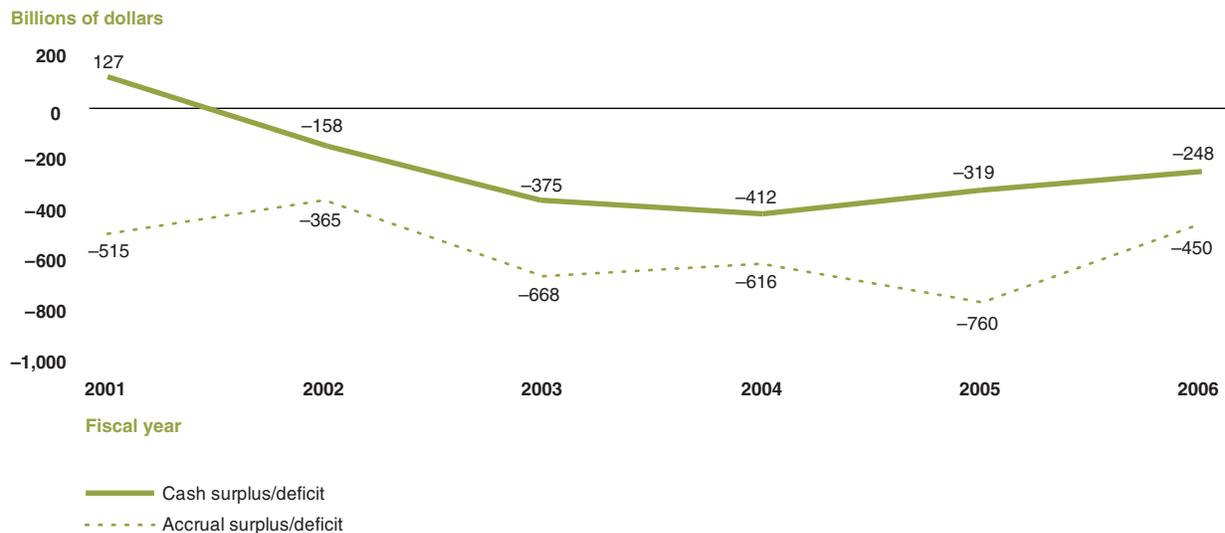


## How Did the Accrual and Cash Measures Change in Fiscal Year 2006?

The following pages update selected information in *Understanding Similarities and Differences between Accrual and Cash Deficits (GAO-07-117SP)* and should be read in conjunction with that document. Importantly, emphasis should not be placed on the precise numbers for either a single year accrual deficit or the change from year to year. Furthermore, for the 10<sup>th</sup> consecutive year, the government was unable to demonstrate the reliability of significant portions of the 2006 *Financial Report of the United States Government*, hereafter referred to as the *Financial Report*, from which the data in this update were taken.<sup>1</sup>

Both the unified budget deficit—sometimes called the “cash deficit”—and the net operating cost—sometimes called the “accrual deficit”—declined in 2006, but the accrual deficit declined more than the cash deficit (see fig. 1). The cash deficit declined by about \$70 billion while the accrual deficit declined by over \$300 billion. These changes are explained in the following pages.<sup>2</sup>

**Figure 1: Cash and Accrual Surpluses/Deficits (Fiscal Years 2001–2006)**



Source: Treasury.

<sup>1</sup> For more information regarding the reliability of federal financial data, see GAO’s auditor report in *Financial Report of the United States Government* (Washington, D.C.: Dec. 15, 2006) and page 16 of [GAO-07-117SP](#).

<sup>2</sup> These changes do not represent a change in the fundamental drivers of the long-term fiscal outlook. For more information on the drivers of the long-term fiscal outlook, see GAO, *The Nation’s Long-Term Fiscal Outlook: September 2006 Update*, [GAO-06-1077R](#) (Washington, D.C.: Sept. 15, 2006).

## Accrual and Cash Deficits Update for Fiscal Year 2006

### What Drove the Change in Cash and Accrual Deficits in Fiscal Year 2006?

The decline in 2006 in both cash and accrual deficits was primarily driven by an increase in federal revenue by almost 12 percent—or about \$255 billion. Because revenue is measured similarly in the budget and financial statements, the increase in revenue reduced both the cash and accrual deficits.

However, cash outlays and accrual-based expenses are measured differently and moved in different directions.<sup>3</sup> Cash outlays increased in 2006 whereas accrual-based expenses declined.<sup>4</sup> This decline was primarily driven by changes in assumptions that are the basis for actuarial estimates for certain accrued long-term liabilities. These changes are discussed below.

#### Veteran and military employee benefits

- **Veterans compensation:** Veterans compensation expenses (in excess of cash outlays) declined by over \$160 billion. The large change is due primarily to changes in the Department of Veterans Affairs' (VA) interest rate assumptions, which are used to discount future benefit payments. In 2006, market-based interest rates used by VA increased. Higher interest rates reduce the present value estimate of future benefit payments and related expenses.
- **Military employee benefits:** Military employee benefit expenses (in excess of cash outlays) declined by about \$95 billion in 2006. This was primarily the result of changes in assumptions underlying the military health benefit liability. In 2005, the military retiree health expense included a larger increase due to changes in assumptions for drug and other costs than in 2006. Additionally in 2006, the military retiree health expense declined because actual experience was better than assumed.

#### Insurance

- The \$50 billion change in insurance expenses (in relation to cash outlays) is primarily attributable to the National Flood Insurance Program. In 2005, insurance costs increased primarily due to expenses accrued for Hurricanes Katrina and Rita, which were paid in 2006.
- Expenses (in excess of cash outlays) related to the Pension Benefit Guaranty Corporation also declined in part because the airline relief provision in the Pension Protection Act of 2006<sup>5</sup> caused some large plans that were previously classified as

<sup>3</sup> The nature of these differences is discussed in [GAO-07-117SP](#) beginning on page 12.

<sup>4</sup> While accrual-based expenses declined, in many areas liabilities still increased as seen in figure 2. The change in the liability is generally equal to accrued expenses less cash payments made to cover expenses.

<sup>5</sup> Pub. L. No. 109-280.

## Accrual and Cash Deficits Update for Fiscal Year 2006

“probable” terminations to be changed to “reasonably possible,” which reduced the estimated losses and removed them from the estimated liability.

### Environmental cleanup and disposal

- One area where expenses (in excess of cash outlays) grew is environmental cleanup, which recorded an increase of about \$35 billion over the previous year. The Department of Energy (DOE) accounts for the largest portion of the increase. According to DOE, this increase resulted from a variety of factors such as regulatory changes and changes in the assumptions it uses about the timing, scope, and technical approach used to clean up or dispose of hazardous waste. For example, DOE’s estimated costs increased significantly because of the additional 7-year delay to 2017 for opening the permanent geologic repository for spent nuclear fuel and radioactive waste at Yucca Mountain.

Because accrual deficits are sensitive to changes in interest rates and other assumptions, any large change in the accrual deficit needs to be examined to evaluate whether it represents a fundamental change in the longer term consequences of today’s policy decisions. Cash deficits are also sensitive to factors unrelated to fundamental changes in policy such as changes in dates when cash is scheduled to be paid or received. For example, in 2006 legislation was passed to delay Medicare payments from the last week of September 2006 into October 2006, effectively shifting about \$4 billion in outlays from fiscal year 2006 to fiscal year 2007.<sup>6</sup> However, these types of changes have been smaller for the cash deficit than for the accrual deficit.

### How Do You Get to the Cash Deficit From the Accrual Deficit?

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

<sup>6</sup> Deficit Reduction Act of 2005 (Pub. L. No. 109-171, section 5203, 120 STAT. 47-48 (2006)).

Understanding Similarities  
and Differences between  
**Accrual and Cash Deficits**  
**Update for Fiscal Year 2006**

**Figure 2: Crosswalk between Accrual and Cash Deficits**

|  | Dollars in billions       |               |
|--|---------------------------|---------------|
|  | FY2005<br>(restated)      | FY2006        |
| <b>Net operating cost (i.e., accrual deficit)</b>                        | <b>-760.2</b>             | <b>-449.5</b> |
| <b>Components of accrual deficit not part of the cash budget deficit</b> |                           |               |
| Changes in liability for military employee benefits                      | 169.6                     | 74.7          |
| Changes in liability for veterans compensation                           | 197.8                     | 31.2          |
| Changes in liability for civilian employee benefits                      | 62.3                      | 81.3          |
| Changes in environmental liabilities                                     | 10.6                      | 45.4          |
| Depreciation expense   | 79.7                      | 82.9          |
| Changes in insurance liabilities   | 31.0                      | -20.4         |
| Other  | -17.2                     | 22.9          |
| <b>Total</b>   | <b>533.8</b>              | <b>318.0</b>  |
| <b>Components of cash budget deficit not part of the accrual deficit</b> |                           |               |
| Outlays for capitalized fixed assets <sup>a</sup>                        | -53.4                     | -103.7        |
| Other  | -33.9                     | -11.7         |
| <b>Total</b>   | <b>-87.3</b>              | <b>-115.4</b> |
| <b>All other reconciling differences</b>                                 |                           |               |
| Net amount of all other reconciling differences                          | -4.8                      | -0.8          |
| <b>Unified budget surplus/deficit (i.e., cash budget deficit)</b>        | <b>-318.5<sup>b</sup></b> | <b>-247.7</b> |

Information available on [www.fms.treas.gov/fr/index.html](http://www.fms.treas.gov/fr/index.html)

Source: Treasury.

Notes: Data reported in the unaudited *Financial Report* for fiscal year 2006. As discussed in the *Financial Report*, the federal government restated its fiscal year 2005 reconciliation statement to correct for errors that occurred during the preparation of the originally issued statement. Because of certain material weaknesses discussed in GAO's audit report, the restated amounts may not be reliable.

<sup>a</sup> Nearly all of this increase was attributable to the Department of Defense (DOD). Because DOD's financial statements are unauditible and the 2005 numbers were restated by a large amount, it is unclear what exactly drove the large change.

<sup>b</sup> The final deficit number published in the President's budget was slightly lower—\$318.3 billion—due to subsequent adjustments. However, we use the numbers reported in the *Financial Report* since it contains the reconciliation between cash and accrual deficits.