisons are displayed, a table presented in the narrative section should disaggregate the changes attributable to:
  - (a) valuation period (for example, the beginning of the projection period is one year later);
  - (b) changes in policies (legislation); and
  - (c) changes in assumptions.

Narrative should explain the reasons for the changes attributable to each of the three categories.

Valuation Date

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<sup>24</sup> Inflation is growth in a general measure of prices, usually expressed as an annual rate of change.  
<sup>25</sup> In economic terms, “real” means adjusted to remove the effects of inflation.  
<sup>26</sup> As applicable, the characteristics of the population should be considered for expenditures that benefit identifiable subgroups.

Deleted: May 9

32. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on (“current year”) as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

Projection Periods

33. Projections in the primary summary display should be for a projection period sufficient to illustrate long-term sustainability.  
(a) If the projection period displayed in the primary summary display is for a finite projection period, the accompanying narrative should display summary totals for an infinite horizon projection period and vice versa.  
(b) If the projection period in the primary summary display is not consistent with the projection period used for Social Security and Medicare in the Statement of Social Insurance (SOSI), the narrative section should display the subtotal and total line items of the primary summary display calculated for the projection period that was used for Social Security and Medicare in the SOSI.<sup>27</sup>

34. Overemphasis on summary measures for a finite projection period, such as a 75-year period, can lead to incorrect perceptions. The accompanying narrative should explain that the trends projected, particularly near the end of the projection period, are important to consider. This Statement also requires information for a time period that extends to the infinite horizon, which provides additional perspective but is subject to much greater uncertainty.

Primary Summary Display

35. This Statement presents the elements that are required to be included in a primary summary display.  
36. An example primary summary display is shown in Appendix B for illustration only.

<sup>27</sup> The SOSI projection period is required to be “sufficient to illustrate long-term sustainability (for example, traditionally the “Social Security” or OASDI, program has used a projection period of 75 years for long-term projections).” See SFFAS 17, paragraph 27.

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- 37. The primary summary display, *Long-Term Fiscal Projections for the U.S. Government*, should state the projection period and display the following projected amounts as both present value dollars and as a percentage of the present value of GDP as of the required valuation date(s) for the projection period indicated:
  - (a) receipts, disaggregated by Medicare, Social Security, and all other revenues, and total receipts;<sup>28</sup>
  - (b) spending, disaggregated by Medicare, Medicaid, Social Security, and all other spending, subtotal of spending before debt held by the public, and total spending plus repayment of debt;<sup>29</sup> and
  - (c) fiscal imbalance (the net amount needed to balance receipts and total spending plus repayment of debt).<sup>30</sup>
  
- 38. The primary summary display should also present
  - (a) fiscal imbalance as a percentage of total projected receipts and as a percentage of total projected spending, and
  - (b) after the initial year of implementation, comparative amounts for the current year and prior year, and the net change for each of the above line items from the prior year.
  
- 39. Additional requirements for narrative and graphics are provided in “Requirements for Narrative, Graphics and Supporting Data,” beginning at paragraph 40.

Requirements for Narrative and Graphics

- 40. Narrative and graphics serve a critical role in making economic concepts and projections understandable to a variety of audience segments, and in helping readers to understand long-term projections by explaining the significant factors that are driving projected trends, by illustrating trends graphically, and by providing context for the information provided.
  
- 41. Narrative should include a “plain English” explanation of present value and interest rates used to calculate present value.

<sup>28</sup> Full payment of amounts due to Social Security and Medicare HI Trust Funds must be shown as revenue for Medicare and Social Security, and outlays for “rest of government.”

<sup>29</sup> See note 28.

<sup>30</sup> A positive fiscal imbalance indicates a shortfall; a negative fiscal imbalance indicates a surplus situation.

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- 42. The narrative should explain that the projections displayed are not forecasts or predictions; they are designed to depict results that may occur under various conditions. The narrative should disclose significant policy assumptions for all scenarios presented. The narrative should explain the most significant departures from current law—for example, if the spending assumptions allow for exceeding the statutory limit on federal debt.
  
- 43. The narrative should include an explanation of the following limitations:
  - (a) Forward-looking projections require assumptions and estimates relating to future events, conditions, and trends; actual results may differ materially from those that are projected.
  - (b) Where indicated, forward-looking projections 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), for which financial projections may be appropriate.
  - (c) Fiscal Sustainability Reporting is limited to the activity of the federal government, and does not include activities of state and local governments. However, the narrative should direct the reader to any recent reports that address the long-term fiscal outlook for state and local governments.<sup>31</sup>
  
- 44. The narrative should explain the significance of the graphics and put the information into context. Options for context may include but are not limited to:
  - (a) comparison of the data/trend with that of other developed nations, and/or
  - (b) where to find information about outside organizations that use similar data to assess the long-term implications for an entity or sovereign government, for example the role of rating organizations and/or European Union rules for member nations.

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<sup>31</sup> For example, the GAO reports *State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge with the Next Decade* (July 18, 2007 GAO-07-1080SP) and *The Nation's Long-Term Fiscal Outlook* August 2007 Update (GAO-07-1261R) address the long-term fiscal outlook for state and local governments.

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45. Narrative and graphics should explain and illustrate a range of possible results in light of the uncertainty inherent in projections and their sensitivity to assumptions. The range need not be based on the most optimistic and most pessimistic sets of assumptions. Instead, the range may present low and high projections based on optimistic and pessimistic assumptions that might reasonably be expected to occur. The range should present the total projected receipts and spending but may also present projections for individual programs. (See Illustration 1a in Appendix B.) The narrative should include a table showing the range for each line item presented on the primary summary display. For variances that would significantly impact the projections, the narrative should identify the major causes of the variances displayed.

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46. Narrative and graphics should explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. For example, two such factors may be (a) the rising cost of health care and (b) demographic trends. Information about how these factors have changed and are expected to change over time is necessary to assist the reader in understanding the factors that influence fiscal imbalances. (See Illustrations 1b and 2 in Appendix B.)

47. Narrative and graphics should explain and illustrate the historical and projected trends for a progression of years beginning at least 20 years before the current year and extending to all projected future years for:

- (a) projected receipts and spending,
- (b) projected deficits, and
- (c) projected Treasury debt as a share of GDP.

(See Illustrations 3, 4, and 5 in Appendix B.)

48. If a fiscal imbalance is indicated by the projections, the narrative section should include a graphic that shows the likely impact of delaying action. Two graphics could display the progressive increase in the change that would be needed to close the fiscal imbalance by (a) reducing noninterest spending and alternatively (b) by increasing receipts. Alternatively, either (a) or (b) could be displayed in a graph and the narrative describe the impact of delay on the item not displayed. (See Illustration 6 in Appendix B.)

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**Supporting Data (Other Accompanying Information)**

49. The quantitative data supporting the primary summary display and the additional narrative and graphics may be provided in or referenced as other accompanying information.<sup>32</sup>

**Effective Date**

50. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2012.

- (a) These standards are effective for periods beginning after September 30, 2009.
- (b) Information should be reported as Required Supplementary Information (RSI) for the first three years of implementation (fiscal years 2010, 2011, and 2012).
- (c) Beginning in fiscal year 2013, the required information should be presented as a basic financial statement and related disclosures.
- (d) Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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<sup>32</sup> For example, a link to a more detailed report such as the President’s Budget, a Congressional Budget Office report, or the Trustees Report (*Status of the Social Security and Medicare Program*) may be provided. Note that the Trustees Report is available at: <http://www.ssa.gov/OACT/TR/>.

**Appendix A: Basis for Conclusions**

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

**Project History**

A1. Many believe that federal financial reports currently do not adequately address the federal financial reporting objective, titled “stewardship,” presented below.

**Objective 3: Stewardship**

Federal financial reporting should assist report users in assessing the impact on the country of the government’s operations and investments for the period and how, as a result, the government’s and the nation’s financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether

- a) the government’s financial position improved or deteriorated over the period,
- b) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- c) government operations have contributed to the nation’s current and future well-being.<sup>33</sup>

A2. In particular, existing reporting may not adequately address sub-objective 3b above. The FASAB considered what information would be most likely to help readers of the CFR to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Ultimately, this may enhance the public’s understanding of long-term fiscal issues.

A3. Discussion of such long-term fiscal issues has been described in terms such as “fiscal sustainability.” In this proposed Statement, the Board’s working definition of “fiscal sustainability” is the federal government’s ability to continue, both now and in the future, to provide

<sup>33</sup>Statement of Federal Financial Accounting Concepts (SFFAC) 1, pars. 134-145, available at <http://www.fasab.gov/codifica.html>.

Deleted: May 9

current levels of benefits and services while maintaining current levels of federal taxation without resulting in debt continuously rising as a share of GDP.<sup>34</sup>

- A4. Throughout this project, the Board considered expert comments from a Fiscal Sustainability Reporting Task Force (“task force”) whose participants have technical knowledge relevant to the issues and/or communications expertise relevant to the challenge of how to effectively communicate complex information on long-term fiscal issues.
- A5. The task force participants included representatives from the American Enterprise Institute, the Cato Institute, the Brookings Institution, and the Urban Institute; the Chief Actuaries for Social Security and Medicare; technical experts from the OMB, the CBO, the Treasury Department, and the GAO; members of Congress; and academics in the areas of public policy and communications.
- A6. FASAB staff also researched existing reporting on comprehensive government-wide long-term projections by other developed, English-speaking countries (for example, the United Kingdom, Australia, New Zealand, and Canada) and conferred with staff of the International Public Sector Accounting Standards Board (IPSASB). The IPSASB is currently undertaking a project with similar objectives.

**Financial Position versus Financial Condition**

- A7. Fiscal Sustainability Reporting is focused on the financial condition of the federal government as a whole. Financial condition is forward-looking and multi-dimensional. Assessing financial condition requires financial and non-financial information related to the long-term fiscal outlook for the federal government. Therefore, Fiscal Sustainability Reporting should provide information about the future to help readers assess the magnitude of future spending and revenues and the burden that any resulting deficits might place on future taxpayers.<sup>35</sup>
- A8. Indicators of financial position, for example, the balance sheet, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. For example, trends in financial position may assist readers in assessing the overall direction of the federal

<sup>34</sup> Determining precisely how much a government can depart—in magnitude and/or duration—from this general notion of fiscal sustainability is beyond the scope of the Board’s efforts.  
<sup>35</sup> SFFAC 1, par. 262.

Deleted: May 9

government’s finances. However, readers may find, among other things, a budget projection under a range of alternative assumptions<sup>36</sup> to be helpful in assessing the financial condition of the U.S. Government. Presenting information about the overall size of the economy relative to the budget projections may assist readers in assessing whether the projected budget amounts are reasonable in comparison to past experience or the experience of other countries. Thus, reporting on financial condition requires financial and nonfinancial information about the national economy and society, as well as about the government itself.<sup>37</sup> Table 1 summarizes the distinguishing characteristics of financial position and financial condition.

**Table 1: Comparison of Financial Position and Financial Condition**

Financial Position	Financial Condition
Entity perspective	Broad perspective including reporting on the nation’s economy and other external trends
Accrual-based data	Additional, forward-based information
Financial data	Financial and nonfinancial data
Assets, liabilities, and net position	Future effects of: <ul style="list-style-type: none"> <li>• current demands, risks, and uncertainties; and</li> <li>• anticipated future events, conditions, and trends</li> </ul>
Example: Balance Sheet	Examples: <ul style="list-style-type: none"> <li>• Projections of revenue, spending, and debt <ul style="list-style-type: none"> <li>• in present value dollars</li> <li>• as a share of GP</li> </ul> </li> <li>• Nonfinancial data, such as demographic trends</li> </ul>

A9. SFFAC 3, *Management’s Discussion and Analysis* (MD&A), addressed many of the elements of financial condition. SFFAC 3 says that the MD&A should answer questions such as the following, to the extent that they are relevant and important for the entity:

What is the potential effect of changed circumstances, and of expected future trends? In other words, to the extent that it is feasible to project

<sup>36</sup> SFFAC 1, par. 145.  
<sup>37</sup> SFFAC 1, par. 144.

Deleted: May 9

the effects of these factors, will future financial position, condition, and results, as reflected in future financial statements, probably be different from this year's and, if yes, why? (Any such discussion should acknowledge that the future is unpredictable and will be influenced by factors outside the reporting entity's control, including actions by Congress.)<sup>38</sup>

**Existing Required Sustainability Reporting**

A10. Existing reports provide relevant information regarding fiscal sustainability. Annual financial reports—both from individual agencies and the CFR—provide forward-looking information and extensive sustainability information regarding social insurance programs such as Social Security and Medicare. Central agencies such as the GAO, OMB, and CBO provide projections of receipts and outlays based on various policy assumptions. However, the Board believes that establishing requirements for a basic financial statement and accompanying narrative and graphics will ensure that the information is included in the annual CFR and that it presents projections based on current policies.

A11. While many of the proposals included in this exposure draft were voluntarily adopted in the fiscal year 2007 CFR and the recent summary report, *The Federal Government's Financial Health: A Citizen's Guide to the 2007 Financial Report of the United States Government*, voluntary adoption is not a guarantee of continued reporting. Some of the existing information sources are described below to aid respondents in evaluating the changes required by this proposal.

Management's Discussion and Analysis (MD&A)

A12. Current reporting requirements for the U.S. Government's long-term fiscal outlook are contained in paragraphs 3 and 6 of Statement of Federal Financial Accounting Standards (SFFAS) 15, *Management's Discussion and Analysis*, as follows:

[3] MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the

<sup>38</sup> SFFAC 3, par. 14.

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possible effects of anticipated future demands, events, conditions, and trends.<sup>3</sup> Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

<sup>3</sup>The word "anticipated" is used in a broad, generic sense in this document. In this context the term may encompass both "probable" losses arising from events that have occurred, which should be recognized on the face of the basic or "principal" financial statements, as well as "reasonably possible" losses arising from events that have occurred, which should be disclosed in notes to those statements. "Anticipated" may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label "projected" or "projection," and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity's financial statements; however, preparers and auditors may find useful background information in the AICPA's Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, "Financial Forecasts and Projections," of the AICPA's *Codification of Statements on Standards for Attestation Engagements*.

[6] MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the general purpose Federal financial report (GPFFR) as a source of information. (The specific topics mentioned in *Concepts for Management's Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- lead to significant actions or proposals by top management of the reporting unit;
- be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or
- significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.

A13. The FASAB elaborated on the above requirements in its companion concept statement, SFFAC 3, Management's Discussion and Analysis,

Deleted: May 9

which explains the Board’s expectations regarding the description of future effects of both existing and anticipated events, conditions, and trends.<sup>39</sup>

Statement of Social Insurance (SOSI)

A14. The Statement of Social Insurance is based on projections of future scheduled expenditures and future revenues for the major social insurance programs: Federal Old-Age, Survivors and Disability Insurance (Social Security), Medicare Parts A, B, and D, Railroad Retirement benefits, and Black Lung benefits.

A15. For the social insurance programs listed in the preceding paragraph, the SOSI presents the actuarial present value for the projection period of:  
(a) all future contributions and tax income (excluding interest) received from or on behalf of all current and future participants,  
(b) estimated future schedule benefits to be paid to or on behalf of current and future participants, and  
(c) the estimated future excess of future benefit payments over future contributions (or excess of future contributions over future benefit payments).

A16. The SOSI (the information required by paragraphs 27(3) and 32(3) of SFFAS 17) is presented as a basic financial statement, and the underlying significant assumptions are included in notes that are presented as an integral part of the basic financial statements.<sup>40</sup> The basic (or principal)<sup>41</sup> financial statements and notes are those on which the auditor expresses an opinion as to whether the information is presented in conformity with generally accepted accounting principles (GAAP). For fiscal year 2007, for the first time, the GAO issued an unqualified or “clean” opinion on the SOSI.

A17. The SOSI is accompanied by RSI that provides the following information:  
(a) the projected annual cash flows—both inflows and outflows—in nominal dollars for at least every fifth year in the projection period,  
(b) the relationship of the total cash outflow and net receipts<sup>42</sup> to taxable

<sup>39</sup> See SFFAC 3, paragraphs 31-36.

<sup>40</sup> See SFFAS 26, paragraphs 5-6.

<sup>41</sup> The terms “basic financial statements” and “principal financial statements” have been used synonymously in federal accounting. See SFFAS 25, paragraph 34.

<sup>42</sup> Net receipts are cash inflows from all sources less net interest on intragovernmental borrowing/lending.

Deleted: May 9

payroll and GDP, and  
(c) sensitivity analysis for the most significant individual assumptions.

A18. The SOSI, notes, and related RSI are program specific. No government-wide projections are provided. While social insurance programs are presently a significant part of an assessment of fiscal sustainability, the Board believes that the context provided by government-wide projections is essential to meeting fiscal sustainability reporting objectives.

*The Trustees of the Social Security and Medicare Trust Funds*

A19. The two largest programs reported in the SOSI are Social Security and Medicare. Each year, the Trustees of the Social Security and Medicare trust funds report on the current and projected financial status of the two programs. There are six trustees: the Secretaries of the Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration, and two public trustees who are generally appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties.

A20. The annual Trustees report addresses the trust funds that Congress established in the U.S. Treasury to account for all program income and disbursements. Social Security and Medicare taxes, premiums, and other income are credited to the funds. Disbursements from the funds can be made only to pay benefits and program administrative costs.

A21. The Department of the Treasury invests program revenues not needed in the current year to pay benefits and administrative costs in special nonmarketable securities of the U.S. Government on which a market rate of interest is credited. Thus, the trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

A22. The annual reports provide short-range (10-year) and long-range (75-year) projections for all Social Security and Medicare funds. Estimates are based on current law and assumptions about factors that affect the income and outflow of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services.

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A23. Because the future is inherently uncertain, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions reflect the Trustees' best estimate of future experience. The low-cost alternative is more optimistic for trust fund financing, and the high-cost alternative is more pessimistic; they show trust fund projections for more and less favorable economic and demographic conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. The statistics and analysis presented in the Summary of the annual Trustees' Reports for Social Security and Medicare are based on the intermediate assumptions.<sup>43</sup>

What would this proposal add to existing reporting?

A24. This proposal adds to existing reporting in the CFR by proposing requirements for:

- (a) a primary summary display of comprehensive long-term projections for all federal government receipts and spending, and
- (b) narrative and graphics that will help readers to understand the long-term projections, for example, by explaining the significant factors that are driving projected trends, illustrating trends graphically, and providing context for the information provided.

**Assumptions**

Limitations of "Current Law" Assumptions

A25. Projections are the central feature of Fiscal Sustainability Reporting and require that assumptions be made. The Board believes that the most useful projections will reflect current levels of spending and taxation.

A26. Although current law is a reasonable starting point in selecting policy assumptions, a simple projection of "current law" would not always reflect current levels of benefits, services, or taxation. The Board's proposal includes central guidance in selecting policy assumptions but acknowledges the role of judgment in filling voids in current law or

<sup>43</sup> A Summary of the 2007 Annual Reports, Social Security and Medicare Boards of Trustees, pages 3-6. Available at: <http://www.ssa.gov/OACT/TRSUM/trsummary.html>.

Deleted: May 9

departing from current law provisions.

A27. Major provisions of current law often do not extend far into the future to be used as a basis for a long-range projection. Discretionary spending is primarily based upon annual appropriation acts, and even some mandatory spending (see note 23) programs are subject to authorizing legislation that expires in the near future. For example, the legislation authorizing several mandatory programs (for example, Food Stamps, student assistance for higher education, and agricultural price supports) expires and would require legislative action for the programs to continue past the expiration date.

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A28. Current law may contain a provision that restricts spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare Trust Funds, respectively, plus inflows of **earmarked revenues**. However, current law does not provide for any specific reductions in Social Security scheduled benefits or Medicare reimbursement rates that would occur due to lack of funding. Thus, current law does not address what will happen when the trust fund balances are exhausted, although this event may reasonably be expected to occur.<sup>44</sup>

A29. Current law also may include tax provisions (for example, tax cuts) that expire within several years, along with a historical trend of extending those tax provisions before they expire—but only for a short period, generally one year. In such situations, current law would indicate that the tax provisions will expire on schedule, while a projection based upon current levels of taxation, and reasonable expectations based on recent historical trends, may indicate that the tax provisions will be extended.

Fiscal Sustainability Task Force Input Regarding Policy Assumptions

A30. A majority of the task force technical experts agreed that policy assumptions for the primary summary display that are consistent with current levels of federal benefits, services, and taxation would be useful

<sup>44</sup> According to the 2007 Trustees Reports, the Social Security Trust Fund is expected to be exhausted in 2041, and Medicare's Hospital Insurance Trust Fund is expected to be exhausted in 2019. For the first time, a "Medicare funding warning" was triggered in 2007, signaling that non-dedicated sources of revenues—primarily general revenues—will soon account for more than 45 percent of Medicare's outlays. By law, this warning requires that the President propose, and Congress consider, remedial action. However, until remedial action is taken, it is difficult to determine how to project future spending for Medicare. A similar situation exists for Social Security, although the amounts are smaller and the expected date for trust fund exhaustion is much further in the future.

Deleted: May 9

for readers of the CFR in assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

A31. A majority of the task force technical experts believe that for mandatory spending on social insurance programs, a modified version of current law (ignoring the exhaustion of the Social Security and Medicare Hospital Insurance Trust Funds—see paragraph A28), which might also be termed “current services,” represents the most useful assumption for projecting spending for social insurance programs. However, a minority believe that any deviation from current law requires a subjective judgment that can be biased.

A32. The technical experts also acknowledged that projections for discretionary spending are more uncertain than projections for mandatory spending, since current law often only addresses the next one or two years. However, there was some agreement among the group that projecting discretionary spending growth at the same rate as assumed GDP per capita would be an example of a reasonable option for some programs.

A33. A recent report issued by the GAO<sup>45</sup> illustrates the tension between choosing current law versus current level of services and taxes. The report’s primary display contains two different projections in a single graphic presentation: the 10-year CBO baseline, which is then projected into the future (called “baseline extended”) and a different projection (called an “alternative simulation”), which includes modifications that are described in the narrative. The “baseline extended” projection is based on assumptions that focus on current law. Those assumptions are changed in the GAO’s “alternative simulation” to reflect historical trends and recent policy preferences.

A34. The GAO’s approach of showing two different sets of numbers provides a more complete picture than selecting one or the other. However, this approach does not achieve one of the most important characteristics of effective communication. All of the communications experts and many of the technical experts on the task force strongly emphasized the importance of simplicity of presentation. The Board noted that one of the greatest challenges inherent in Fiscal Sustainability Reporting is the tension between technical rigor and simplicity of presentation.

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<sup>45</sup> *The Nation’s Long-Term Fiscal Outlook* August 2007 Update (GAO-07-1261R).

A35. The term “current policy” as defined in this Statement is not intended to be used as the title for any display, but rather as an abbreviated term to assist the overall readability of this exposure draft. An abbreviated term is useful, particularly in sentences where the term “current levels of benefits, services, and taxation” would make the sentence difficult to read and understand.

A36. A majority of the technical experts agreed with the substance of the proposed guidance in the ED—that the primary summary display should present current levels of spending and taxation<sup>46</sup>—but noted that it is difficult to coin a term to refer to this concept without implying something else. A majority of the technical experts recommended the term “modified current law” as being preferable to the term “current policy.” However, the Board believes that substituting the term “modified current law” for “current policy” throughout the exposure draft would make many sentences unclear or misleading, because the emphasis on continuing current levels of benefits, services, and taxation would be unclear.

Basis for the Board’s Proposal Regarding Policy Assumptions

A37. The Board believes that the most useful reporting on fiscal sustainability would illustrate the long-term effects of current levels of benefits or services and tax revenues. However, there are numerous ways of projecting current levels into the future. For example, it could be assumed that discretionary spending will continue as a constant share of GDP. Another alternative would be to assume constant real spending per capita (which could give a different result from assuming growth at a constant share of GDP). Yet another alternative would be to assume constant growth at the rate of inflation, which may be different than the growth of GDP.<sup>47</sup> (Historically, nondefense discretionary spending has grown roughly with GDP while defense discretionary spending has grown slightly faster than inflation but less than GDP, often in a nonlinear pattern.)

<sup>46</sup> “Current levels” as defined in this proposed Statement is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

<sup>47</sup> For example, the CBO projects that the rate of inflation will be lower than the rate of GDP growth for 2007-2017. See page xi, *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007). Available at: <http://www.cbo.gov>.

Deleted: May 9

A38. The Board believes that the details of the assumptions for projecting “current level of service” or “current level of taxation” should be left to the judgment of the preparer and auditor. Regardless of which assumptions are used for a primary presentation, the narrative should include an explanation of the assumptions used and alternative scenarios. Readers will have access to important explanatory material.

A39. Current law may not address events that may reasonably be expected to occur (for example the exhaustion of the Medicare Hospital Insurance Trust Fund). As noted previously, although current law limits spending to the amounts available in the trust funds and current earmarked revenue, current law does not provide for any specific reductions in benefit payments or reimbursement rates due to lack of funds. Thus, current law is inconsistent and does not provide an answer.

A40. When current law is inconsistent, the Board believes that in selecting assumptions, the projections should indicate current levels of government benefits, services, and taxation, and should answer the question “what if current levels were continued over time?” The resulting projection should be accompanied by a narrative that explains what would happen if an alternative event occurs (in the example in paragraph A39, the narrative would explain what percentage of Medicare reimbursements could not be paid if legislation does not provide for maintaining current levels).

Economic and Demographic Assumptions

A41. Economic and demographic assumptions are somewhat broader in scope than policy assumptions, since they include such factors as population demographics and economic growth. The elements of economic and demographic assumptions are generally influenced more by a variety of external factors than by direct legislative impact.

A42. There was no consensus from the task force technical experts for economic and demographic projections, although none objected strongly to either CBO, OMB, or the economic and demographic assumptions currently used for the Social Security and Medicare portions of the Statement of Social Insurance (SOSI).

A43. Table 2 displays representative elements of CBO and OMB assumptions, with a comparison with the assumptions currently used for

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Social Security and Medicare in the Statement of Social Insurance.

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Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government  
July 11, 2008  
**Staff Draft Exposure Draft– Do Not Circulate**

Table 2: Major Elements of CBO and OMB Economic and Demographic Assumptions, Compared with Assumptions used in the Statement of Social Insurance (SOSI)

	CBO Baseline (2007-2017)	OMB Stewardship Reporting	SOSI assumptions for Social Security and Medicare
<b>Economic/Demographic Assumptions:</b>			
Consumer Price Index inflation	2.5% in 2007; average 2.2% per year for 2008-2017	2007-2017: Administration projections used for the budget, constant thereafter <sup>48</sup>	Intermediate Trustees Reports assumption: 2.8%
Population demographics (birth/death/immigration)	Intermediate Trustees reports assumptions	2007-2017: Administration projections used for the budget, Intermediate Trustees Reports assumptions thereafter	Intermediate Trustees Reports assumptions
Real GDP growth <sup>49</sup>	Average 2009-2012: 2.9% 2013-2017: 2.5%	2007-2017: Administration productivity projections used for the budget period, constant thereafter at 2.3%, with Trustees Intermediate assumptions for labor force growth	Intermediate Trustees Reports assumption: 1.7%

Sources:  
 CBO Baseline: *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007). Available at: <http://www.cbo.gov>.  
 OMB Stewardship Reporting: Chapter 13, "Stewardship" of *Analytical Perspectives*, U.S. Budget, FY 2008.  
 SOSI/FR: FY 2006 Financial Report of the U.S. Government.

<sup>48</sup> After that, projected holding constant inflation, interest rates, and unemployment at the levels assessed for 2017. Details of OMB projections:  
 Real GDP growth: average 3% for 2008-2012 (3.1% in 2008, declining to 2.9% in 2012)  
 CPI inflation: average 2.42% for 2008-2012 (2.6% in 2008, declining to 2.3% in 2012)

<sup>49</sup> There are two major components of projections for real GDP growth: productivity (real GDP per capita) and labor supply. While productivity growth is typically assumed to be constant, labor force growth varies over time with the demographic assumptions.

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A44. One of the technical experts noted that there are several advantages to using the economic and demographic assumptions used for Social Security and Medicare in the preparation of the SOSI:

- Since the SOSI is now a basic financial statement, auditors are bound by generally accepted government auditing standards to examine and assess the reasonableness of the assumptions. Since the SOSI is generally derived from the Trustees Report, the result is that the assumptions used in the Medicare and Social Security Trustees Reports are subject to audit.
- In contrast, the CBO and OMB economic and demographic assumptions are not subject to audit.
- If the economic and demographic assumptions used for Social Security and Medicare in the preparation of the SOSI are used, there would be consistency between the economic and demographic assumptions used for the SOSI and for the Fiscal Sustainability Reporting.

A45. Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, does not prescribe specific economic or demographic assumptions for Social Security and Medicare in the SOSI. Accordingly, the Board concurred that the reporting requirements for Fiscal Sustainability Reporting should not dictate specific economic and demographic assumptions, but should require that the primary displays for Fiscal Sustainability Reporting should use economic and demographic assumptions that are consistent with the economic and demographic assumptions for Social Security and Medicare in the SOSI. In addition, the narrative should include information about how different assumptions would impact the projections.

**International Perspective**

A46. Other nations have issued reports addressing “fiscal sustainability.” While a precise definition has not been developed, countries generally describe fiscal sustainability in a manner consistent with the following:  
Fiscal sustainability is the government’s ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.<sup>50</sup>

<sup>50</sup> Australia, Intergenerational Report 2002-3, page 2. Available at: [http://www.budget.gov.au/2002-03/bp5/html/02\\_BP5Overview.html#P23\\_3643](http://www.budget.gov.au/2002-03/bp5/html/02_BP5Overview.html#P23_3643)

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**Primary Summary Display**

A47. The primary summary display is a financial statement presenting present value amounts in dollars as well as in relation to the present value of GDP for the projection period. The primary summary display will be presented as RSI for a period of three years and will then become a basic financial statement.

A48. Elements considered for inclusion as mandatory requirements for the primary summary display were:

- (a) total projected spending and receipts,
- (b) the total of all projected receipts and spending (including debt held by the public) presented as the fiscal imbalance,
- (c) amounts displayed as both (present value) dollars and percent of GDP,
- (d) fiscal imbalance as a percent of total projected receipts and total projected spending,
- (e) year-to-year (for example, side-by-side) comparison with prior year,
- (f) net change from year-to-year as a separate column
- (g) disaggregation of major programs funded by earmarked funds (Social Security and Medicare Part A), and
- (h) range information.

A49. A majority of the members decided that (a) through (f) above should be included as minimum requirements for the primary summary display, with the format of the elements left to the discretion of the preparer. An illustrative statement is included in Appendix B.

A50. The Board concluded that disaggregation beyond the categories of Social Security and Medicare for receipts and Social Security, Medicare, and Medicaid for spending would be left to the discretion of the preparer. In addition, the Board decided to require narrative and graphics regarding the possible range of outcomes but not to require presentation of the range on the face of the primary summary display. Such additional items of information can be added by the preparer but are not required.

**Per Capita Measures**

A51. The Board considered whether to include per capita measures in the summary display. The technical experts serving on the Fiscal Sustainability Task Force did not come to agreement regarding the display of summary numbers on a per capita, per worker, and/or per household

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basis.

A52. A majority of the technical experts on the task force recommended against per capita measures, for the following reasons:

- (a) Several technical experts strongly objected to the use of per capita summary numbers using current-year population for the denominator. They said that such measures would imply that the current-year population is solely responsible for funding program shortfalls into the distant future. They believe that any changes needed to address the shortfalls projected through, for example, the next 75 years, should be spread across the population throughout that 75-year period.
- (b) Other technical experts noted that per capita measures may be useful in conveying the magnitude of projected fiscal imbalances and could be displayed if summary amounts are divided by the population that parallels the horizon indicated and a narrative is included that explains present value and the nature of the numerator and denominator.
- (c) Per capita measures for infinite-horizon projection periods present special problems. It is uncertain how a reasonable per capita denominator for an infinite horizon ratio would be selected and explained, especially if the denominator includes an estimate of all individuals that enter the population during the projection period.
- (d) Two technical experts believe that even present value per capita amounts can be misinterpreted, because the reader will compare the amount with current salary levels and not understand the role of potential future productivity increases.
- (e) One technical expert objects to per capita amounts because they represent amounts distributed equally among individuals with widely different abilities to pay.

A53. After a discussion of the above issues, the Board decided not to include per capita measures in the proposed reporting requirements.

Time Horizon for Projections

A54. There was strong disagreement among the task force participants regarding the selection of a time horizon for projections, in particular a finite horizon (for example, 75-year) versus an infinite horizon. One task force participant believes that only infinite-horizon projections should be displayed but others believe that infinite-horizon projections should not be

Deleted: May 9

shown. Some participants suggested that information using both finite and infinite-horizon projections be included.

A55. A majority of the communications experts believe that information for both finite and infinite-horizon projections should be provided to readers, but not necessarily both within a primary display.

A56. Below are arguments for the finite and infinite-horizon projection periods for the primary summary display that the Board discussed.

A57. Arguments in favor of a finite horizon:

- (a) A finite period would be sufficient to cover essentially all of the working and retirement years for current participants.
- (b) A finite period is subject to less uncertainty than an infinite horizon.
- (c) A finite period is meaningful to readers. For example, readers can relate to a time period that will include the retirement of the youngest members of the current workforce. An infinite horizon is less meaningful to readers. Readers are less likely to relate to or be concerned about the U.S. Government’s fiscal condition in 200, 500 or 1,000 years in the future.
- (d) Infinite-horizon projections are no more informative to policymakers than 75-year projections, in part because projections beyond the 75-year horizon are subject to huge uncertainty. A more detailed version of this argument is made in an article in the National Tax Journal:  
 ...many people already believe that the 75–year horizon is too distant to be meaningful, and that detailed projections over longer horizons suggest a false precision. A simpler projection assumption is that after 75 years (or some other interval, T), the system will have settled into a steady state in which rates of growth of costs and tax revenues are thereafter constant, although not necessarily equal.<sup>51</sup>

A58. Arguments in favor of an infinite horizon:

- (a) Unless trends are level towards the end of the period, projections may be subject to the “moving window” effect, where shortfalls (or surpluses) increase significantly from one reporting year to the next due to the change in the projection period. For example, if a projection period is 75 years, the activity in “year 76” is outside the projection period for that year, but will be included in the projection period for the following year. An infinite horizon would avoid the “moving window”

<sup>51</sup> *Sustainable Social Security- What Would It Cost?* National Tax Journal, Vol. LVI, No. 1, Part 1, March 2003, page 34. Available at [http://ntj.tax.org/wwtax/ntjrec.nsf/5DC000487120304885256D8E0054C858/\\$FILE/Lee.pdf](http://ntj.tax.org/wwtax/ntjrec.nsf/5DC000487120304885256D8E0054C858/$FILE/Lee.pdf)

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effect that occurs when there are significant changes to an estimate from one year to the next that are caused by the passage of time.

- (b) Some have argued that a finite projection period essentially assumes zero for years beyond the projection period. Infinite-horizon projections would not assume zero for years beyond the cutoff point for projections.

A59. The Board believes that the advantages of both finite and infinite horizons are sufficiently compelling that both finite and infinite-horizon information should be provided, although only one projection period should be used for the primary summary display. Whichever type of projection period is selected for the primary display, the other type of projection period should be presented with the required narrative and graphics.

A60. The Board also believes that one of the projection periods used (in either the primary summary display or the narrative section) should be consistent with that used for the SOSI. This will ensure consistency between major line items in the SOSI (for example, projected earmarked receipts and spending for Social Security and Medicare) and corresponding line items in the primary summary display or the required narrative.

The Concept of Fiscal Imbalance

A61. The Board considered two potential “bottom line” measures for the primary summary display: fiscal imbalance and fiscal gap.

(a) The fiscal imbalance is the net present value of existing federal debt plus projected spending,<sup>52</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period.

(b) The fiscal gap is the change in spending or revenue that would be necessary to maintain federal debt as a constant percentage of GDP.

A62. Several of the Task Force technical experts believe that the fiscal imbalance, as defined above, overstates the size of the problem over any finite time period such as 75 years. The fiscal imbalance is defined as the

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<sup>52</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 in Appendix C of the draft ED.

Deleted: May 9

existing federal debt plus projected spending less projected receipts. If projected receipts are large enough to set the fiscal imbalance to zero after 75 years (or any other fixed time period), this would imply the debt was paid off at the end of the period. That is not necessary for continued solvency provided the economy is expected to last longer than 75 years. A positive level of debt is fiscally acceptable at the end of the projection period, provided it is not too large or growing too fast.

A63. A different measure, often called the fiscal gap, allows for a positive level of debt at the end of the forecast horizon, but it generally sets a limit arbitrarily on how large that debt should be relative to the economy, and shows how increases in receipts (or cuts in spending) would be needed to achieve that target.

A64. Any measure that provides for a positive level of debt at the end of the projection period would also need to state a limit as to the size and growth rate of the debt. In the United States, there is currently no legislated goal for debt as a share of GDP or a legislated limit on borrowing other than the statutory debt limit, which historically has been frequently raised. Since the Board has no objective basis for selecting a debt-to-GDP limit or goal, the Board selected the "fiscal imbalance" concept rather than the fiscal gap concept for the primary summary display.

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Appendix B: Example Formats and Illustrations

The examples in this Appendix are illustrative only; they do not represent authoritative guidance.

**Primary Summary Display  
Long-Term Fiscal Projections for the U.S. Government**

Long-Term Fiscal Projections for the U.S. Government  
Amounts projected to 75 years

	<u>As of January 1, 2008 (Current Year)</u>		<u>As of January 1, 20XX (Prior Year)</u>		<u>Change from Prior Year</u>	
	<u>PV Dollars</u>	<u>% GDP*</u>	<u>PV Dollars</u>	<u>% GDP*</u>	<u>PV Dollars</u>	<u>% GDP*</u>
	<u>(in trillions)</u>		<u>(in trillions)</u>		<u>(in trillions)</u>	
<b>Receipts</b>						
Medicare	\$ 10.7	1.5%	\$ XX.X	X.X%	\$ X.X	X.X%
Social Security	36.3	5.1%	XX.X	X.X%	X.X	X.X%
All Other Receipts	91.0	12.8%	XX.X	X.X%	X.X	X.X%
<b>Total Receipts</b>	<b>\$ 137.9</b>	<b>19.4%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>
<b>Spending</b>						
Medicare	\$ 44.8	6.3%	\$ XX.X	X.X%	\$ X.X	X.X%
Medicaid	15.6	2.2%	XX.X	X.X%	X.X	X.X%
Social Security	40.5	5.7%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	73.9	10.4%	XX.X	X.X%	X.X	X.X%
<b>Subtotal- Spending</b>	<b>\$ 174.9</b>	<b>24.6%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>
Add: Debt Held by the Public	5.0	.7%	X.X	X.X%	X.X	X.X%
<b>Total Projected Spending plus Repayment of Debt</b>	<b>\$ 179.9</b>	<b>25.3%</b>	<b>\$ XX.X</b>	<b>XX.X%</b>	<b>\$ XX.X</b>	<b>XX.X%</b>
<b>Fiscal Imbalance***</b>	<b>\$ 41.9</b>	<b>5.9%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>

	As of January 1, 2008 (Current Year)	As of January 1, 20XX (Prior Year)	Change from Prior Year
Fiscal Imbalance as a percentage of projected receipts	30.9%	XX.X%	X.X%
Fiscal Imbalance as a percentage of projected spending	23.9%	XX.X%	X.X%

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Note: Amounts are estimated based upon guidance for selecting assumptions provided in this Statement. Receipts and spending include repayment of Social Security Trust Fund (estimated 0.3 percent of GDP). Fiscal imbalance is calculated as a percentage of projected receipts and spending net of intragovernmental receipts and spending estimated at 0.3 percent of GDP.

Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government  
**July 11, 2008**

**Staff Draft Exposure Draft– Do Not Circulate**

**Descriptions of the following columns/line items should appear directly below the primary summary display:**

\* GDP (Gross domestic product) can be roughly defined as all of the nation's income or everything the country produces.

\*\* Rest of government: The repayment of borrowings from the Social Security and Medicare Trust Funds should be included in Receipts for Social Security and Medicare, and Outlays for Rest of government. (If material, these amounts should be displayed on separate sublines.)

\*\*\* The fiscal imbalance is the amount of present value dollars that would be necessary to balance future outlays and receipts and repay existing debt.

Analysis of changes

Paragraph 38 provides that after the initial year of implementation, comparative amounts for the current year and prior year, and the net change for each line item of the primary summary display be provided. Paragraph 31 requires that when year-by-year comparisons are displayed, a table disaggregate the changes from one year to the next attributable to:

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- (a) Valuation period
- (b) Changes in policies (legislation), and
- (c) Changes in assumptions.

The following illustrates how such a table might be displayed. The analysis could be displayed on the face of the primary summary display or in the narrative section.

Analysis of change in fiscal imbalance

	PV Dollars (in trillions)	% GDP
Fiscal Imbalance, Prior Year	\$ XX.X	X.X%
Valuation period	X.X	X.X
Legislation	X.X	X.X
Changes in assumptions	X.X	X.X
Fiscal Imbalance, Current Year	\$ XX.X	X.X%

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In addition, paragraph 31 requires that narrative explain the reasons for the changes attributable to each of the three categories above.

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Accompanying Narrative and Graphics

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The following illustrations display and/or describe narrative and graphics that might supplement the primary summary display in a manner consistent with the standard.<sup>53</sup>

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As noted on page 46, these illustrations are illustrative only and do not represent authoritative guidance. Illustrations are not provided for all requirements. The requirements for narrative and graphics are in paragraphs 31 and 40- 48.

1. Rising Cost of Health Care

Paragraph 45 provides that ranges may optionally be displayed for individual programs. For example, if the rising cost of federal spending on health care is a major factor in the long-term spending projections, the narrative section accompanying the primary summary display might include the following;

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- (a) If the growth in health care costs exceeds the growth in GDP, the narrative might explain that the growth in any spending program cannot continue indefinitely to exceed the growth in the economy, because at some point, the costs would exceed the resources that can be extracted from the economy.
- (b) A range encompassing alternative scenarios (for example, baseline, high, and low estimates) along with a potential “most likely” trajectory if different from “intermediate,” might be presented in a graphic as a percentage of GDP. The graphic could use the example format in Illustration1a.

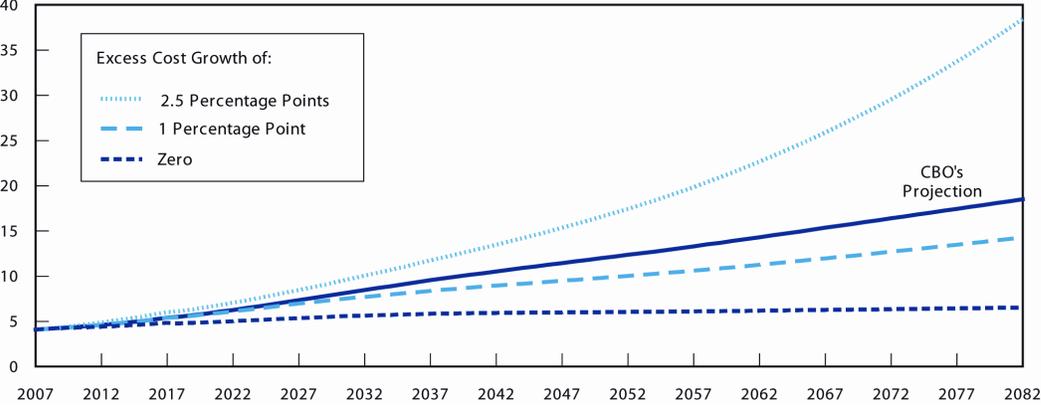
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<sup>53</sup> See paragraphs 40-48 of this standard.

Illustration 1a: Range of Alternative Assumptions Graphic

Federal Spending for Medicare and Medicaid as a Percentage of Gross Domestic Product Under Different Assumptions About Excess Cost Growth



Source: Congressional Budget Office, *The Long-Term Outlook for Health Care Spending* (November 2007) Figure 5, page 15. Available at: <http://www.cbo.gov/>.

A narrative might describe the assumptions involved in the low, intermediate, and high projections, and if applicable a fourth, "most likely" projection.

In addition, a graphic might display the relative contribution of two or more major cost drivers. For example, Illustration 1b displays the effect of the aging of the population on federal spending on Medicare and Medicaid versus excess cost growth.<sup>54</sup>

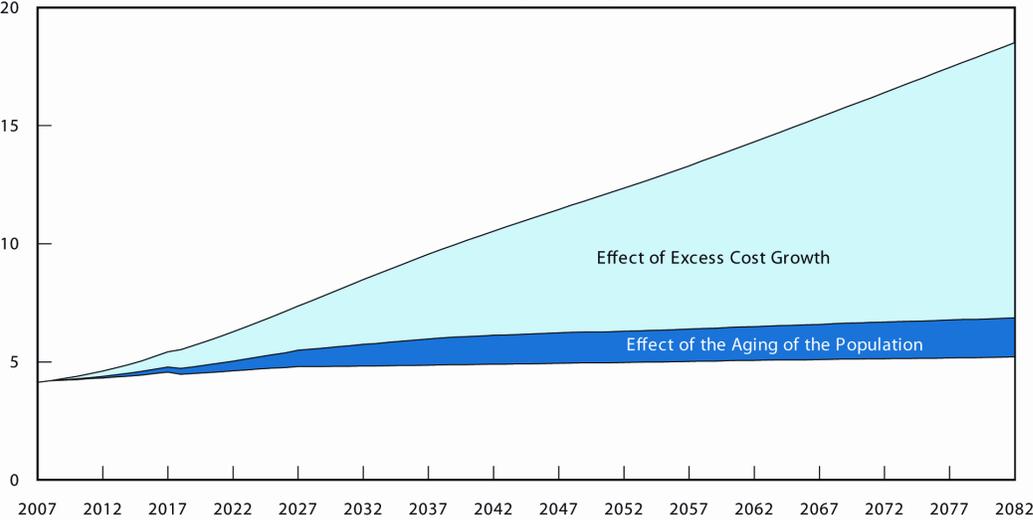
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<sup>54</sup> Excess cost growth refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

Illustration 1b: Relative Contribution of Two Major Cost Drivers

Sources of Growth in Projected Federal Spending on Medicare and Medicaid



Source: Congressional Budget Office, *Op. Cit.*, page 14.

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 July 11, 2008  
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## 2. Demographic Trends

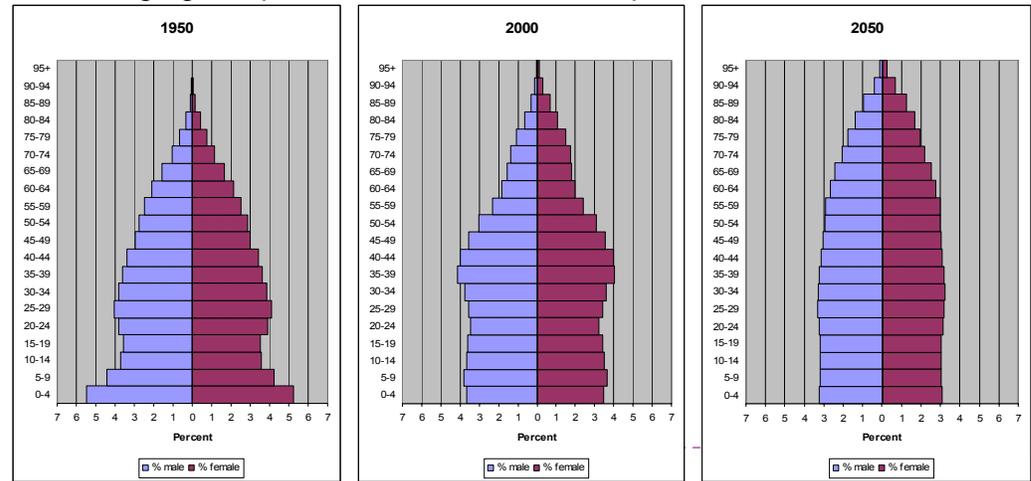
Paragraph 46 requires that narrative and graphics explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. The narrative might describe demographic trends and briefly explain the major drivers of change in demographic trends, for example, trends in longevity and birth rates, and refer the reader to more extensive coverage of the topic in other existing reports, for example, the Social Security and Medicare Trustees Reports. The narrative could describe the change in the ratio of workers to retirees and how this change relates to long-term fiscal outlook for social insurance programs.

A simple graphic to accompany and illustrate the narrative may follow the format of the example shown below. The illustrative sample format below is called an “age/gender pyramid.” The graphic could display two or three age/gender pyramids side-by-side, for example:

- (1) the current (or other baseline) year minus at least 50 years;
- (2) the current year (or other baseline year, for example, 2000); and
- (3) a projection of the current (or other baseline) year plus at least 50 years.

Illustration 2: Age-Gender Pyramid

### The Changing Shape of the United States’ Population



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Source: Social Security Administration, Area Population Statistics.

Alternatively, simple age demographics rather than workforce participation could be used (i.e., “over 64 instead of “retired”) provided that they are used consistently.<sup>55</sup>

The narrative could also discuss the “total dependency” ratio (dependent children plus retirees per worker) for each “worker-to-retiree” ratio that is provided in the narrative.

The narrative also could provide perspective by explaining that similar demographic trends are occurring in other developed countries, and provide examples of developed nation(s) projected to have a greater number of retirees per worker than the United States, and developed nation(s) projected to have fewer retirees per worker.

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<sup>55</sup> The European Commission defines the total dependency ratio as the “Population under 15 and over 64 as a percentage of the population aged 15-64.” *European Economy: Special Report 1/2006*, page 313.

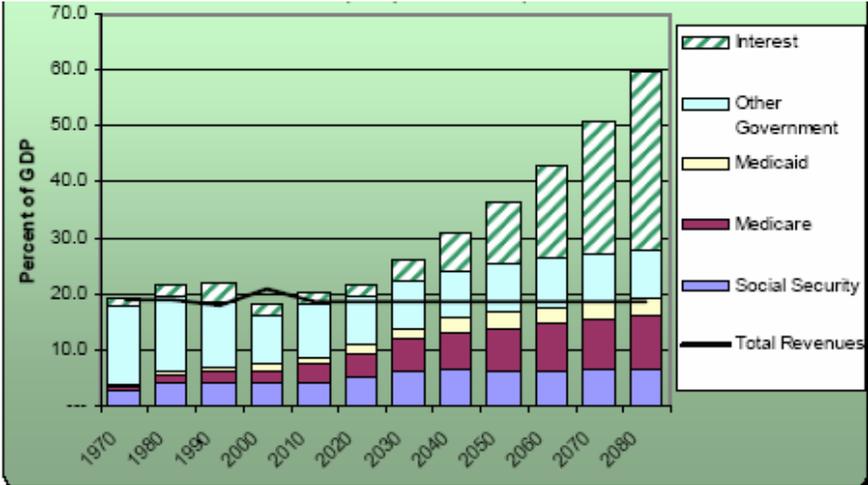
Paragraph 47(a)-(c) requires that narrative ad graphics explain and illustrate the historical and projected trends for a progression of years. Illustrations 3, 4 and 5 display how this might be accomplished.

### 3. Relationship of Projected Receipts and Spending

The narrative section could include a graphic of the relationship between projected receipts and spending for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year.

Below is an example.

**Projected U.S. Government Receipts and Spending**  
(As a percent of GDP)



Source: FY 2007 *Financial Report of the U.S. Government*, Chart H, page 18. Available at <http://fms.treas.gov/fr/index.html>.

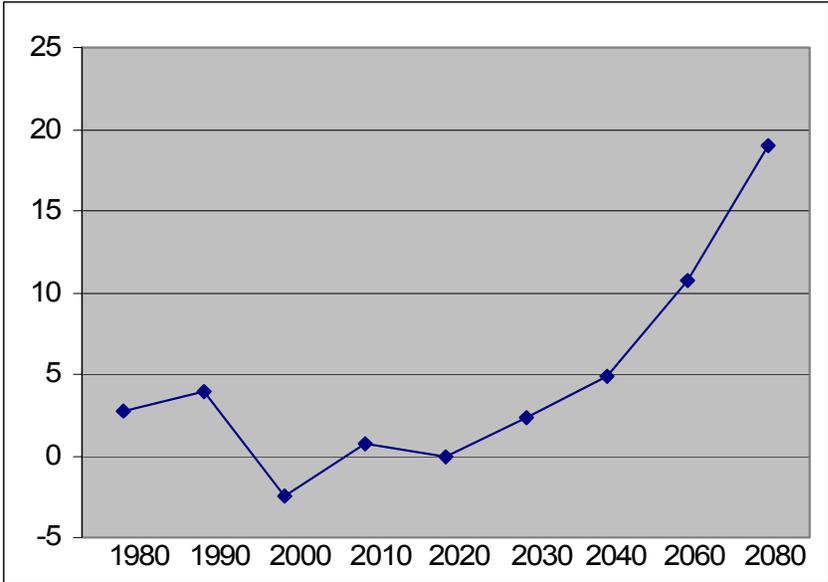
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### 4. Trends in Deficit Spending

The trends in deficit spending could be graphically displayed as a percentage of GDP for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year.

Illustration 3a: Projected Deficit/Surplus as a Percentage of GDP

### Projected Deficit (Surplus) as a Percentage of GDP



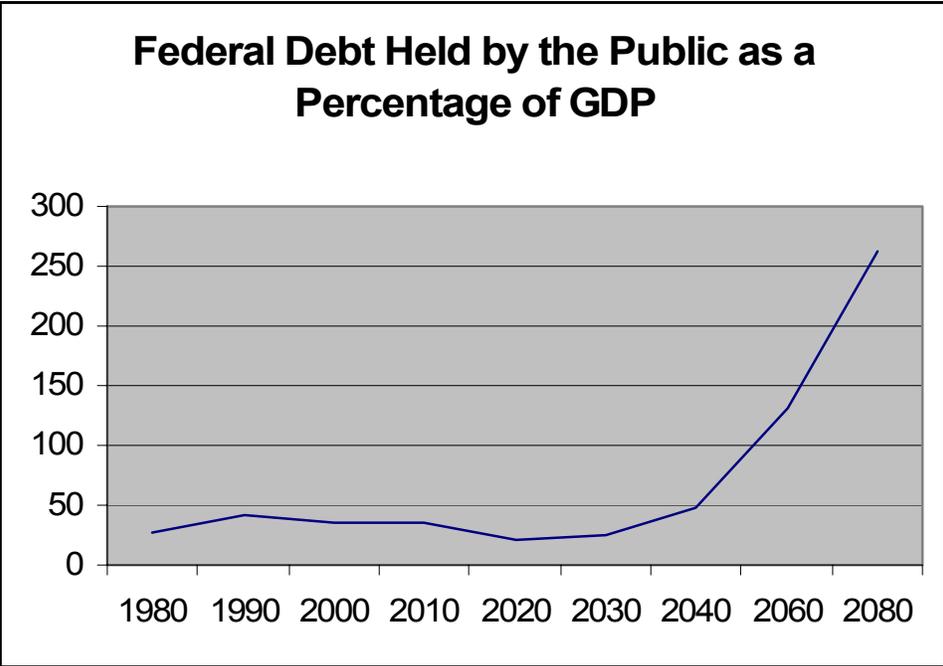
Data source: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget.

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### 5. Trends in Treasury Debt

A graphic could display the projected trends in Treasury debt as a percentage of GDP, for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year. This graphic could illustrate the assumption that increased borrowing would be substituted for increased taxes and/or reduced spending.

Illustration 3b- Increase in Federal Debt Held by the Public



Data source: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget.

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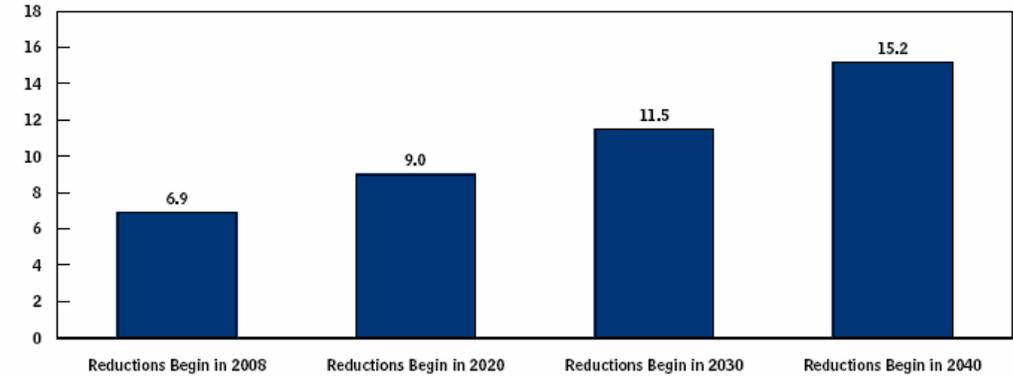
### 6. Impact of Delaying Action

Paragraph 48 provides that if a fiscal imbalance (shortfall) is indicated by the projections, the narrative section would include a graphic that shows the likely impact of delaying action. Two graphics could display the progressive increase in the change that would be needed to close the fiscal imbalance by (a) reducing spending and alternatively (b) by increasing taxes. Alternatively, either (a) or (b) could be displayed in a graph while the narrative describes the impact of delay on the item not displayed. An example of graphic presentation of (a) is shown below.

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#### Reductions in Noninterest Spending Needed to Close the Fiscal Gap in Various Years Under CBO's Alternative Fiscal Scenario

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: The fiscal gap is a measure of federal shortfalls over a given period. It represents the extent to which the government would need to immediately and permanently either raise tax revenues or cut spending—or do both, to some degree—to make the government's debt the same size (in relation to the economy) at the end of that period as it was at the beginning.

The alternative fiscal scenario deviates from CBO's baseline projections during the next 10 years, incorporating changes in policy that are widely expected to occur and that policymakers have regularly made in the past.

Source: Congressional Budget Office, *The Long-Term Budget Outlook* (December 2007) Table 1-3, page 16.

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Federal Accounting Standards Advisory Board  
Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government

July 11, 2008

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7. Range information

Paragraph 45 provides for the explanation and illustration of a range of possible results, and requires a table showing the range for each line item presented in the primary summary display. The following illustration is an example of how such a table might be displayed.

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¶ Paragraph

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	High	Statement	Low
Receipts:			
Medicare			
Social Security			
All Other			
Total Receipts			
Spending			
Medicare			
Medicaid			
Social Security			
Rest of Government			
Total Spending			
Add: Debt Held by the Public			
Total Spending plus Repayment of Debt			
Fiscal Imbalance			

8. Other narrative information

Additional narrative information is required by paragraphs 31 and 40- 48 but is not explicitly described or illustrated in this appendix. For example, paragraphs 41- 43 require an explanation of the nature and limitations of projections. Paragraph 44 requires that the narrative should explain the significance of the graphics and put the information into context.

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Appendix C: FAQs

FAQ 1. What is “Fiscal Sustainability Reporting”?

“Fiscal Sustainability Reporting” is the short term for “Comprehensive Long-Term Fiscal Projections and Accompanying Narrative and Graphics in the Financial Report of the U.S. Government.”

FAQ 2. What is GDP?

A nation’s gross domestic product, or GDP, is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:  $GDP = \textit{consumption} + \textit{investment} + \textit{government spending} + (\textit{exports} - \textit{imports})$

FAQ 3. (a) What is the **debt-to-GDP** ratio? (b) Why does the debt-to-GDP ratio matter?

- (a) The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by GDP. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]
- (b) The debt-to-GDP ratio provides an indication of a nation’s ability to repay its public debt by comparing the size of its debt to the size of its economy. For example, during the formation of the European Union (EU), one of the conditions for initial membership in the EU, which included eligibility to convert its currency to the Euro, was that each nation had to meet certain conditions, including debt-to-GDP ratio.

FAQ 4. What is present value?

Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank today in order to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

In present value calculations, the further out in the future the needed amount, the smaller the amount you would need today. In the first year, you earn interest on the amount that you deposit (the “principal” amount). In the second year, you earn interest on both the original principal amount and the amount of interest that was earned in year one. In year three, you would earn interest on:

- the original principal amount, plus
- the interest earned in year one on the principal amount,

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- the interest earned in year two on the principal amount, and
- the interest earned in year two on year one’s interest earnings.

This is colloquially called “the magic of compounding.” If inflation is less than the rate of interest earned (in this example, ten percent per year), the “magic of compounding” is an advantage to the party that is earning the interest.

FAQ 5. What is the fiscal imbalance measure?

The fiscal imbalance illustrates the amount of present value dollars that would be necessary to balance future spending and receipts and repay existing debt.

FAQ 6. What are projections?

Projections are not forecasts or predictions; they are designed to ask the question “what if?” For example, possible “what ifs” may include that tax cuts are (a) allowed to expire or (b) extended. Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

FAQ 7. What factors affect projections?

Projections are affected by three kinds of assumptions: policy assumptions, economic assumptions, and demographic assumptions.

Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees. Policy assumptions include projected changes in the framework for assessing taxes and fees that will be collected, and projected spending rules (for example, benefit formulas) for both mandatory and discretionary programs.

Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Projections are also affected by uncertainty. Economic and demographic assumptions are generally expressed in a range of possible results. Policy assumptions are generally expressed by providing alternative scenarios that show more than one possible broad direction in which policy might proceed.

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FAQ 8. What is the difference between earmarked revenue and other revenue, and what is the nature of **federal trust funds**?

“Earmarked revenue” is revenue that comes from a source that is distinct from general tax revenues and may be used only for the purpose for which it is collected. Examples of earmarked revenue are: Social Security taxes, Medicare taxes, Federal Unemployment taxes, and federal excise taxes on gasoline.

Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” Examples include the Social Security Trust Fund, the Medicare Trust Funds, the Unemployment Trust Fund, and the Highway Trust Fund. The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).
- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.
- When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>56</sup>

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<sup>56</sup> SFFAS 27, paragraph 27.

Appendix D: Abbreviations

CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
FAQ	Frequently Asked Question
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
GAO	Government Accountability Office (formerly, General Accounting Office)
GDP	Gross Domestic Product
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOSI	Statement of Social Insurance
U.S.	United States

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Appendix E: Glossary

**Debt-to-GDP Ratio** - The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by gross domestic product.

**Demographic Assumptions** - Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

**Discretionary Spending** - In the federal budget process, “discretionary spending” refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required for the continuing operation of all federal programs that are not “**mandatory**.” “Mandatory spending” includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

**Earmarked Revenue** – Earmarked revenue is revenue that comes from a source that is distinct from general tax revenues and may be used only for the purpose for which it is collected. Examples of earmarked revenue are: Social Security taxes, Medicare taxes, Federal Unemployment taxes, and federal excise taxes on gasoline.

Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).

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- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements. When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>57</sup>

**Economic Assumptions** - Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation, and growth in GDP).

**Federal “trust funds”** - Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” Examples include the Social Security Trust Fund, the Medicare Trust Funds, the Unemployment Trust Fund, and the Highway Trust Fund. The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).
- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.

When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>58</sup>

**Fiscal Gap** - The fiscal gap is the change in spending or revenue that would be necessary to maintain public debt as a constant percentage of GDP.

<sup>57</sup> SFFAS 27, paragraph 27.  
<sup>58</sup> SFFAS 27, paragraph 27.

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**Fiscal Imbalance** -The fiscal imbalance is the net **present value** of existing federal debt plus projected spending<sup>59</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period. The fiscal imbalance as of a stated valuation date<sup>60</sup> may be expressed as:

- (a) a summary amount in present value dollars,
- (b) a share of the present value of the GDP<sup>61</sup> for the projection period, and/or
- (c) a share of the present value of projected receipts or projected spending.<sup>62</sup>

**Fiscal Sustainability Reporting** – In federal financial reporting, “Fiscal Sustainability Reporting” is the short term for “Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative in the Financial Report of the U.S. Government.”

**Gross Domestic Produce (GDP)** - A nation’s gross domestic product is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:

$GDP = \text{consumption} + \text{investment} + \text{government spending} + (\text{exports} - \text{imports})$

**Mandatory Spending** - “Mandatory spending” includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

**Policy Assumptions** - Policy assumptions address the level of services provided by the federal government for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.

<sup>59</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 on page 58.

<sup>60</sup> See requirement for valuation date in paragraph 32.

<sup>61</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

<sup>62</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

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**Present Value** - Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

**Projections** – A projection is the calculation of future data based upon the application of trends to present data. Projections are not forecasts or predictions; they are designed to ask the question “what if?” For example, possible “what ifs” may include that tax cuts are (a) allowed to expire or (b) extended. Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

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### **FASAB Staff**

Wendy M. Payne, Executive Director

### **Project Staff**

Eileen W. Parlow

Federal Accounting Standards Advisory Board  
441 G Street NW, Suite 6814  
Mail Stop 6K17V  
Washington, DC 20548  
Telephone 202-512-7350  
FAX 202-512-7366  
[www.fasab.gov](http://www.fasab.gov)

The Board is proposing a summary display of comprehensive long-term fiscal projections as well as specific narrative and graphic displays for the annual consolidated financial report of the U.S. Government (CFR).

A primary summary display would present fiscal projections for all activities of the federal government and calculate a “bottom line” fiscal imbalance (the amount necessary to balance future spending and repay existing debt).

The narrative and graphics would serve a critical role of making economic concepts and projections accessible to a variety of audience segments, and in helping readers understand long-term projections by illustrating trends graphically and by providing context for the information provided.

The narrative would provide a “plain English” explanation of present value and interest rates used to calculate present value.

Narrative and graphics would explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. Current examples of major factors are the rising cost of health care and demographic trends.

Narrative and graphics would explain and illustrate historical and projected trends for a succession of years for:

- the relationship between projected receipts and spending,
- projected deficits or surpluses, and
- projected Treasury debt as a share of gross domestic product (GDP).

If a fiscal imbalance is indicated by the projections, the narrative section would include a graphic that shows the likely impact of delaying corrective action.

The narrative would explain the significance of the graphics and put the information into context. Options for context may include but are not limited to:  
comparison of the data/trend with that of other developed nations;  
comparison of the data/trend with everyday life, for example, spending in excess of income over a long period of time; and/or  
where to find information about outside organizations that use similar data to assess the long-term implications for an entity or sovereign government, for example the role of rating organizations and/or European Union rules for member nations.

The Board is proposing to require that the consolidated financial report of the United States Government (CFR) presents information addressing the fundamental question of whether the Government can sustain public services and

meet its obligations as they come due.<sup>1</sup> Answering this question requires analyzing current and projected levels of federal spending, federal receipts and federal debt in relation to the economy. Such an analysis is complex and the result is challenging to communicate. Nonetheless, it is the most significant fiscal question regarding the U.S. government and of concern to all citizens.

The Board believes that a comprehensive package is needed, consisting of a narrative that integrates and explains the information that is provided through a primary summary display and graphic presentations. The overall package should:

- convey key projected fiscal measures such as projected receipts, spending, deficits and debt;
- provide context for the measures such as how they relate to the overall economy;
- highlight the major factors contributing to trends;
- help readers understand the projections and their inherent uncertainty as well as possible alternative projections; and
- include information regarding the implications of inaction.

Clear communication of such a complex analysis is critical. The Board recognizes that accounting standards alone will not guarantee success and that the standards must be flexible to facilitate alternative approaches. However, certain information is consistently found in reports published by U.S. entities and many other countries, and supports an understanding of the underlying issue. For example, Information on the present value of receipts and spending conveys the magnitude of policy changes that would be required to sustain delivery of goods and services. Presenting this information in relation to a meaningful base (e.g., total projected spending, total projected receipts or the gross domestic product (GDP)) assists in understanding large dollar amounts. The trajectory of spending and receipts shows the timing of the government's need for financing and allows for comparison to historic financing needs on an annual basis. Presenting the trend in debt-to-GDP ratios in graphic form facilitates an understanding of when the rising drain on financial markets might constrain borrowing. If the debt-to-GDP ratio is rising uncontrollably then there will come a time when the Government cannot pay its bills because it is unable to finance deficit spending. Most projections are based on maintaining the current level of effort devoted to federal programs and the current framework for taxation. This supports an understanding of where the government is headed if it maintains its current course.

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<sup>1</sup> Note that the fiscal year 2007 CFR included certain voluntary presentation of information relevant to this question. The due process relied upon by the Board would ensure the general acceptance of the underlying principles and the continued reporting of this important information.

The proposed standards would require:

A primary summary display presenting the present value of projected receipts and spending for all activities of the federal government, how those amounts relate to projected GDP, and the summary measures “fiscal imbalance” and/or “fiscal gap.”

Narrative and graphics would explain and illustrate the projected trends in:  
The relationship between receipts and spending  
Deficits or surpluses, and  
Treasury debt as a share of GDP.

Narrative and graphics also would explain and illustrate:

The assumptions underlying the projections

Factors influencing trends

The range of possible results using alternative assumptions

The likely impact of delaying corrective action when a fiscal imbalance exists

The Board believes that these projections—although inherently uncertain—will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.



Federal Accounting Standards Advisory Board

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**Reporting Comprehensive Long-Term Fiscal Projections for the  
U.S. Government**

**Statement of Federal Financial Accounting Standards **XX****

***Exposure Draft***

Written comments are requested by **October 13, 2008**

**July 11, 2008**

**Staff draft- Do Not Circulate**

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## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- “Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”
- “Mission Statement: Federal Accounting Standards Advisory Board”, Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB’s website at: [www.fasab.gov](http://www.fasab.gov).

Federal Accounting Standards Advisory Board  
441 G Street, NW, Suite 6814  
Mail stop 6K17V  
Washington, DC 20548  
Telephone 202-512-7350  
FAX – 202-512-7366  
[www.fasab.gov](http://www.fasab.gov)

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Federal Accounting Standards Advisory Board

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July 10, 2008

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. Specific questions for your consideration appear on page 8 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by **October 10, 2008**.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. **A public hearing for this exposure draft has been scheduled at 9:00 AM on October 22, 2008, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.**

**Notice of the date and location of this public hearing also will be published in the *Federal Register* and in the FASAB's newsletter.**

Tom L. Allen  
Chairman

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**Executive Summary****What is the Board proposing?**

The Board is proposing to require that the consolidated financial report of the United States Government (CFR) present information addressing the fundamental question of whether the Government can sustain public services and meet its obligations as they come due.<sup>2</sup> Answering this question requires analyzing current and projected levels of federal spending, federal receipts and federal debt in relation to the economy. Such an analysis is complex and the result is challenging to communicate. Nonetheless, it is the most significant fiscal question regarding the U.S. government and of concern to all citizens.

The Board believes that a comprehensive package is needed, consisting of a narrative that integrates and explains the information that is provided through a primary summary display and graphic presentations. The overall package should:

1. convey key projected fiscal measures such as projected receipts, spending, deficits and debt;
2. provide context for the measures such as how they relate to the overall economy;
3. highlight the major factors contributing to trends;
4. help readers understand the projections and their inherent uncertainty as well as possible alternative projections; and
5. include information regarding the implications of inaction.

Clear communication of such a complex analysis is critical. The Board recognizes that accounting standards alone will not guarantee success and that the standards must be flexible to facilitate alternative approaches. However, certain information is consistently found in reports published by U.S. entities and many other countries, and supports an understanding of the underlying issue. For example,

1. Information on the present value of receipts and spending conveys the magnitude of policy changes that would be required to sustain delivery of goods and services. Presenting this information in relation to a meaningful base (e.g., total projected spending, total projected receipts or the gross domestic product (GDP)) assists in understanding large dollar amounts.

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<sup>2</sup> Note that the fiscal year 2007 CFR included certain voluntary presentation of information relevant to this question. The due process relied upon by the Board would ensure the general acceptance of the underlying principles and the continued reporting of this important information.

2. The trajectory of spending and receipts shows the timing of the government's need for financing and allows for comparison to historic financing needs on an annual basis.
3. Presenting the trend in debt-to-GDP ratios in graphic form facilitates an understanding of when the rising drain on financial markets might constrain borrowing. If the debt-to-GDP ratio is rising uncontrollably then there will come a time when the Government cannot pay its bills because it is unable to finance deficit spending.
4. Most projections are based on maintaining the current level of effort devoted to federal programs and the current framework for taxation. This supports an understanding of where the government is headed if it maintains its current course.

The proposed standards would require:

1. A primary summary display presenting the present value of projected receipts and spending for all activities of the federal government, how those amounts relate to projected GDP, and the summary measures "fiscal imbalance" and/or "fiscal gap."
2. Narrative and graphics would explain and illustrate the projected trends in:
  - a. The relationship between receipts and spending,
  - b. Deficits or surpluses, and
  - c. Treasury debt as a share of GDP.
3. Narrative and graphics also would explain and illustrate:
  - a. The assumptions underlying the projections,
  - b. Factors influencing trends,
  - c. The range of possible results using alternative assumptions, and
  - d. The likely impact of delaying corrective action when a fiscal imbalance exists.

The Board believes that these projections—although inherently uncertain—will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

### **How would this proposal contribute to meeting the federal financial reporting objectives?**

This proposal supports the Stewardship Objective (Objective 3):

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for

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the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>3</sup>

In particular, this proposal directly addresses sub-objective 3B:

Federal financial reporting should provide information that helps the reader to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>4</sup>

This proposal would provide specific reporting requirements that the Board believes will be useful to readers in assessing the potential future impact of current levels of benefits, services, and taxation.

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<sup>3</sup> Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraph 134.

<sup>4</sup> SFFAC 1, paragraphs 135 and 139.

**Table of Contents**

**Executive Summary** ..... **4**  
 What is the Board proposing? ..... 4  
 How would this proposal contribute to meeting the federal financial reporting objectives? ..... 5  
**Questions for Respondents** ..... **8**  
**Introduction** ..... **13**  
 Purpose ..... 13  
 Objectives of Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative (“Fiscal Sustainability Reporting”) ..... 14  
 Materiality ..... 15  
 Effective Date ..... 15  
**Accounting Standard** ..... **16**  
 Definitions ..... 16  
 Scope ..... 17  
     Policy, Economic, and Demographic Assumptions ..... 17  
     Changes in Assumptions ..... 20  
     Projection Periods ..... 21  
 Primary Summary Display ..... 21  
 Requirements for Narrative and Graphics ..... 22  
 Supporting Data (Other Accompanying Information) ..... 25  
 Effective Date ..... 25  
**Appendix A: Basis for Conclusions** ..... **26**  
 Project History ..... 26  
 Financial Position versus Financial Condition ..... 27  
 Existing Required Sustainability Reporting ..... 29  
     Management’s Discussion and Analysis (MD&A) ..... 29  
     Statement of Social Insurance (SOSI) ..... 31  
     What would this proposal add to existing reporting? ..... 33  
 Assumptions ..... 33  
 International Perspective ..... 40  
 Primary Summary Display ..... 41  
     Per Capita Measures ..... 41  
     Time Horizon for Projections ..... 42  
     The Concept of Fiscal Imbalance ..... 44  
**Appendix B: Example Formats and Illustrations** ..... **46**  
 Primary Summary Display ..... 46  
 Additional Information ..... 48  
     1. Rising Cost of Health Care ..... 48  
     2. Demographic Trends ..... 51  
     3. Relationship of Projected Receipts and Spending ..... 53  
     4. Trends in Deficit Spending ..... 54  
     5. Trends in Treasury Debt ..... 55  
     6. Impact of Delaying Action ..... 56  
**Appendix C: FAQs** ..... **58**  
**Appendix D: Abbreviations** ..... **61**  
**Appendix E: Glossary** ..... **62**

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## Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at [www.fasab.gov/exposure.html](http://www.fasab.gov/exposure.html). Your responses to the Questions for Respondents should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

All responses are requested by **October 13, 2008**.

Q1. This exposure draft proposes reporting that would support FASAB Objective 3, Stewardship, and in particular, Sub-Objective 3B:

Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>5</sup>

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<sup>5</sup> SFFAC 1, par. 134.

Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>6</sup>

More detailed discussion of the reporting objective and the objectives of fiscal sustainability reporting can be found in paragraphs 1 through 8.

Do you believe that the proposed reporting supports the above objectives? If not, please explain why you disagree.

Q2. In this proposed Statement, projections are prepared not to predict the future, but rather to depict results that may occur under various conditions. Accordingly, projections require assumptions to be made about the future. This exposure draft proposes broad and general guidance for selecting policy, economic, and demographic assumptions for long-term projections with a primary focus on the future implications of the continuation of current levels of benefits, services, and taxation. The guidance begins at paragraph 18.

Do you believe that the guidance for assumptions is appropriate? If not, please suggest alternative guidance. Please provide the rationale for your response.

Q3. This exposure draft proposes a primary summary display,<sup>7</sup> in addition to narrative and graphics. (Description begins at paragraph 35 and an illustrative example of the primary summary display is provided in Appendix B.) The Board has indicated that the primary audiences for the consolidated financial report of the U.S. Government (CFR) are citizens and citizen intermediaries such as journalists and public policy analysts.

Do you believe that this display would be understandable and meaningful for the primary audiences of the CFR? Please note any changes that you believe should be made to the requirements for a primary summary display.

Q4. Finite and infinite time horizons for fiscal projections are discussed in the Basis for Conclusions, paragraphs A54 through A59. This exposure draft proposes the following requirements regarding time horizons for projections: (a) the projections presented in the primary summary display should be “sufficient to illustrate long-term sustainability” (for example, traditionally the Social Security program has used a projection period of 75 years for long-term projections); (b)

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<sup>6</sup> SFFAC 1, par. 139.

<sup>7</sup> The primary summary display will be presented as RSI for a period of three years and subsequently as a basic financial statement.

projections for both a finite and an infinite horizon should be provided, one in the primary summary display and the other in the narrative section; and (c) either the primary display or the narrative section should include projections for Social Security and Medicare based on the time horizon used for long-term projections for Social Security and Medicare in the Statement of Social Insurance (SOSI).

- a. Do you believe that the above requirements for time horizons are appropriate to meet the reporting objectives of Fiscal Sustainability Reporting? If not, please explain.
- b. Do you believe that there should be a specific time horizon requirement (for example, 75 years) for the primary summary display for Fiscal Sustainability Reporting and/or the SOSI? If so, what time horizon do you believe should be required?

Q5. The Board's mission is to issue reporting requirements for the federal government's general purpose financial statements, and not to recommend budget policy. This exposure draft proposes a title for the primary summary display: "Long-Term Fiscal Projections for the U.S. Government." An alternative title, "Statement of Fiscal Sustainability," might imply to some that the Board has established or plans to establish specific rules that define "fiscal sustainability" and/or budget rules that would result in fiscal sustainability. However, others have indicated that the "plain English" meaning of the words "fiscal" and "sustainability" should be adequate, and that the title "Statement of Fiscal Sustainability" might be more appropriate.

The Board's working definition of "fiscal sustainability reporting" is explained in the Basis for Conclusions, paragraph A3. The concept of "Financial Condition" is explained in the Basis for Conclusions, paragraphs A7 and A8.

Do you believe that the primary summary display should be titled:

- a. "Long-Term Fiscal Projections for the U.S. Government,"
- b. "Statement of Fiscal Sustainability,"
- c. "Statement of Financial Condition," or
- d. A title not listed above (please specify).

Please explain the reasons for your choice.

Q6. This exposure draft proposes a minimum level of disaggregation for the primary summary display. For projected receipts, Medicare and Social Security would be shown separately from the rest of government. For projected spending, Medicare, Social Security, and Medicaid would be shown separately from the rest of government.

- a. Do you believe that the above projections should be disaggregated in the primary summary display? Please explain the basis for your views.

- b. Do you believe that additional line items should be disaggregated in the primary summary display? If so, please identify the line items and explain your reasoning.

Q7. This exposure draft proposes that a range (high and low) be required in the narrative section for each line item in the primary summary display. It also proposes that a range might optionally be displayed in the narrative for major factors impacting projected receipts and spending (such as the rising cost of health care) (see paragraph 45 and illustrative examples in Appendix B on pages 47 - 50.

Do you believe that a range of possible results for some of all of the line items should be displayed on the face the primary summary display? If so, which line item(s) should display a range of results?

Q8. This exposure draft proposes narrative and graphic displays to effectively communicate to the reader historical and projected trends and to help the reader understand the major drivers influencing projected receipts and spending. The requirements begin at paragraph 40 and illustrations begin on page 48.

- a. Do you believe that the required narrative and graphics would be useful in helping the reader to understand the information that is reported in the primary summary display?
- b. Are there any items that you believe should be added to, or deleted from, the requirements for narrative and graphics? If so, please explain.

Q9. The Frequently Asked Questions (FAQs) at Appendix C provide a “plain English” explanation of terms and concepts used in long-term projections.

- a. Do you find the FAQs helpful?
- b. Should the Treasury Department be encouraged to include any of the FAQs in the CFR to promote understandability of the terms and concepts? If so, please specify the FAQs that should be considered for inclusion (and/or exclusion).

Q10. Effective Date and Phased Implementation: This proposed Statement would be effective for periods beginning after September 30, 2009 with earlier implementation encouraged. This proposed Statement would require that the Primary Summary Display and the additional required information including graphics and narrative be included in Required Supplementary Information (RSI) for the first three years of implementation, and basic information (i.e., principal financial statement and notes) for all subsequent years.

- a. Do you believe that this implementation date is reasonable and appropriate?

- b. Do you agree with the phased implementation period (3 years)?
- c. Do you believe that some or all of the required information should remain as RSI after the 3-year implementation period? If so, please explain the basis for your view.

## Introduction

### Purpose

1. In Statement of Federal Financial Accounting Concepts (SFFAC) 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.<sup>8</sup> The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.
2. Objective 3, Stewardship, is the primary focus for this Statement. Objective 3 states that:  
Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.<sup>9</sup>
3. Sub-objective 3B states that:  
Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.<sup>10</sup>
4. While federal financial reporting is not expected by itself to accomplish the stewardship reporting objective, it can contribute to meeting the objective.<sup>11</sup> Sub-objective 3B is concerned with the future and with the resources expected to be consumed through programs of the federal government in the future.
5. The Board believes that including comprehensive long-term fiscal **projections**<sup>12</sup> and accompanying narrative and graphics in the consolidated financial report of the U.S. Government (CFR) will

<sup>8</sup> SFFAC 1, par. 109.

<sup>9</sup> SFFAC 1, par. 134.

<sup>10</sup> SFFAC 1, par. 139.

<sup>11</sup> SFFAC 1, par. 235.

<sup>12</sup> Terms defined in the Glossary are shown in **bold-face** the first time they appear.

contribute to meeting the stewardship objective and especially sub-objective 3B. The more detailed objectives presented below were developed as one means of guiding the Board in selecting from a variety of possible summary display formats as well as in identifying the most important areas to be addressed in narrative and/or graphic format.

### **Objectives of Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative (“Fiscal Sustainability Reporting”)**

6. In this Statement, “**Fiscal Sustainability Reporting**” is the short term for the comprehensive long-term fiscal projections and accompanying narrative and graphics required by this Statement to be provided in the CFR. Fiscal Sustainability Reporting should provide information to assist readers of the CFR in assessing whether future budgetary resources of the U.S. Government will likely be sufficient to sustain public services and to meet obligations as they come due,<sup>13</sup> assuming that current levels of benefits, services, and taxation are continued.<sup>14</sup>
7. Assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due is important not only because such an assessment has financial implications but also because it has social and political implications. For example, users of financial reports should be provided with information that is helpful in assessing the likelihood that the government will continue to provide the current level of benefits and services to constituent groups and to assess whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits.<sup>15</sup> Fiscal Sustainability Reporting should assist the reader in understanding these financial, social and political implications.
8. Fiscal Sustainability Reporting should be understandable to the intended users of the CFR. The primary intended users of this report are citizens and citizen intermediaries (for example, the

<sup>13</sup> SFFAC 1, par. 139.

<sup>14</sup> Note that fiscal sustainability reporting does not extend to supporting a detailed assessment of whether current levels of benefits, services, and taxation are optimal; rather, it addresses the fiscal outlook if current levels are continued.

<sup>15</sup> The latter notion is sometimes referred to as “interperiod equity.”

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media, public interest and advocacy groups, and others). The CFR should be easily understandable to the “average citizen” who has a reasonable understanding of federal government activities and is willing to study the information with reasonable diligence. Moreover, the CFR is a high-level summary report; it tells users where to find additional information in other reports and publications, for example, reports issued by the Department of the Treasury, the Government Accountability Office (GAO), the Office of Management and Budget (OMB), and the Congressional Budget Office (CBO) and other agencies.<sup>16</sup>

9. The Frequently Asked Questions (FAQs) at Appendix C provide a “Plain English” explanation of terms and concepts used in this Statement.

## Materiality

10. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

## Effective Date

11. This proposal provides for a phased-in implementation, but earlier implementation is encouraged. Information would be reported as Required Supplementary Information (RSI) for the first three years of implementation (fiscal years 2010, 2011, and 2012). Beginning in fiscal year 2013, the required information would be presented as a basic financial statement and related disclosures.

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<sup>16</sup> See SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, paragraphs 6-7 and 15-20.

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## Accounting Standard

### Definitions

#### 12. Fiscal Imbalance

The fiscal imbalance is the net **present value** of existing federal debt plus projected spending<sup>17</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period. The fiscal imbalance as of a stated valuation date<sup>18</sup> may be expressed as:

- (a) a summary amount in present value dollars,
- (b) a share of the present value of the **gross domestic product (GDP)**<sup>19</sup> for the projection period, and/or
- (c) a share of the present value of projected receipts or projected spending.<sup>20</sup>

#### 13. Policy Assumptions

Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees. Policy assumptions address projected spending rules for both **mandatory** and **discretionary spending** as well as the framework for assessing taxes and fees.

#### 14. Current Policy

In this standard, current policy refers to current levels of federal government services and benefits (for example, current reimbursement rates for Medicare and scheduled benefits for Social Security) combined with current levels of taxation and other receipts.<sup>21</sup>

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<sup>17</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 on page 58.

<sup>18</sup> See requirement for valuation date in paragraph 32.

<sup>19</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

<sup>20</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

<sup>21</sup> "Current levels" is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to

15. **Economic Assumptions**

Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

16. **Demographic Assumptions**

Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

## Scope

17. The reporting requirements in this Statement apply to the consolidated financial report of the U.S. Government. They do not apply to financial statements prepared at the component entity level. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose type of report.

## Policy, Economic, and Demographic Assumptions

18. Fiscal Sustainability Reporting for the U.S. Government should provide information that helps the reader to determine whether current policy is likely to produce future budgetary resources sufficient to sustain current levels of public services and to meet obligations as they come due. Long-term projections of current levels of federal benefits and services and current levels of taxes and other revenues should help the reader to understand the implications of current levels of benefits, services, and taxation and other factors such as demographic trends.
19. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions—for example, what if current levels of benefits, services, and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

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20. Long-term projections are derived from models that rely heavily on assumptions. There is an expectation that such models will evolve over time. Therefore, this Statement provides guiding principles for making choices among alternative assumptions. The guiding principles address three types of assumptions: policy, economic, and demographic.
  21. Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees.
  22. Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).
  23. Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).
  24. When combined with policy assumptions, economic, and demographic assumptions determine the level of future projected receipts and spending.
  25. To illustrate the distinction between policy, economic and demographic assumptions: the Social Security program provides benefits. Assumptions relating to future Social Security eligibility and benefit formulas represent policy assumptions. Assumptions about productivity growth, inflation, and other factors represent economic assumptions. Assumptions about the future population represent demographic assumptions.
  26. The guiding principle for selecting policy assumptions is to base selections on assumptions consistent with current policies (current levels of federal benefits, services, and taxation). With some exceptions, projections of future receipts and spending should be based upon policy assumptions consistent with current law. However, in certain instances a simple assumption of "current law" will not provide an adequate basis for long-term projections under current policies. For example, in some cases current law may expire almost immediately, or not fully support current levels of benefits or services, or produce levels of taxation that are significantly different from current levels of taxation. In these cases, the preparer should use judgment in applying the

general guidelines presented below for selecting policy assumptions that are consistent with current policies.

27. When a simple assumption of current law does not provide a basis for projections of future receipts and spending that is consistent with current policies, assumptions should reflect “current policies” as defined in this standard.<sup>22</sup> Following are examples:
- (a) Legislation providing for **discretionary spending**<sup>23</sup> provides funding that extends at most a few years into the future. Therefore, assumptions will be required in order to prepare a long-range projection. A current-law policy assumption would show discretionary spending falling to zero within a few years. Such a projection would not be meaningful or useful, since it would not reflect current levels of benefits or services.
  - (b) Some provisions of tax law (for example the Alternative Minimum Tax (AMT), which is not indexed) do not provide for future taxation at current levels. Current law would result in the AMT negatively impacting many more taxpayers in the future. A current-law policy assumption would show large increases in future receipts as the AMT eventually impacts 100 percent of taxpayers. Such a projection would not realistically reflect current levels of taxation.
  - (c) Current law also may include provisions that have been changed in a consistent direction over a period of time. For example, the statutory limit on federal debt has been consistently raised. A current-law policy assumption would assume that Treasury borrowing will never increase beyond the dollar amount of the current statutory limit. Such an assumption would not support a projection of current levels of benefits, services, or taxation.

<sup>22</sup> See paragraph 14.

<sup>23</sup> In the federal budget process, “discretionary spending” refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required to fund the continuing operation of all federal programs that are not “mandatory.” “Mandatory spending” includes entitlement authority such as Social Security and Medicare and payment of interest on the national debt. Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP. Available at: <http://gaoweb.gao.gov/gaoproducts.php>.

28. In those cases where simple assumptions of current law do not provide a basis for projections that is consistent with “current policies” as defined in this standard, assumption of a uniform growth rate for all types of revenues and spending is not required. Assumptions may be based on, but are not limited to, the notion that spending or revenues are likely to:
- (a) maintain a constant share of GDP,
  - (b) grow with inflation,<sup>24</sup> or
  - (c) maintain a constant real<sup>25</sup> per capita level<sup>26</sup>
29. Judgment should be applied in selecting assumptions. Policy assumptions representing the worst case scenario are not required. Rather, the assumptions should be viewed as a whole and individual selections made which result in a reasonable overall projection. The preparer’s objective should be to produce unbiased projections.
30. The same economic and demographic assumptions should be used for the primary summary display for Fiscal Sustainability Reporting and for Social Security and Medicare in the Statement of Social Insurance.

#### Changes in Assumptions

31. When year-by-year comparisons are displayed, a table presented in the narrative section should disaggregate the changes attributable to:
- (a) valuation period (for example, the beginning of the projection period is one year later);
  - (b) changes in policies (legislation); and
  - (c) changes in assumptions.

Narrative should explain the reasons for the changes attributable to each of the three categories.

#### Valuation Date

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<sup>24</sup> Inflation is growth in a general measure of prices, usually expressed as an annual rate of change.

<sup>25</sup> In economic terms, “real” means adjusted to remove the effects of inflation.

<sup>26</sup> As applicable, the characteristics of the population should be considered for expenditures that benefit identifiable subgroups.

32. All projections and estimates required in this Statement should be made as of a date (the valuation date) as close to the end of the fiscal year being reported on (“current year”) as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.

### Projection Periods

33. Projections in the primary summary display should be for a projection period sufficient to illustrate long-term sustainability.
- (a) If the projection period displayed in the primary summary display is for a finite projection period, the accompanying narrative should display summary totals for an infinite horizon projection period and vice versa.
  - (b) If the projection period in the primary summary display is not consistent with the projection period used for Social Security and Medicare in the Statement of Social Insurance (SOSI), the narrative section should display the subtotal and total line items of the primary summary display calculated for the projection period that was used for Social Security and Medicare in the SOSI.<sup>27</sup>
34. Overemphasis on summary measures for a finite projection period, such as a 75-year period, can lead to incorrect perceptions. The accompanying narrative should explain that the trends projected, particularly near the end of the projection period, are important to consider. This Statement also requires information for a time period that extends to the infinite horizon, which provides additional perspective but is subject to much greater uncertainty.

### Primary Summary Display

35. This Statement presents the elements that are required to be included in a primary summary display.
36. An example primary summary display is shown in Appendix B for illustration only.

<sup>27</sup> The SOSI projection period is required to be “sufficient to illustrate long-term sustainability (for example, traditionally the “Social Security” or OASDI, program has used a projection period of 75 years for long-term projections).” See SFFAS 17, paragraph 27.

37. The primary summary display, *Long-Term Fiscal Projections for the U.S. Government*, should state the projection period and display the following projected amounts as both present value dollars and as a percentage of the present value of GDP as of the required valuation date(s) for the projection period indicated:
- (a) receipts, disaggregated by Medicare, Social Security, and all other revenues, and total receipts;<sup>28</sup>
  - (b) spending, disaggregated by Medicare, Medicaid, Social Security, and all other spending, subtotal of spending before debt held by the public, and total spending plus repayment of debt;<sup>29</sup> and
  - (c) fiscal imbalance (the net amount needed to balance receipts and total spending plus repayment of debt).<sup>30</sup>
38. The primary summary display should also present
- (a) fiscal imbalance as a percentage of total projected receipts and as a percentage of total projected spending, and
  - (b) after the initial year of implementation, comparative amounts for the current year and prior year, and the net change for each of the above line items from the prior year.
39. Additional requirements for narrative and graphics are provided in “Requirements for Narrative, Graphics and Supporting Data,” beginning at paragraph 40.

## Requirements for Narrative and Graphics

40. Narrative and graphics serve a critical role in making economic concepts and projections understandable to a variety of audience segments, and in helping readers to understand long-term projections by explaining the significant factors that are driving projected trends, by illustrating trends graphically, and by providing context for the information provided.
41. Narrative should include a “plain English” explanation of present value and interest rates used to calculate present value.

<sup>28</sup> Full payment of amounts due to Social Security and Medicare HI Trust Funds must be shown as revenue for Medicare and Social Security, and outlays for “rest of government.”

<sup>29</sup> See note 28.

<sup>30</sup> A positive fiscal imbalance indicates a shortfall; a negative fiscal imbalance indicates a surplus situation.

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42. The narrative should explain that the projections displayed are not forecasts or predictions; they are designed to depict results that may occur under various conditions. The narrative should disclose significant policy assumptions for all scenarios presented. The narrative should explain the most significant departures from current law—for example, if the spending assumptions allow for exceeding the statutory limit on federal debt.
43. The narrative should include an explanation of the following limitations:
- (a) Forward-looking projections require assumptions and estimates relating to future events, conditions, and trends; actual results may differ materially from those that are projected.
  - (b) Where indicated, forward-looking projections 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), for which financial projections may be appropriate.
  - (c) Fiscal Sustainability Reporting is limited to the activity of the federal government, and does not include activities of state and local governments. However, the narrative should direct the reader to any recent reports that address the long-term fiscal outlook for state and local governments.<sup>31</sup>
44. The narrative should explain the significance of the graphics and put the information into context. Options for context may include but are not limited to:
- (a) comparison of the data/trend with that of other developed nations, and/or
  - (b) where to find information about outside organizations that use similar data to assess the long-term implications for an entity or sovereign government, for example the role of rating organizations and/or European Union rules for member nations.

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<sup>31</sup> For example, the GAO reports *State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge with the Next Decade* (July 18, 2007 GAO-07-1080SP) and *The Nation's Long-Term Fiscal Outlook August 2007 Update* (GAO-07-1261R) address the long-term fiscal outlook for state and local governments.

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45. Narrative and graphics should explain and illustrate a range of possible results in light of the uncertainty inherent in projections and their sensitivity to assumptions. The range need not be based on the most optimistic and most pessimistic sets of assumptions. Instead, the range may present low and high projections based on optimistic and pessimistic assumptions that might reasonably be expected to occur. The range should present the total projected receipts and spending but may also present projections for individual programs. (See Illustration 1a in Appendix B.) The narrative should include a table showing the range for each line item presented on the primary summary display. For variances that would significantly impact the projections, the narrative should identify the major causes of the variances displayed.
46. Narrative and graphics should explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. For example, two such factors may be (a) the rising cost of health care and (b) demographic trends. Information about how these factors have changed and are expected to change over time is necessary to assist the reader in understanding the factors that influence fiscal imbalances. (See Illustrations 1b and 2 in Appendix B.)
47. Narrative and graphics should explain and illustrate the historical and projected trends for a progression of years beginning at least 20 years before the current year and extending to all projected future years for:
- (a) projected receipts and spending,
  - (b) projected deficits, and
  - (c) projected Treasury debt as a share of GDP.
- (See Illustrations 3, 4, and 5 in Appendix B.)
48. If a fiscal imbalance is indicated by the projections, the narrative section should include a graphic that shows the likely impact of delaying action. Two graphics could display the progressive increase in the change that would be needed to close the fiscal imbalance by (a) reducing noninterest spending and alternatively (b) by increasing receipts. Alternatively, either (a) or (b) could be displayed in a graph and the narrative describe the impact of delay on the item not displayed. (See Illustration 6 in Appendix B.)

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**Supporting Data (Other Accompanying Information)**

49. The quantitative data supporting the primary summary display and the additional narrative and graphics may be provided in or referenced as other accompanying information.<sup>32</sup>

**Effective Date**

50. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2012.
- (a) These standards are effective for periods beginning after September 30, 2009.
  - (b) Information should be reported as Required Supplementary Information (RSI) for the first three years of implementation (fiscal years 2010, 2011, and 2012).
  - (c) Beginning in fiscal year 2013, the required information should be presented as a basic financial statement and related disclosures.
  - (d) Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

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<sup>32</sup> For example, a link to a more detailed report such as the President's Budget, a Congressional Budget Office report, or the Trustees Report (*Status of the Social Security and Medicare Program*) may be provided. Note that the Trustees Report is available at: <http://www.ssa.gov/OACT/TR/>.

## Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement—not the material in this appendix—should govern the accounting for specific transactions, events, or conditions.

### Project History

- A1. Many believe that federal financial reports currently do not adequately address the federal financial reporting objective, titled “stewardship,” presented below.

#### **Objective 3: Stewardship**

Federal financial reporting should assist report users in assessing the impact on the country of the government’s operations and investments for the period and how, as a result, the government’s and the nation’s financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether

- a) the government’s financial position improved or deteriorated over the period,
  - b) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
  - c) government operations have contributed to the nation’s current and future well-being.<sup>33</sup>
- A2. In particular, existing reporting may not adequately address sub-objective 3b above. The FASAB considered what information would be most likely to help readers of the CFR to assess whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Ultimately, this may enhance the public’s understanding of long-term fiscal issues.
- A3. Discussion of such long-term fiscal issues has been described in terms such as “fiscal sustainability.” In this proposed Statement, the Board’s working definition of “fiscal sustainability” is the federal government’s ability to continue, both now and in the future, to provide

<sup>33</sup> *Statement of Federal Financial Accounting Concepts (SFFAC) 1*, pars. 134-145, available at <http://www.fasab.gov/codifica.html>.

current levels of benefits and services while maintaining current levels of federal taxation without resulting in debt continuously rising as a share of GDP.<sup>34</sup>

- A4. Throughout this project, the Board considered expert comments from a Fiscal Sustainability Reporting Task Force (“task force”) whose participants have technical knowledge relevant to the issues and/or communications expertise relevant to the challenge of how to effectively communicate complex information on long-term fiscal issues.
- A5. The task force participants included representatives from the American Enterprise Institute, the Cato Institute, the Brookings Institution, and the Urban Institute; the Chief Actuaries for Social Security and Medicare; technical experts from the OMB, the CBO, the Treasury Department, and the GAO; members of Congress; and academics in the areas of public policy and communications.
- A6. FASAB staff also researched existing reporting on comprehensive government-wide long-term projections by other developed, English-speaking countries (for example, the United Kingdom, Australia, New Zealand, and Canada) and conferred with staff of the International Public Sector Accounting Standards Board (IPSASB). The IPSASB is currently undertaking a project with similar objectives.

### Financial Position versus Financial Condition

- A7. Fiscal Sustainability Reporting is focused on the financial condition of the federal government as a whole. Financial condition is forward-looking and multi-dimensional. Assessing financial condition requires financial and non-financial information related to the long-term fiscal outlook for the federal government. Therefore, Fiscal Sustainability Reporting should provide information about the future to help readers assess the magnitude of future spending and revenues and the burden that any resulting deficits might place on future taxpayers.<sup>35</sup>
- A8. Indicators of financial position, for example, the balance sheet, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. For example, trends in financial position may assist readers in assessing the overall direction of the federal

<sup>34</sup> Determining precisely how much a government can depart—in magnitude and/or duration—from this general notion of fiscal sustainability is beyond the scope of the Board’s efforts.

<sup>35</sup> SFFAC 1, par. 262.

government's finances. However, readers may find, among other things, a budget projection under a range of alternative assumptions<sup>36</sup> to be helpful in assessing the financial condition of the U.S. Government. Presenting information about the overall size of the economy relative to the budget projections may assist readers in assessing whether the projected budget amounts are reasonable in comparison to past experience or the experience of other countries. Thus, reporting on financial condition requires financial and nonfinancial information about the national economy and society, as well as about the government itself.<sup>37</sup> Table 1 summarizes the distinguishing characteristics of financial position and financial condition.

**Table 1: Comparison of Financial Position and Financial Condition**

Financial Position	Financial Condition
Entity perspective	Broad perspective including reporting on the nation's economy and other external trends
Accrual-based data	Additional, forward-based information
Financial data	Financial and nonfinancial data
Assets, liabilities, and net position	Future effects of: <ul style="list-style-type: none"> <li>• current demands, risks, and uncertainties; and</li> <li>• anticipated future events, conditions, and trends</li> </ul>
Example: Balance Sheet	Examples: <ul style="list-style-type: none"> <li>• Projections of revenue, spending, and debt <ul style="list-style-type: none"> <li>• in present value dollars</li> <li>• as a share of GP</li> </ul> </li> <li>• Nonfinancial data, such as demographic trends</li> </ul>

A9. SFFAC 3, *Management's Discussion and Analysis (MD&A)*, addressed many of the elements of financial condition. SFFAC 3 says that the MD&A should answer questions such as the following, to the extent that they are relevant and important for the entity:

What is the potential effect of changed circumstances, and of expected future trends? In other words, to the extent that it is feasible to project

<sup>36</sup> SFFAC 1, par. 145.

<sup>37</sup> SFFAC 1, par. 144.

the effects of these factors, will future financial position, condition, and results, as reflected in future financial statements, probably be different from this year's and, if yes, why? (Any such discussion should acknowledge that the future is unpredictable and will be influenced by factors outside the reporting entity's control, including actions by Congress.)<sup>38</sup>

### Existing Required Sustainability Reporting

A10. Existing reports provide relevant information regarding fiscal sustainability. Annual financial reports—both from individual agencies and the CFR—provide forward-looking information and extensive sustainability information regarding social insurance programs such as Social Security and Medicare. Central agencies such as the GAO, OMB, and CBO provide projections of receipts and outlays based on various policy assumptions. However, the Board believes that establishing requirements for a basic financial statement and accompanying narrative and graphics will ensure that the information is included in the annual CFR and that it presents projections based on current policies.

A11. While many of the proposals included in this exposure draft were voluntarily adopted in the fiscal year 2007 CFR and the recent summary report, *The Federal Government's Financial Health: A Citizen's Guide to the 2007 Financial Report of the United States Government*, voluntary adoption is not a guarantee of continued reporting. Some of the existing information sources are described below to aid respondents in evaluating the changes required by this proposal.

#### Management's Discussion and Analysis (MD&A)

A12. Current reporting requirements for the U.S. Government's long-term fiscal outlook are contained in paragraphs 3 and 6 of Statement of Federal Financial Accounting Standards (SFFAS) 15, *Management's Discussion and Analysis*, as follows:

[3] MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known demands, risks, uncertainties, events, conditions and trends. MD&A may also include forward-looking information about the

<sup>38</sup> SFFAC 3, par. 14.

possible effects of anticipated future demands, events, conditions, and trends.<sup>3</sup> Forward-looking information may comprise a separate section of MD&A or may be incorporated with the sections listed above.

<sup>3</sup>The word "anticipated" is used in a broad, generic sense in this document. In this context the term may encompass both "probable" losses arising from events that have occurred, which should be recognized on the face of the basic or "principal" financial statements, as well as "reasonably possible" losses arising from events that have occurred, which should be disclosed in notes to those statements. "Anticipated" may include the effects of future events that are deemed probable, for which a financial forecast would be appropriate. The term may also encompass hypothetical future trends or events that are not necessarily deemed probable, for which financial projections may be appropriate. Such information about the possible effects of anticipated future demands, events, conditions and trends, if presented, should include the term or label "projected" or "projection," and the key hypothetical underlying assumptions should be explained. As with other information presented in MD&A, no examination of this information by the auditor is now routinely included within the scope of an audit of a federal entity's financial statements; however, preparers and auditors may find useful background information in the AICPA's Statements on Standards for Attestation Engagements Nos. 1 and 4, codified as section 200, "Financial Forecasts and Projections," of the AICPA's *Codification of Statements on Standards for Attestation Engagements*.

[6] MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the general purpose Federal financial report (GPFFR) as a source of information. (The specific topics mentioned in *Concepts for Management's Discussion and Analysis* are examples of items that might be relevant for MD&A of a given entity.) Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- lead to significant actions or proposals by top management of the reporting unit;
- be significant to the managing, budgeting, and oversight functions of Congress and the Administration; or
- significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.

A13. The FASAB elaborated on the above requirements in its companion concept statement, SFFAC 3, Management's Discussion and Analysis,

which explains the Board's expectations regarding the description of future effects of both existing and anticipated events, conditions, and trends.<sup>39</sup>

#### Statement of Social Insurance (SOSI)

A14. The Statement of Social Insurance is based on projections of future scheduled expenditures and future revenues for the major social insurance programs: Federal Old-Age, Survivors and Disability Insurance (Social Security), Medicare Parts A, B, and D, Railroad Retirement benefits, and Black Lung benefits.

A15. For the social insurance programs listed in the preceding paragraph, the SOSI presents the actuarial present value for the projection period of:

- (a) all future contributions and tax income (excluding interest) received from or on behalf of all current and future participants,
- (b) estimated future schedule benefits to be paid to or on behalf of current and future participants, and
- (c) the estimated future excess of future benefit payments over future contributions (or excess of future contributions over future benefit payments).

A16. The SOSI (the information required by paragraphs 27(3) and 32(3) of SFFAS 17) is presented as a basic financial statement, and the underlying significant assumptions are included in notes that are presented as an integral part of the basic financial statements.<sup>40</sup> The basic (or principal)<sup>41</sup> financial statements and notes are those on which the auditor expresses an opinion as to whether the information is presented in conformity with generally accepted accounting principles (GAAP). For fiscal year 2007, for the first time, the GAO issued an unqualified or "clean" opinion on the SOSI.

A17. The SOSI is accompanied by RSI that provides the following information:

- (a) the projected annual cash flows—both inflows and outflows—in nominal dollars for at least every fifth year in the projection period,
- (b) the relationship of the total cash outflow and net receipts<sup>42</sup> to taxable

<sup>39</sup> See SFFAC 3, paragraphs 31-36.

<sup>40</sup> See SFFAS 26, paragraphs 5-6.

<sup>41</sup> The terms "basic financial statements" and "principal financial statements" have been used synonymously in federal accounting. See SFFAS 25, paragraph 34.

<sup>42</sup> Net receipts are cash inflows from all sources less net interest on intragovernmental borrowing/lending.

payroll and GDP, and  
 (c) sensitivity analysis for the most significant individual assumptions.

A18. The SOSI, notes, and related RSI are program specific. No government-wide projections are provided. While social insurance programs are presently a significant part of an assessment of fiscal sustainability, the Board believes that the context provided by government-wide projections is essential to meeting fiscal sustainability reporting objectives.

*The Trustees of the Social Security and Medicare Trust Funds*

A19. The two largest programs reported in the SOSI are Social Security and Medicare. Each year, the Trustees of the Social Security and Medicare trust funds report on the current and projected financial status of the two programs. There are six trustees: the Secretaries of the Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration, and two public trustees who are generally appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties.

A20. The annual Trustees report addresses the trust funds that Congress established in the U.S. Treasury to account for all program income and disbursements. Social Security and Medicare taxes, premiums, and other income are credited to the funds. Disbursements from the funds can be made only to pay benefits and program administrative costs.

A21. The Department of the Treasury invests program revenues not needed in the current year to pay benefits and administrative costs in special nonmarketable securities of the U.S. Government on which a market rate of interest is credited. Thus, the trust funds represent the accumulated value, including interest, of all prior program annual surpluses and deficits, and provide automatic authority to pay benefits.

A22. The annual reports provide short-range (10-year) and long-range (75-year) projections for all Social Security and Medicare funds. Estimates are based on current law and assumptions about factors that affect the income and outflow of each trust fund. Assumptions include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as factors relating to disability incidence and the cost of hospital, medical, and prescription drug services.

A23. Because the future is inherently uncertain, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions reflect the Trustees' best estimate of future experience. The low-cost alternative is more optimistic for trust fund financing, and the high-cost alternative is more pessimistic; they show trust fund projections for more and less favorable economic and demographic conditions for trust fund financing than the best estimate. The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised as warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. The statistics and analysis presented in the Summary of the annual Trustees' Reports for Social Security and Medicare are based on the intermediate assumptions.<sup>43</sup>

What would this proposal add to existing reporting?

A24. This proposal adds to existing reporting in the CFR by proposing requirements for:

- (a) a primary summary display of comprehensive long-term projections for all federal government receipts and spending, and
- (b) narrative and graphics that will help readers to understand the long-term projections, for example, by explaining the significant factors that are driving projected trends, illustrating trends graphically, and providing context for the information provided.

## Assumptions

### Limitations of "Current Law" Assumptions

A25. Projections are the central feature of Fiscal Sustainability Reporting and require that assumptions be made. The Board believes that the most useful projections will reflect current levels of spending and taxation.

A26. Although current law is a reasonable starting point in selecting policy assumptions, a simple projection of "current law" would not always reflect current levels of benefits, services, or taxation. The Board's proposal includes central guidance in selecting policy assumptions but acknowledges the role of judgment in filling voids in current law or

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<sup>43</sup> A Summary of the 2007 Annual Reports, Social Security and Medicare Boards of Trustees, pages 3-6. Available at: <http://www.ssa.gov/OACT/TRSUM/trsummary.html>.

departing from current law provisions.

- A27. Major provisions of current law often do not extend far into the future to be used as a basis for a long-range projection. Discretionary spending is primarily based upon annual appropriation acts, and even some mandatory spending (see note 23) programs are subject to authorizing legislation that expires in the near future. For example, the legislation authorizing several mandatory programs (for example, Food Stamps, student assistance for higher education, and agricultural price supports) expires and would require legislative action for the programs to continue past the expiration date.
- A28. Current law may contain a provision that restricts spending on certain social insurance programs, for example, Social Security and Part A of Medicare, to the amounts available in the Social Security or Medicare Trust Funds, respectively, plus inflows of **earmarked revenues**. However, current law does not provide for any specific reductions in Social Security scheduled benefits or Medicare reimbursement rates that would occur due to lack of funding. Thus, current law does not address what will happen when the trust fund balances are exhausted, although this event may reasonably be expected to occur.<sup>44</sup>
- A29. Current law also may include tax provisions (for example, tax cuts) that expire within several years, along with a historical trend of extending those tax provisions before they expire—but only for a short period, generally one year. In such situations, current law would indicate that the tax provisions will expire on schedule, while a projection based upon current levels of taxation, and reasonable expectations based on recent historical trends, may indicate that the tax provisions will be extended.

#### Fiscal Sustainability Task Force Input Regarding Policy Assumptions

- A30. A majority of the task force technical experts agreed that policy assumptions for the primary summary display that are consistent with current levels of federal benefits, services, and taxation would be useful

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<sup>44</sup> According to the 2007 Trustees Reports, the Social Security Trust Fund is expected to be exhausted in 2041, and Medicare's Hospital Insurance Trust Fund is expected to be exhausted in 2019. For the first time, a "Medicare funding warning" was triggered in 2007, signaling that non-dedicated sources of revenues—primarily general revenues—will soon account for more than 45 percent of Medicare's outlays. By law, this warning requires that the President propose, and Congress consider, remedial action. However, until remedial action is taken, it is difficult to determine how to project future spending for Medicare. A similar situation exists for Social Security, although the amounts are smaller and the expected date for trust fund exhaustion is much further in the future.

for readers of the CFR in assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

- A31. A majority of the task force technical experts believe that for mandatory spending on social insurance programs, a modified version of current law (ignoring the exhaustion of the Social Security and Medicare Hospital Insurance Trust Funds—see paragraph A28), which might also be termed “current services,” represents the most useful assumption for projecting spending for social insurance programs. However, a minority believe that any deviation from current law requires a subjective judgment that can be biased.
- A32. The technical experts also acknowledged that projections for discretionary spending are more uncertain than projections for mandatory spending, since current law often only addresses the next one or two years. However, there was some agreement among the group that projecting discretionary spending growth at the same rate as assumed GDP per capita would be an example of a reasonable option for some programs.
- A33. A recent report issued by the GAO<sup>45</sup> illustrates the tension between choosing current law versus current level of services and taxes. The report’s primary display contains two different projections in a single graphic presentation: the 10-year CBO baseline, which is then projected into the future (called “baseline extended”) and a different projection (called an “alternative simulation”), which includes modifications that are described in the narrative. The “baseline extended” projection is based on assumptions that focus on current law. Those assumptions are changed in the GAO’s “alternative simulation” to reflect historical trends and recent policy preferences.
- A34. The GAO’s approach of showing two different sets of numbers provides a more complete picture than selecting one or the other. However, this approach does not achieve one of the most important characteristics of effective communication. All of the communications experts and many of the technical experts on the task force strongly emphasized the importance of simplicity of presentation. The Board noted that one of the greatest challenges inherent in Fiscal Sustainability Reporting is the tension between technical rigor and simplicity of presentation.

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<sup>45</sup> *The Nation’s Long-Term Fiscal Outlook* August 2007 Update (GAO-07-1261R).

A35. The term “current policy” as defined in this Statement is not intended to be used as the title for any display, but rather as an abbreviated term to assist the overall readability of this exposure draft. An abbreviated term is useful, particularly in sentences where the term “current levels of benefits, services, and taxation” would make the sentence difficult to read and understand.

A36. A majority of the technical experts agreed with the substance of the proposed guidance in the ED—that the primary summary display should present current levels of spending and taxation<sup>46</sup>—but noted that it is difficult to coin a term to refer to this concept without implying something else. A majority of the technical experts recommended the term “modified current law” as being preferable to the term “current policy.” However, the Board believes that substituting the term “modified current law” for “current policy” throughout the exposure draft would make many sentences unclear or misleading, because the emphasis on continuing current levels of benefits, services, and taxation would be unclear.

#### Basis for the Board’s Proposal Regarding Policy Assumptions

A37. The Board believes that the most useful reporting on fiscal sustainability would illustrate the long-term effects of current levels of benefits or services and tax revenues. However, there are numerous ways of projecting current levels into the future. For example, it could be assumed that discretionary spending will continue as a constant share of GDP. Another alternative would be to assume constant real spending per capita (which could give a different result from assuming growth at a constant share of GDP). Yet another alternative would be to assume constant growth at the rate of inflation, which may be different than the growth of GDP.<sup>47</sup> (Historically, nondefense discretionary spending has grown roughly with GDP while defense discretionary spending has grown slightly faster than inflation but less than GDP, often in a nonlinear pattern.)

<sup>46</sup> “Current levels” as defined in this proposed Statement is not equivalent to levels measured in dollars. In the broader context of current policy, current levels are to be considered with respect to the service or benefit being provided (or scheduled to be provided) and the general relationship of taxation to the economy (for example, taxable income, GDP, or some other base).

<sup>47</sup> For example, the CBO projects that the rate of inflation will be lower than the rate of GDP growth for 2007-2017. See page xi, *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007). Available at: <http://www.cbo.gov>.

- A38. The Board believes that the details of the assumptions for projecting “current level of service” or “current level of taxation” should be left to the judgment of the preparer and auditor. Regardless of which assumptions are used for a primary presentation, the narrative should include an explanation of the assumptions used and alternative scenarios. Readers will have access to important explanatory material.
- A39. Current law may not address events that may reasonably be expected to occur (for example the exhaustion of the Medicare Hospital Insurance Trust Fund). As noted previously, although current law limits spending to the amounts available in the trust funds and current earmarked revenue, current law does not provide for any specific reductions in benefit payments or reimbursement rates due to lack of funds. Thus, current law is inconsistent and does not provide an answer.
- A40. When current law is inconsistent, the Board believes that in selecting assumptions, the projections should indicate current levels of government benefits, services, and taxation, and should answer the question “what if current levels were continued over time?” The resulting projection should be accompanied by a narrative that explains what would happen if an alternative event occurs (in the example in paragraph A39, the narrative would explain what percentage of Medicare reimbursements could not be paid if legislation does not provide for maintaining current levels).

#### Economic and Demographic Assumptions

- A41. Economic and demographic assumptions are somewhat broader in scope than policy assumptions, since they include such factors as population demographics and economic growth. The elements of economic and demographic assumptions are generally influenced more by a variety of external factors than by direct legislative impact.
- A42. There was no consensus from the task force technical experts for economic and demographic projections, although none objected strongly to either CBO, OMB, or the economic and demographic assumptions currently used for the Social Security and Medicare portions of the Statement of Social Insurance (SOSI).
- A43. Table 2 displays representative elements of CBO and OMB assumptions, with a comparison with the assumptions currently used for

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Social Security and Medicare in the Statement of Social Insurance.

Table 2: Major Elements of CBO and OMB Economic and Demographic Assumptions, Compared with Assumptions used in the Statement of Social Insurance (SOSI)

	CBO Baseline (2007-2017)	OMB Stewardship Reporting	SOSI assumptions for Social Security and Medicare
Economic/Demographic Assumptions:			
Consumer Price Index inflation	2.5% in 2007; average 2.2% per year for 2008-2017	2007-2017: Administration projections used for the budget, constant thereafter <sup>48</sup>	Intermediate Trustees Reports assumption: 2.8%
Population demographics (birth/death/immigration)	Intermediate Trustees reports assumptions	2007-2017: Administration projections used for the budget, Intermediate Trustees Reports assumptions thereafter	Intermediate Trustees Reports assumptions
Real GDP growth <sup>49</sup>	Average 2009-2012: 2.9% 2013-2017: 2.5%	2007-2017: Administration productivity projections used for the budget period, constant thereafter at 2.3%, with Trustees Intermediate assumptions for labor force growth	Intermediate Trustees Reports assumption: 1.7%

Sources:

CBO Baseline: *The Budget and Economic Outlook: Fiscal Years 2008 to 2017* (January 2007).

Available at: <http://www.cbo.gov>.

OMB Stewardship Reporting: Chapter 13, "Stewardship" of *Analytical Perspectives*, U.S. Budget, FY 2008.

SOSI/FR: FY 2006 Financial Report of the U.S. Government.

<sup>48</sup> After that, projected holding constant inflation, interest rates, and unemployment at the levels assessed for 2017.

Details of OMB projections:

Real GDP growth: average 3% for 2008-2012 (3.1% in 2008, declining to 2.9% in 2012)

CPI inflation: average 2.42% for 2008-2012 (2.6% in 2008, declining to 2.3% in 2012)

<sup>49</sup> There are two major components of projections for real GDP growth: productivity (real GDP per capita) and labor supply. While productivity growth is typically assumed to be constant, labor force growth varies over time with the demographic assumptions.

- A44. One of the technical experts noted that there are several advantages to using the economic and demographic assumptions used for Social Security and Medicare in the preparation of the SOSI:
- Since the SOSI is now a basic financial statement, auditors are bound by generally accepted government auditing standards to examine and assess the reasonableness of the assumptions. Since the SOSI is generally derived from the Trustees Report, the result is that the assumptions used in the Medicare and Social Security Trustees Reports are subject to audit.
  - In contrast, the CBO and OMB economic and demographic assumptions are not subject to audit.
  - If the economic and demographic assumptions used for Social Security and Medicare in the preparation of the SOSI are used, there would be consistency between the economic and demographic assumptions used for the SOSI and for the Fiscal Sustainability Reporting.
- A45. Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*, does not prescribe specific economic or demographic assumptions for Social Security and Medicare in the SOSI. Accordingly, the Board concurred that the reporting requirements for Fiscal Sustainability Reporting should not dictate specific economic and demographic assumptions, but should require that the primary displays for Fiscal Sustainability Reporting should use economic and demographic assumptions that are consistent with the economic and demographic assumptions for Social Security and Medicare in the SOSI. In addition, the narrative should include information about how different assumptions would impact the projections.

## International Perspective

- A46. Other nations have issued reports addressing “fiscal sustainability.” While a precise definition has not been developed, countries generally describe fiscal sustainability in a manner consistent with the following:
- Fiscal sustainability is the government’s ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.<sup>50</sup>

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<sup>50</sup> Australia, Intergenerational Report 2002-3, page 2. Available at: [http://www.budget.gov.au/2002-03/bp5/html/02\\_BP5Overview.html#P23\\_3643](http://www.budget.gov.au/2002-03/bp5/html/02_BP5Overview.html#P23_3643)

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## Primary Summary Display

A47. The primary summary display is a financial statement presenting present value amounts in dollars as well as in relation to the present value of GDP for the projection period. The primary summary display will be presented as RSI for a period of three years and will then become a basic financial statement.

A48. Elements considered for inclusion as mandatory requirements for the primary summary display were:

- (a) total projected spending and receipts,
- (b) the total of all projected receipts and spending (including debt held by the public) presented as the fiscal imbalance,
- (c) amounts displayed as both (present value) dollars and percent of GDP,
- (d) fiscal imbalance as a percent of total projected receipts and total projected spending,
- (e) year-to-year (for example, side-by-side) comparison with prior year,
- (f) net change from year-to-year as a separate column
- (g) disaggregation of major programs funded by earmarked funds (Social Security and Medicare Part A), and
- (h) range information.

A49. A majority of the members decided that (a) through (f) above should be included as minimum requirements for the primary summary display, with the format of the elements left to the discretion of the preparer. An illustrative statement is included in Appendix B.

A50. The Board concluded that disaggregation beyond the categories of Social Security and Medicare for receipts and Social Security, Medicare, and Medicaid for spending would be left to the discretion of the preparer. In addition, the Board decided to require narrative and graphics regarding the possible range of outcomes but not to require presentation of the range on the face of the primary summary display. Such additional items of information can be added by the preparer but are not required.

## Per Capita Measures

A51. The Board considered whether to include per capita measures in the summary display. The technical experts serving on the Fiscal Sustainability Task Force did not come to agreement regarding the display of summary numbers on a per capita, per worker, and/or per household

basis.

- A52. A majority of the technical experts on the task force recommended against per capita measures, for the following reasons:
- (a) Several technical experts strongly objected to the use of per capita summary numbers using current-year population for the denominator. They said that such measures would imply that the current-year population is solely responsible for funding program shortfalls into the distant future. They believe that any changes needed to address the shortfalls projected through, for example, the next 75 years, should be spread across the population throughout that 75-year period.
  - (b) Other technical experts noted that per capita measures may be useful in conveying the magnitude of projected fiscal imbalances and could be displayed if summary amounts are divided by the population that parallels the horizon indicated and a narrative is included that explains present value and the nature of the numerator and denominator.
  - (c) Per capita measures for infinite-horizon projection periods present special problems. It is uncertain how a reasonable per capita denominator for an infinite horizon ratio would be selected and explained, especially if the denominator includes an estimate of all individuals that enter the population during the projection period.
  - (d) Two technical experts believe that even present value per capita amounts can be misinterpreted, because the reader will compare the amount with current salary levels and not understand the role of potential future productivity increases.
  - (e) One technical expert objects to per capita amounts because they represent amounts distributed equally among individuals with widely different abilities to pay.

- A53. After a discussion of the above issues, the Board decided not to include per capita measures in the proposed reporting requirements.

#### Time Horizon for Projections

- A54. There was strong disagreement among the task force participants regarding the selection of a time horizon for projections, in particular a finite horizon (for example, 75-year) versus an infinite horizon. One task force participant believes that only infinite-horizon projections should be displayed but others believe that infinite-horizon projections should not be

shown. Some participants suggested that information using both finite and infinite-horizon projections be included.

A55. A majority of the communications experts believe that information for both finite and infinite-horizon projections should be provided to readers, but not necessarily both within a primary display.

A56. Below are arguments for the finite and infinite-horizon projection periods for the primary summary display that the Board discussed.

A57. Arguments in favor of a finite horizon:

- (a) A finite period would be sufficient to cover essentially all of the working and retirement years for current participants.
- (b) A finite period is subject to less uncertainty than an infinite horizon.
- (c) A finite period is meaningful to readers. For example, readers can relate to a time period that will include the retirement of the youngest members of the current workforce. An infinite horizon is less meaningful to readers. Readers are less likely to relate to or be concerned about the U.S. Government's fiscal condition in 200, 500 or 1,000 years in the future.

(d) Infinite-horizon projections are no more informative to policymakers than 75-year projections, in part because projections beyond the 75-year horizon are subject to huge uncertainty. A more detailed version of this argument is made in an article in the National Tax Journal:

...many people already believe that the 75-year horizon is too distant to be meaningful, and that detailed projections over longer horizons suggest a false precision. A simpler projection assumption is that after 75 years (or some other interval, T), the system will have settled into a steady state in which rates of growth of costs and tax revenues are thereafter constant, although not necessarily equal.<sup>51</sup>

A58. Arguments in favor of an infinite horizon:

- (a) Unless trends are level towards the end of the period, projections may be subject to the "moving window" effect, where shortfalls (or surpluses) increase significantly from one reporting year to the next due to the change in the projection period. For example, if a projection period is 75 years, the activity in "year 76" is outside the projection period for that year, but will be included in the projection period for the following year. An infinite horizon would avoid the "moving window"

<sup>51</sup> *Sustainable Social Security- What Would It Cost?* National Tax Journal, Vol. LVI, No. 1, Part 1, March 2003, page 34. Available at [http://ntj.tax.org/wwwtax/ntjrec.nsf/5DC000487120304885256D8E0054C858/\\$FILE/Lee.pdf](http://ntj.tax.org/wwwtax/ntjrec.nsf/5DC000487120304885256D8E0054C858/$FILE/Lee.pdf)

effect that occurs when there are significant changes to an estimate from one year to the next that are caused by the passage of time.

- (b) Some have argued that a finite projection period essentially assumes zero for years beyond the projection period. Infinite-horizon projections would not assume zero for years beyond the cutoff point for projections.

A59. The Board believes that the advantages of both finite and infinite horizons are sufficiently compelling that both finite and infinite-horizon information should be provided, although only one projection period should be used for the primary summary display. Whichever type of projection period is selected for the primary display, the other type of projection period should be presented with the required narrative and graphics.

A60. The Board also believes that one of the projection periods used (in either the primary summary display or the narrative section) should be consistent with that used for the SOSI. This will ensure consistency between major line items in the SOSI (for example, projected earmarked receipts and spending for Social Security and Medicare) and corresponding line items in the primary summary display or the required narrative.

### The Concept of Fiscal Imbalance

A61. The Board considered two potential “bottom line” measures for the primary summary display: fiscal imbalance and fiscal gap.

(a) The fiscal imbalance is the net present value of existing federal debt plus projected spending,<sup>52</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period.

(b) The fiscal gap is the change in spending or revenue that would be necessary to maintain federal debt as a constant percentage of GDP.

A62. Several of the Task Force technical experts believe that the fiscal imbalance, as defined above, overstates the size of the problem over any finite time period such as 75 years. The fiscal imbalance is defined as the

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<sup>52</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 in Appendix C of the draft ED.

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existing federal debt plus projected spending less projected receipts. If projected receipts are large enough to set the fiscal imbalance to zero after 75 years (or any other fixed time period), this would imply the debt was paid off at the end of the period. That is not necessary for continued solvency provided the economy is expected to last longer than 75 years. A positive level of debt is fiscally acceptable at the end of the projection period, provided it is not too large or growing too fast.

A63. A different measure, often called the fiscal gap, allows for a positive level of debt at the end of the forecast horizon, but it generally sets a limit arbitrarily on how large that debt should be relative to the economy, and shows how increases in receipts (or cuts in spending) would be needed to achieve that target.

A64. Any measure that provides for a positive level of debt at the end of the projection period would also need to state a limit as to the size and growth rate of the debt. In the United States, there is currently no legislated goal for debt as a share of GDP or a legislated limit on borrowing other than the statutory debt limit, which historically has been frequently raised. Since the Board has no objective basis for selecting a debt-to-GDP limit or goal, the Board selected the “fiscal imbalance” concept rather than the fiscal gap concept for the primary summary display.

Appendix B: Example Formats and Illustrations

The examples in this Appendix are illustrative only; they do not represent authoritative guidance.

**Primary Summary Display  
Long-Term Fiscal Projections for the U.S. Government**

Long-Term Fiscal Projections for the U.S. Government  
Amounts projected to 75 years

	As of January 1, 2008 (Current Year)		As of January 1, 20XX (Prior Year)		Change from Prior Year	
	PV Dollars (in trillions)	% GDP*	PV Dollars (in trillions)	% GDP*	PV Dollars (in trillions)	% GDP*
<b>Receipts</b>						
Medicare	\$ 10.7	1.5%	\$ XX.X	X.X%	\$ X.X	X.X%
Social Security	36.3	5.1%	XX.X	X.X%	X.X	X.X%
All Other Receipts	<u>91.0</u>	<u>12.8%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Total Receipts</b>	<b>\$ 137.9</b>	<b>19.4%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>
<b>Spending</b>						
Medicare	\$ 44.8	6.3%	\$ XX.X	X.X%	\$ X.X	X.X%
Medicaid	15.6	2.2%	XX.X	X.X%	X.X	X.X%
Social Security	40.5	5.7%	XX.X	X.X%	X.X	X.X%
Rest of Federal Government**	<u>73.9</u>	<u>10.4%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Subtotal- Spending</b>	<b>\$ 174.9</b>	<b>24.6%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>
Add: Debt Held by the Public	<u>5.0</u>	<u>.7%</u>	<u>X.X</u>	<u>X.X%</u>	<u>X.X</u>	<u>X.X%</u>
<b>Total Projected Spending plus Repayment of Debt</b>	<b>\$ 179.9</b>	<b>25.3%</b>	<b>\$ XX.X</b>	<b>XX.X%</b>	<b>\$ XX.X</b>	<b>XX.X%</b>
<b>Fiscal Imbalance***</b>	<b>\$ 41.9</b>	<b>5.9%</b>	<b>\$ XX.X</b>	<b>X.X%</b>	<b>\$ X.X</b>	<b>X.X%</b>

	As of January 1, 2008 (Current Year)	As of January 1, 20XX (Prior Year)	Change from Prior Year
Fiscal Imbalance as a percentage of projected receipts	30.9%	XX.X%	X.X%
Fiscal Imbalance as a percentage of projected spending	23.9%	XX.X%	X.X%

Note: Amounts are estimated based upon guidance for selecting assumptions provided in this Statement. Receipts and spending include repayment of Social Security Trust Fund (estimated 0.3 percent of GDP). Fiscal imbalance is calculated as a percentage of projected receipts and spending net of intragovernmental receipts and spending estimated at 0.3 percent of GDP.

**Descriptions of the following columns/line items should appear directly below the primary summary display:**

\* GDP (Gross domestic product) can be roughly defined as all of the nation’s income or everything the country produces.

\*\* Rest of government: The repayment of borrowings from the Social Security and Medicare Trust Funds should be included in Receipts for Social Security and Medicare, and Outlays for Rest of government. (If material, these amounts should be displayed on separate sublines.)

\*\*\* The fiscal imbalance is the amount of present value dollars that would be necessary to balance future outlays and receipts and repay existing debt.

### Analysis of changes

Paragraph 38 provides that after the initial year of implementation, comparative amounts for the current year and prior year, and the net change for each line item of the primary summary display be provided. Paragraph 31 requires that when year-by-year comparisons are displayed, a table disaggregate the changes from one year to the next attributable to:

- (a) Valuation period
- (b) Changes in policies (legislation), and
- (c) Changes in assumptions.

The following illustrates how such a table might be displayed. The analysis could be displayed on the face of the primary summary display or in the narrative section.

***Analysis of change in fiscal imbalance***

	PV Dollars (in trillions)	% GDP
Fiscal Imbalance, Prior Year	\$ XX.X	X.X%
Valuation period	X.X	X.X
Legislation	X.X	X.X
Changes in assumptions	X.X	X.X
Fiscal Imbalance, Current Year	\$ XX.X	X.X%

In addition, paragraph 31 requires that narrative explain the reasons for the changes attributable to each of the three categories above.

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## Accompanying Narrative and Graphics

The following illustrations display and/or describe narrative and graphics that might supplement the primary summary display in a manner consistent with the standard.<sup>53</sup>

As noted on page 46, these illustrations are illustrative only and do not represent authoritative guidance. Illustrations are not provided for all requirements. The requirements for narrative and graphics are in paragraphs 31 and 40- 48.

### 1. Rising Cost of Health Care

Paragraph 45 provides that ranges may optionally be displayed for individual programs. For example, if the rising cost of federal spending on health care is a major factor in the long-term spending projections, the narrative section accompanying the primary summary display might include the following:

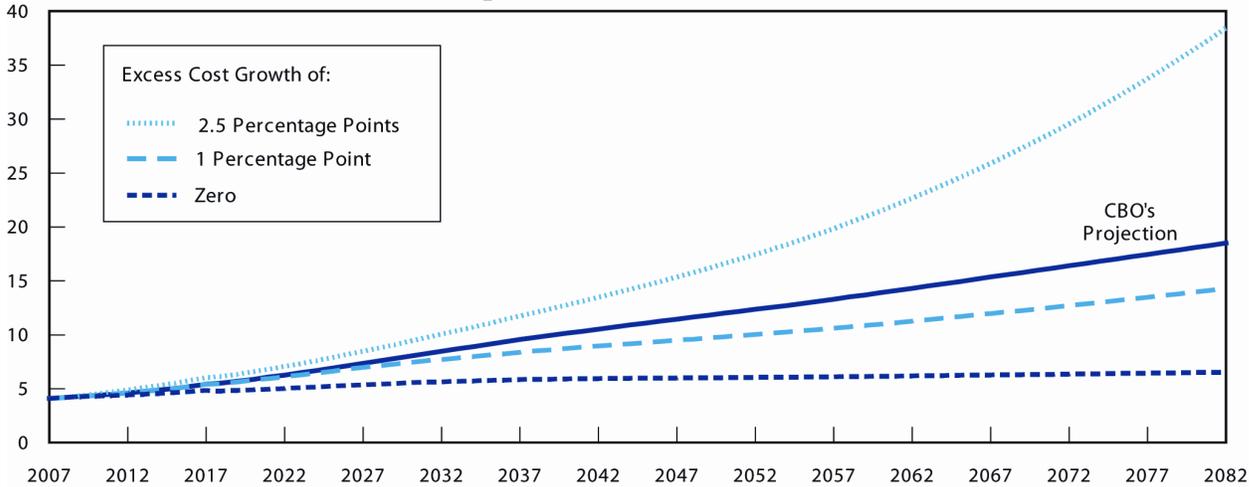
- (a) If the growth in health care costs exceeds the growth in GDP, the narrative might explain that the growth in any spending program cannot continue indefinitely to exceed the growth in the economy, because at some point, the costs would exceed the resources that can be extracted from the economy.
- (b) A range encompassing alternative scenarios (for example, baseline, high, and low estimates) along with a potential “most likely” trajectory if different from “intermediate,” might be presented in a graphic as a percentage of GDP. The graphic could use the example format in Illustration 1a.

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<sup>53</sup> See paragraphs 40-48 of this standard.

Illustration 1a: Range of Alternative Assumptions Graphic

Federal Spending for Medicare and Medicaid as a Percentage of Gross Domestic Product Under Different Assumptions About Excess Cost Growth



Source: Congressional Budget Office, *The Long-Term Outlook for Health Care Spending* (November 2007) Figure 5, page 15. Available at: <http://www.cbo.gov/>.

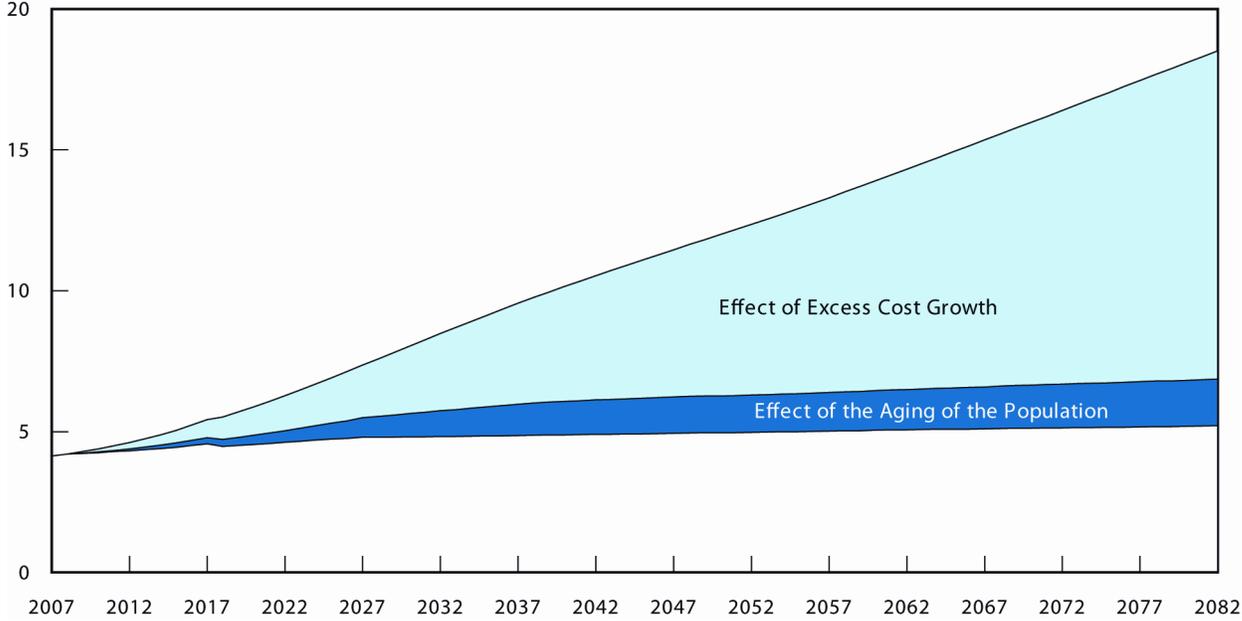
A narrative might describe the assumptions involved in the low, intermediate, and high projections, and if applicable a fourth, “most likely” projection.

In addition, a graphic might display the relative contribution of two or more major cost drivers. For example, Illustration 1b displays the effect of the aging of the population on federal spending on Medicare and Medicaid versus excess cost growth.<sup>54</sup>

<sup>54</sup> Excess cost growth refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal gross domestic product per capita.

Illustration 1b: Relative Contribution of Two Major Cost Drivers

Sources of Growth in Projected Federal Spending on Medicare and Medicaid



Source: Congressional Budget Office, *Op. Cit.*, page 14.

## 2. Demographic Trends

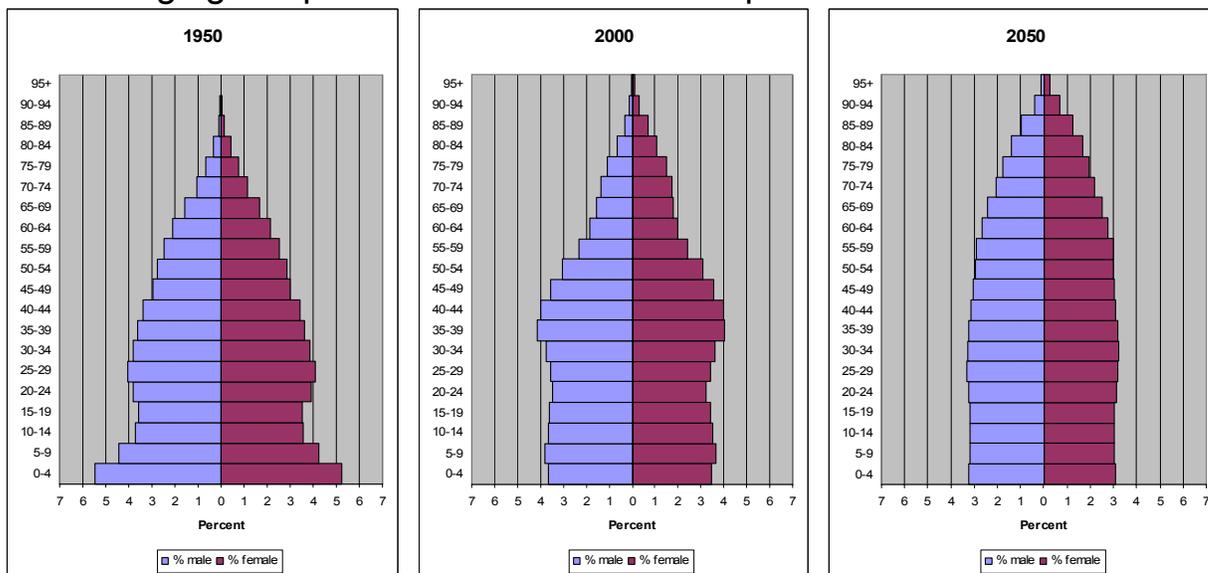
Paragraph 46 requires that narrative and graphics explain and illustrate the major factors that are expected to have a significant impact upon future receipts and spending of the federal government. The narrative might describe demographic trends and briefly explain the major drivers of change in demographic trends, for example, trends in longevity and birth rates, and refer the reader to more extensive coverage of the topic in other existing reports, for example, the Social Security and Medicare Trustees Reports. The narrative could describe the change in the ratio of workers to retirees and how this change relates to long-term fiscal outlook for social insurance programs.

A simple graphic to accompany and illustrate the narrative may follow the format of the example shown below. The illustrative sample format below is called an “age/gender pyramid.” The graphic could display two or three age/gender pyramids side-by-side, for example:

- (1) the current (or other baseline) year minus at least 50 years;
- (2) the current year (or other baseline year, for example, 2000); and
- (3) a projection of the current (or other baseline) year plus at least 50 years.

*Illustration 2: Age-Gender Pyramid*

### The Changing Shape of the United States’ Population



Source: Social Security Administration, Area Population Statistics.

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Alternatively, simple age demographics rather than workforce participation could be used (i.e., “over 64 instead of “retired”) provided that they are used consistently.<sup>55</sup>

The narrative could also discuss the “total dependency” ratio (dependent children plus retirees per worker) for each “worker-to-retiree” ratio that is provided in the narrative.

The narrative also could provide perspective by explaining that similar demographic trends are occurring in other developed countries, and provide examples of developed nation(s) projected to have a greater number of retirees per worker than the United States, and developed nation(s) projected to have fewer retirees per worker.

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<sup>55</sup> The European Commission defines the total dependency ratio as the “Population under 15 and over 64 as a percentage of the population aged 15-64.” *European Economy: Special Report 1/2006*, page 313.

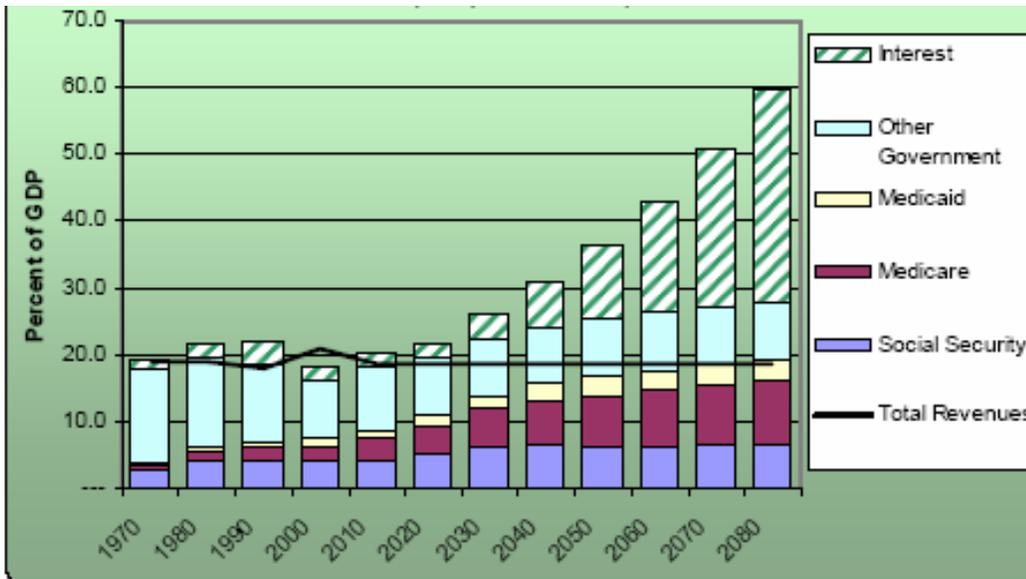
Paragraph 47(a)-(c) requires that narrative ad graphics explain and illustrate the historical and projected trends for a progression of years. Illustrations 3, 4 and 5 display how this might be accomplished.

### 3. Relationship of Projected Receipts and Spending

The narrative section could include a graphic of the relationship between projected receipts and spending for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year.

Below is an example.

**Projected U.S. Government Receipts and Spending**  
(As a percent of GDP)



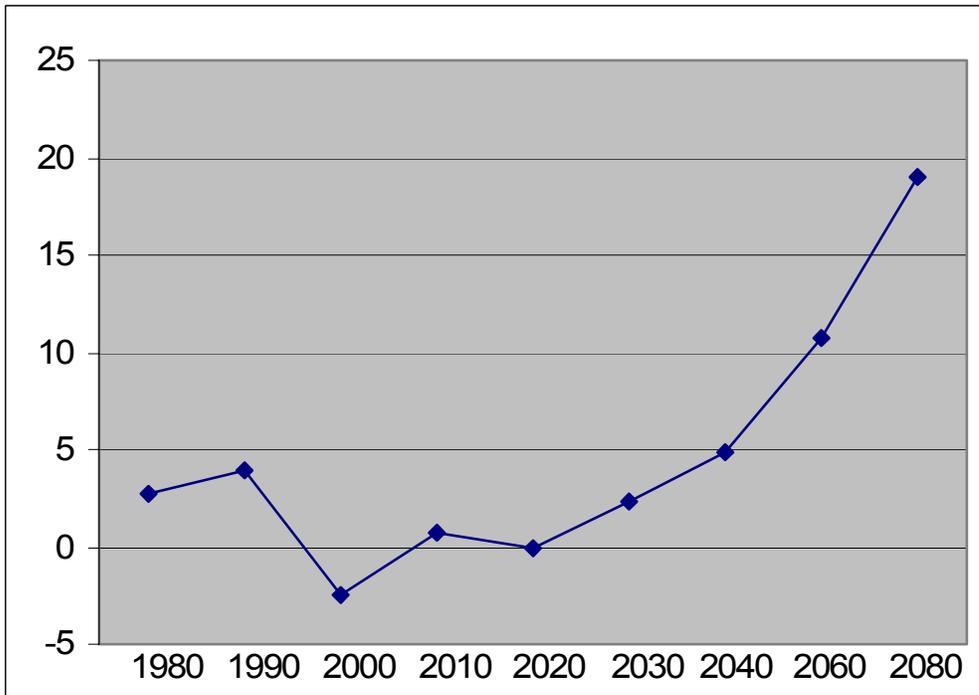
Source: FY 2007 *Financial Report of the U.S. Government*, Chart H, page 18. Available at <http://fms.treas.gov/fr/index.html>.

### 4. Trends in Deficit Spending

The trends in deficit spending could be graphically displayed as a percentage of GDP for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year.

*Illustration 3a: Projected Deficit/Surplus as a Percentage of GDP*

### Projected Deficit (Surplus) as a Percentage of GDP

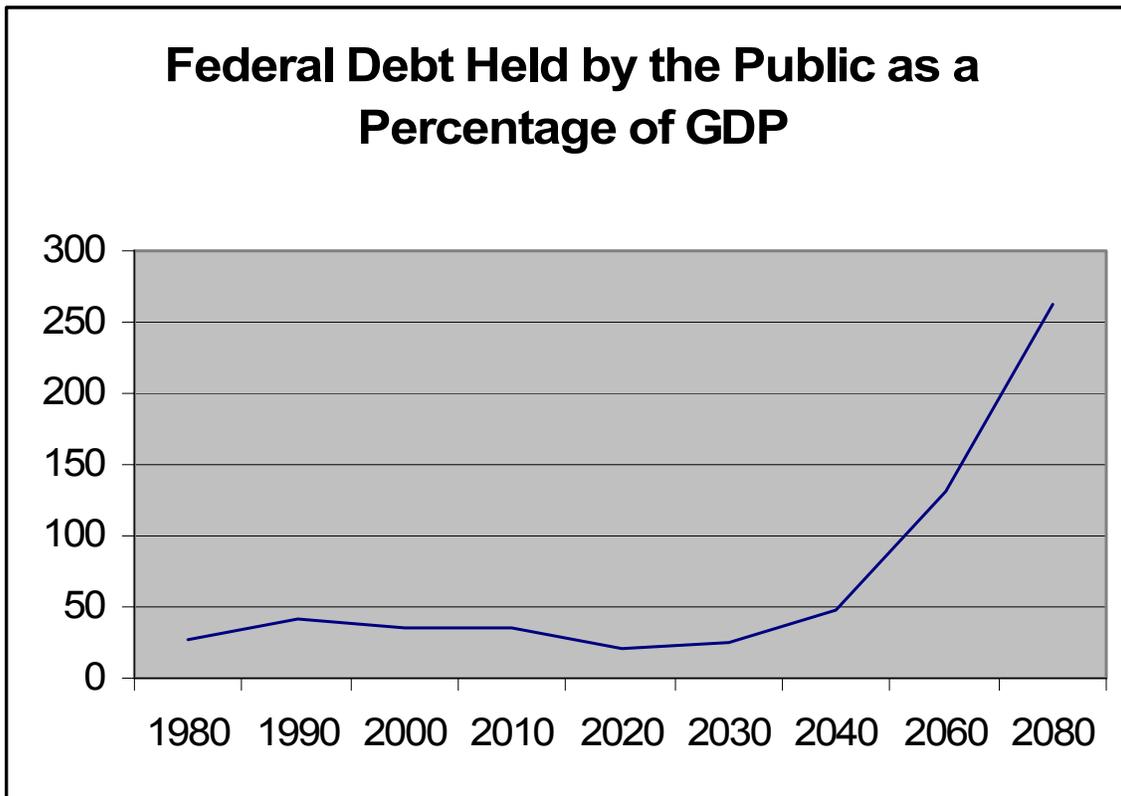


Data source: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget.

### 5. Trends in Treasury Debt

A graphic could display the projected trends in Treasury debt as a percentage of GDP, for a progression of years beginning at least 20 years before the current year and future years projected to at least 75 years after the current year. This graphic could illustrate the assumption that increased borrowing would be substituted for increased taxes and/or reduced spending.

Illustration 3b- Increase in Federal Debt Held by the Public



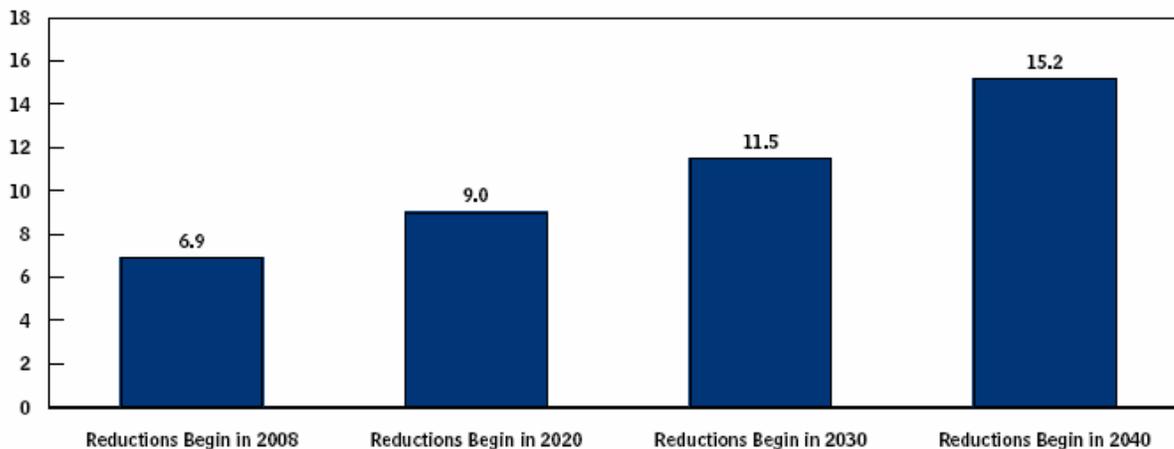
Data source: Office of Management and Budget, Table 13-2, Chapter 13, "Stewardship," *Analytical Perspectives*, FY 2008 Budget.

## 6. Impact of Delaying Action

Paragraph 48 provides that if a fiscal imbalance (shortfall) is indicated by the projections, the narrative section would include a graphic that shows the likely impact of delaying action. Two graphics could display the progressive increase in the change that would be needed to close the fiscal imbalance by (a) reducing spending and alternatively (b) by increasing taxes. Alternatively, either (a) or (b) could be displayed in a graph while the narrative describes the impact of delay on the item not displayed. An example of graphic presentation of (a) is shown below.

### **Reductions in Noninterest Spending Needed to Close the Fiscal Gap in Various Years Under CBO's Alternative Fiscal Scenario**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Notes: The fiscal gap is a measure of federal shortfalls over a given period. It represents the extent to which the government would need to immediately and permanently either raise tax revenues or cut spending—or do both, to some degree—to make the government's debt the same size (in relation to the economy) at the end of that period as it was at the beginning.

The alternative fiscal scenario deviates from CBO's baseline projections during the next 10 years, incorporating changes in policy that are widely expected to occur and that policymakers have regularly made in the past.

Source: Congressional Budget Office, *The Long-Term Budget Outlook* (December 2007) Table 1-3, page 16.

## 7. Range information

Paragraph 45 provides for the explanation and illustration of a range of possible results, and requires a table showing the range for each line item presented in the primary summary display. The following illustration is an example of how such a table might be displayed.

	High	Statement	Low
Receipts:			
Medicare			
Social Security			
All Other			
Total Receipts			
Spending			
Medicare			
Medicaid			
Social Security			
Rest of Government			
Total Spending			
Add: Debt Held by the Public			
Total Spending plus Repayment of Debt			
Fiscal Imbalance			

## 8. Other narrative information

Additional narrative information is required by paragraphs 31 and 40- 48 but is not explicitly described or illustrated in this appendix. For example, paragraphs 41- 43 require an explanation of the nature and limitations of projections. Paragraph 44 requires that the narrative should explain the significance of the graphics and put the information into context.

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**Appendix C: FAQs**
FAQ 1. What is “Fiscal Sustainability Reporting”?

“Fiscal Sustainability Reporting” is the short term for “Comprehensive Long-Term Fiscal Projections and Accompanying Narrative and Graphics in the Financial Report of the U.S. Government.”

FAQ 2. What is GDP?

A nation’s gross domestic product, or GDP, is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:  $GDP = \text{consumption} + \text{investment} + \text{government spending} + (\text{exports} - \text{imports})$

FAQ 3. (a) What is the **debt-to-GDP** ratio? (b) Why does the debt-to-GDP ratio matter?

- (a) The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by GDP. [An alternative ratio would be the amount of total public debt (federal, state, and local) divided by GDP.]
- (b) The debt-to-GDP ratio provides an indication of a nation’s ability to repay its public debt by comparing the size of its debt to the size of its economy. For example, during the formation of the European Union (EU), one of the conditions for initial membership in the EU, which included eligibility to convert its currency to the Euro, was that each nation had to meet certain conditions, including debt-to-GDP ratio.

FAQ 4. What is present value?

Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank today in order to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

In present value calculations, the further out in the future the needed amount, the smaller the amount you would need today. In the first year, you earn interest on the amount that you deposit (the “principal” amount). In the second year, you earn interest on both the original principal amount and the amount of interest that was earned in year one. In year three, you would earn interest on:

- the original principal amount, plus
- the interest earned in year one on the principal amount,

- the interest earned in year two on the principal amount, and
- the interest earned in year two on year one's interest earnings.

This is colloquially called “the magic of compounding.” If inflation is less than the rate of interest earned (in this example, ten percent per year), the “magic of compounding” is an advantage to the party that is earning the interest.

FAQ 5. What is the fiscal imbalance measure?

The fiscal imbalance illustrates the amount of present value dollars that would be necessary to balance future spending and receipts and repay existing debt. .

FAQ 6. What are projections?

Projections are not forecasts or predictions; they are designed to ask the question “what if?” For example, possible “what ifs” may include that tax cuts are (a) allowed to expire or (b) extended. Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

FAQ 7. What factors affect projections?

Projections are affected by three kinds of assumptions:

policy assumptions, economic assumptions, and demographic assumptions.

Policy assumptions address the level of services provided by the federal government as well as the framework for assessing taxes and fees. Policy assumptions include projected changes in the framework for assessing taxes and fees that will be collected, and projected spending rules (for example, benefit formulas) for both mandatory and discretionary programs.

Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation and growth in GDP).

Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

Projections are also affected by uncertainty. Economic and demographic assumptions are generally expressed in a range of possible results. Policy assumptions are generally expressed by providing alternative scenarios that show more than one possible broad direction in which policy might proceed.

FAQ 8. What is the difference between earmarked revenue and other revenue, and what is the nature of **federal trust funds**?

“Earmarked revenue” is revenue that comes from a source that is distinct from general tax revenues and may be used only for the purpose for which it is collected. Examples of earmarked revenue are: Social Security taxes, Medicare taxes, Federal Unemployment taxes, and federal excise taxes on gasoline.

Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” Examples include the Social Security Trust Fund, the Medicare Trust Funds, the Unemployment Trust Fund, and the Highway Trust Fund. The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).
- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.
- When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>56</sup>

<sup>56</sup> SFFAS 27, paragraph 27.

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**Appendix D: Abbreviations**

CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
FAQ	Frequently Asked Question
FASAB	Federal Accounting Standards Advisory Board
FY	Fiscal Year
GAO	Government Accountability Office (formerly, General Accounting Office)
GDP	Gross Domestic Product
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SOSI	Statement of Social Insurance
U.S.	United States

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**Appendix E: Glossary**

**Debt-to-GDP Ratio** - The debt-to-GDP ratio, for the purposes of federal financial reporting, is the amount of federal (Treasury) debt held by the public divided by gross domestic product.

**Demographic Assumptions** - Demographic assumptions address projected population trends (for example, birth rates, mortality rates, and net immigration).

**Discretionary Spending** - In the federal budget process, “discretionary spending” refers to outlays from budget authority that is controlled by annual appropriation acts. Annual appropriation acts are required for the continuing operation of all federal programs that are not “**mandatory**.” “Mandatory spending” includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

**Earmarked Revenue** – Earmarked revenue is revenue that comes from a source that is distinct from general tax revenues and may be used only for the purpose for which it is collected. Examples of earmarked revenue are: Social Security taxes, Medicare taxes, Federal Unemployment taxes, and federal excise taxes on gasoline.

Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).

- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements. When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>57</sup>

**Economic Assumptions** - Economic assumptions address the economic factors that are not under the direct legislative control of the federal government (for example, inflation, and growth in GDP).

**Federal “trust funds”** - Earmarked revenue is generally accounted for in the budget separately, in accounts categorized as “special funds” or “trust funds.” Examples include the Social Security Trust Fund, the Medicare Trust Funds, the Unemployment Trust Fund, and the Highway Trust Fund. The distinction of whether an earmarked fund is categorized in the budget as a “special fund” or a “trust fund” is determined by the applicable legislation. In order to reduce confusion between accounts designated as “trust funds” in the budget and private-sector trust funds, FASAB’s Statement of Federal Financial Accounting Standards (SFFAS) 27, *Identifying and Reporting Earmarked Funds*, prohibits the use of the term “trust fund” for earmarked funds except when referring to the legal title of the fund, and requires the following note disclosure to explain the nature of federal trust funds:

Investments in Treasury securities for earmarked funds should be accompanied by a note that explains the following issues:

- The U.S. Treasury does not set aside assets to pay future expenditures associated with earmarked funds. Instead, the cash generated from earmarked funds is used by the U.S. Treasury for general government purposes.
- Treasury securities are issued to the earmarked fund as evidence of earmarked receipts and provide the fund with the authority to draw upon the U.S. Treasury for future authorized expenditures (although for some funds, this is subject to future appropriation).
- Treasury securities held by an earmarked fund are an asset of the fund and a liability of the U.S. Treasury, so they are eliminated in consolidation for the U.S. Government-wide financial statements.

When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures.<sup>58</sup>

**Fiscal Gap** - The fiscal gap is the change in spending or revenue that would be necessary to maintain public debt as a constant percentage of GDP.

<sup>57</sup> SFFAS 27, paragraph 27.

<sup>58</sup> SFFAS 27, paragraph 27.

**Fiscal Imbalance** -The fiscal imbalance is the net **present value** of existing federal debt plus projected spending<sup>59</sup> minus projected receipts. The fiscal imbalance illustrates the amount that would be necessary to balance projected receipts, projected spending, and repayment of debt for a stated projection period. The fiscal imbalance as of a stated valuation date<sup>60</sup> may be expressed as:

- (a) a summary amount in present value dollars,
- (b) a share of the present value of the GDP<sup>61</sup> for the projection period, and/or
- (c) a share of the present value of projected receipts or projected spending.<sup>62</sup>

**Fiscal Sustainability Reporting** – In federal financial reporting, “Fiscal Sustainability Reporting” is the short term for “Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative in the Financial Report of the U.S. Government.”

**Gross Domestic Produce (GDP)** - A nation’s gross domestic product is one of the ways for measuring the size of its economy. The GDP of a nation is defined as the market value of all final goods and services produced within a country in a given period of time. The most common approach to measuring and understanding GDP is the expenditure method:

$$GDP = \text{consumption} + \text{investment} + \text{government spending} + (\text{exports} - \text{imports})$$

**Mandatory Spending** - “Mandatory spending” includes entitlement authority (for example, Social Security and Medicare and payment of interest on the national debt). Congress controls mandatory spending by controlling eligibility and setting benefit and payment rules, rather than by annual appropriation legislation. For additional information, see *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP.

**Policy Assumptions** - Policy assumptions address the level of services provided by the federal government for both mandatory and discretionary spending as well as the framework for assessing taxes and fees.

<sup>59</sup> Since interest is factored into the present value calculation, the fiscal imbalance as a share of spending is expressed as a share of spending excluding interest. See FAQ 4 on page 58.

<sup>60</sup> See requirement for valuation date in paragraph 32.

<sup>61</sup> GDP is the total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports.

<sup>62</sup> Showing the fiscal imbalance as a ratio of the present values of total projected receipts, alternatively total projected spending, is useful to illustrate by how much projected receipts or spending would have to be changed in order to reduce the fiscal imbalance to zero. However, some policy adjustments may alter both the numerators and denominators of those ratios, thereby compromising the usefulness of ratio comparisons across fiscal projections under different policies.

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**Present Value** - Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

**Projections** – A projection is the calculation of future data based upon the application of trends to present data. Projections are not forecasts or predictions; they are designed to ask the question “what if?” For example, possible “what ifs” may include that tax cuts are (a) allowed to expire or (b) extended. Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

## **FASAB Board Members**

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Alan H. Schumacher

Harold I. Steinberg

Danny Werfel

### **FASAB Staff**

Wendy M. Payne, Executive Director

### **Project Staff**

Eileen W. Parlow

Federal Accounting Standards Advisory Board  
441 G Street NW, Suite 6814  
Mail Stop 6K17V  
Washington, DC 20548  
Telephone 202-512-7350  
FAX 202-512-7366  
[www.fasab.gov](http://www.fasab.gov)

## Attachment 6 - Handout from the February 2008 Board Meeting - Fiscal Sustainability Reporting, Option A

### Option A: Summary of Long-Term Fiscal Position

#### Summary of Long-Term Fiscal Position

As of January 1, 2008

	75 Years		All Future Years	
	PV Dollars (in trillions)	%GDP*	PV Dollars	%GDP*
<b>Receipts</b>				
Medicare	\$ XX.X	1.5%	\$ XX.X	X.X%
Social Security	XX.X	4.8%	XX.X	X.X%
All other receipts	XX.X	12.8%	XX.X	X.X%
<b>Total Receipts</b>	<b>\$ XX.X</b>	<b>19.1%</b>	<b>\$ XX.X</b>	<b>X.X%</b>
<b>Outlays</b>				
Medicare	\$ XX.X	6.3%	\$ XX.X	X.X%
Medicaid	XX.X	2.2%	XX.X	X.X%
Social Security	XX.X	5.7%	XX.X	X.X%
Rest of Federal Government**	XX.X	10.1%	XX.X	X.X%
<b>Total Outlays</b>	<b>\$ XX.X</b>	<b>24.3%</b>	<b>\$ XX.X</b>	<b>X.X%</b>
<b>Fiscal Imbalance***</b>	<b>\$ XX.X</b>	<b>5.2%</b>	<b>\$ XX.X</b>	<b>X.X%</b>
<b>Other Sustainability Measures</b>				
	(in trillions)		(in trillions)	
Total Fiscal Gap****	\$ XX.X		\$ XX.X	

#### Descriptions of the following columns/line items should appear directly below the summary display:

\* GDP (Gross Domestic Product) can be roughly defined as all of our nation's income or everything the country produces.

\*\* Rest of government: The repayment of principal and interest on borrowings from the Social Security and Medicare HI Trust Funds should be included in receipts for Social Security and Medicare, and Outlays for Rest of government. If material, these amounts should be displayed on separate sub-lines.

\*\*\* The fiscal imbalance is the present value of net receipts/outlays plus public debt. The fiscal imbalance illustrates the amount of present value dollars that would be necessary to balance future outlays and receipts and repay existing debt. The fiscal imbalance measure places no constraints on the level of debt. However, excessively high levels of debt can have serious negative consequences on the Government through substantial interest cost in relation to receipts and be unsustainable in attracting investors.

\*\*\*\* The fiscal gap assumes the public debt is maintained at a constant percentage of GDP. Fiscal gap measures assist in understanding the effect of allowing public debt to increase as a constant percentage of GDP. This amount illustrates the amount of present value dollars that would be necessary to maintain public debt as a constant percentage of GDP.