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Accounting and Information
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March 22, 1996

The Honorable John R. Kasich
Chairman
Committee on the Budget
House of Representatives

Dear Mr. Chairman:

In your September 6, 1995, letter to the Comptroller General, you expressed concern that the cash budget does not provide the Congress with complete information on the costs of federal insurance programs. In 1990, the Congress recognized this shortcoming for purposes of controlling and budgeting for loan and loan guarantee programs and passed the Federal Credit Reform Act, which required accrual reporting for credit programs. Based on this experience, you asked GAO to identify options for using accrual concepts in the budget for federal insurance programs[1] and to highlight trade-offs and implementation issues associated with the alternatives. This letter provides an interim report on our work.

The federal government insures individuals and entities against a wide variety of risks ranging from natural disasters to bank failures and pension plan insolvencies. Historically, the private sector has been unwilling or unable to provide insurance against these hazards. The fact that these risks tend to be difficult to predict and catastrophic in size has hindered the development of actuarially sound premium rates and loss reserves. In some cases, the federal government subsidizes insurance in order to achieve public policy objectives. Through insurance programs, the federal government is committed to costs that are uncertain and that are not recognized in the budget when the Congress authorizes the insurance to be provided.

[1]The enclosure lists the 13 programs included in our study.

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GAO has long maintained that the cash basis of reporting used in the federal budget may significantly distort the government's costs and that the concept of reporting accrual costs in the budget could result in improved disclosure. When the administration proposed accrual budgeting for insurance programs in 1992, we endorsed the concept but urged the Congress reject the proposal made at that time due to serious concerns about the design and implementation of the approach.[2] As you requested, our current work is focused on more thoroughly developing the significant issues–including design and implementation–in any change in the budget treatment of insurance programs.

Our work to date continues to support our previously stated concern that cash-based budget reporting for federal insurance programs provides incomplete information on the cost of these programs. Cash flows reported in the budget obscure the government's cost and the timing and magnitude of the program's economic impact. The cost of the government's new insurance commitments may be understated or overstated in relation to other federal programs in any particular year because the time between receipt of program collections, the occurrence of an insured event, and the final payment of a claim can extend over several budget periods. As a result, current and future resource allocation may be distorted.

For example, the Pension Benefit Guaranty Corporation (PBGC) collects pension insurance premiums years before the government will have to pay for benefits it insured. In fact, the cash budget has reported a surplus for PBGC in each year since it began operating in 1975. At the same time, PBGC's financial statements, which take into account the future payments to be made resulting from insured events that have already occurred, reported a large accumulated deficit at the end of fiscal year 1995. However, there are also potential future claims from currently operating pension plans not reflected in this accumulated deficit.

The use of accrual concepts in the budget for insurance programs has the potential for enabling budget decisions to be made on the basis of their full expected cost; however, we are still studying a number of significant implementation issues which would have to be addressed before using accruals in budgeting for these programs. Our full report will provide an in-depth analysis of the shortcomings of cash budgeting for insurance programs and the trade-offs and implementation issues which must be considered if the Congress decides to move

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[2]Accrual Budgeting (GAO/AFMD-92-49R, February 28, 1992).

toward accrual reporting for these programs. We hope this interim progress report meets your needs, and we will keep the committee informed as we proceed with our analysis. We are sending a copy this letter to the Ranking Minority Member of your committee.

Our work is being conducted under generally accepted government audit standards. Please contact me at (202) 512-9142 if you or your staff have any questions concerning this letter.

Sincerely yours,

Susan J. Irving

Susan J. Irving
Associate Director, Budget Issues

Enclosure

PROGRAMS INCLUDED IN GAO'S BUDGETING FOR FEDERAL INSURANCE STUDY

PROGRAMS

Aviation War-Risk Insurance
Bank Insurance
Federal Crop Insurance
Federal Employees' Group Life Insurance
National Credit Union Share Insurance
National Flood Insurance
Political Risk Insurance (OPIC)
Pension Insurance (PBGC)
Savings Association Insurance
Service-Disabled Veterans Insurance
Veterans Mortgage Life Insurance
Vaccine Injury Compensation (Post-1988)
War Risk (Maritime) Insurance

Our study includes only those programs previously identified as federal insurance by the Office of Management and Budget and/or the Federal Accounting Standards Advisory Board.

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