Institute for Truth in Accounting

1500 Skokie Boulevard, Suite 304
Northbrook, IL 60062
847-835-5200 fax 847-835-3470
www.truthinaccounting.org

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

Dear Ms. Payne:

Subject: April 10, 2009 Written Testimony

The Institute for Truth in Accounting (IFTA) thanks Chairman Allen and the other distinguished Federal Accounting Standards Advisory Board (FASAB) members for the opportunity to testify before you today. The Institute, founded in 2002, is a nonprofit organization with no political affiliations. It is made up of business, academic, governmental and other community leaders who are committed to high standards of ethics and integrity, and who support these principles in the private as well as in the public sector. Our mission is to enhance the credibility of public and private sector financial reporting by encouraging the issuance of understandable, reliable and relevant information. The federal government of the United States of America (the Government), being the largest fiscal organization in the world, should be the leader in providing such information. To be active participants in their democracy, citizens need such information. To promote the accountability of elected officials, the Government has a special responsibility to provide the public with information that allows for the evaluation of the decisions made by those elected officials.

On February 25 you heard numerous testimonies from people who are working or have worked for the federal government or other governmental entities. Because of my humility I am hesitant to infer that I am only speaker here today who truly represent the ordinary citizens outside of the Washington, D.C. area. But please consider these facts:

- This process is happening in the seat of the federal government, which is far away from the vast majority of our huge country;
- Most Americans are busy working hard to stay ahead during these strenuous economic times, and most people can't afford the time and resources to join us here today. As the list of people testifying today demonstrates, the ordinary working Joe or Josephine does not have the (and I use this term loosely) **luxury** and resources to pay for a hotel room and to buy a plane ticket to travel to their nation's capital to comment on an accounting standard that affects tens of trillions of their taxpayer dollars and their personal retirement security.

- I am fortunate to be able to commit my **personal** time and money to speak to you today.

So as you consider the testimony you hear today and the written testimony on these two important exposure drafts, please keep in mind you have not heard from a true representation of Joe, six-pack; Joe, the plumber, or just the ordinary men, women, and most importantly the **children** of America. I will do my best to give you an idea of what they might think of these proposed standards.

But first I would like to give you some history on budget deficits, myself and the Institute for Truth in Accounting.

I started working on federal budget issues in 1992. At that point the budget deficit had reached an all-time high of $290 billion. By 1997 the budget deficit was reported to be $22 billion. On January 27, 1998 in his State of the Union Address President William Jefferson Clinton expressed his commitment to strengthening Social Security by stating that we must put "Social Security First." At that point he started an effort to educate the public about the program and the long-term sustainability issues, so they would understand the need for the reforms he would propose in the next year. This education program was going along smoothly, when lo and behold on May 26, 1998 President Clinton announced a $39 billion projected annual budget surplus and a $150 billion surplus projected over the next ten years. Later it was projected that we would have surpluses "As far as the eye could see."

When President Clinton made this announcement the "Social Security First" education program stopped and any ideas of reforming Social Security were buried. After all, Americans thought that we had hundreds of billions of dollars, if not trillions of dollars, in Washington just waiting to be spent. Couldn't we just use that money to fix Social Security and to do whatever else we wanted?

The "surpluses" continued for the next couple years. But something was troubling me and to audiences I was giving speeches to. How could we be running surpluses while the debt was going up? As an accountant this made no sense to me. So I spent a whole summer digging through the 197 federal budget investigating this. I don't remember why I didn't have something better to do that summer. In the fall I came to the conclusion that we were not really running surpluses. Any surplus money was already allocated to Social Security and other "trust funds". Harvard Law School professor Howell Jackson's study found that if you accounted for Social Security on the accrual basis we were actually running half of a trillion dollar deficit.

Then came the 2000 Presidential election. The use of the "surpluses" became a big campaign issue. Some of you might have voted for Gov. George W. Bush because he said the surplus should be returned to the taxpayer in the form of tax cuts. Some of you might have voted for Vice President Al Gore because he said he would use some of the surplus for tax cuts, some for spending programs and put the Social Security surplus in a "lock box." But I knew that if you did the accounting "right", there was no surplus. I started the Institute for Truth in Accounting over my frustration that the American people had elected the leader of the largest financial institution in the world, the United States federal government, based on fuzzy math. The facts were that we did not have surpluses we actually had more than $3.5 trillion of public debt and $20 trillion of unfunded liabilities for Social Security and Medicare. Instead of focusing on how

the country was going to deal with these unfunded liabilities, especially in light of the coming baby boomer retirement, people were focused on how to spend factious "surpluses."
These examples illustrate the fact that how you account for surpluses and deficits does matter. It is imperative that the financial statements have a number that is the accrual equivalent of the cash basis budget deficit number. That number should be the "Net Operating Cost" that appears on the Statements of Operations and Changes in Net Position. I will return to the importance of the Budget Deficit/Net Cost discussion later in my testimony.

Thomas Jefferson once said, "An informed electorate is the basis of a sound democracy." To be knowledgeable participants in their government the public must be given relevant, accurate, objective and understandable information. At the core of such information are unbiased accounting standards. *The heart of these standards is the standard setting body. The soul of this body is independence.* The information reported, using these standards, must not be skewed to the advantage of elected officials, their appointees and employees, or any political entities. The selection of Federal Accounting Standards Advisory Board (FASAB or the Board) members and the procedures used to set standards must facilitate this neutrality and objectivity.

The selection of FASAB members and the procedures used to set standards must facilitate neutrality and objectivity. In November 2006 FASAB issued a document titled, "Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting." This document correctly noted, "Independence has been identified as the most significant criterion for a GAAP standards-setter." The 2008 FASAB Facts states that, "To accomplish its mission, the FASAB acts to: Be objective and neutral and ensure, as much as possible, that the information resulting from its proposed standards is a faithful representation of the effects of Federal Government activities." This document continues, "Objective and neutral mean free from bias, precluding the FASAB from placing any particular interest above the interests of the many who rely on the information contained in financial reports." To ensure public confidence the independence of the FASB needs to be above question.

Many question the FASAB's objectivity and neutrality. Significant political consequences may result from the information reported on the federal financial statements. The Board's three principals are appointed to their positions by elected officials and four Board members are employed by elected officials. Because most of the principals and federal members of the Board hold their position based upon their relationship to elected officials, they have a vested interest in the content and format of information reported to the voting public. The clear conflict of interest faced by the Federal government employees, places them in an awkward and untenable position when considering decisions that can have a direct or even indirect impact on their agencies. And virtually all the FASAB decisions have a direct impact on these members' employers. This is especially true with the proposed standards we are discussing today.

These standards cannot be tainted by the interest of any particular group, inside or outside the government.

The influence of governmental officials was questioned last time the Board debated whether Social Insurance should be a liability. In a December 21, 2000 Fax Alert titled, "The Case of the Missing Liability", he Concord Coalition noted that the requirement to report the Social

Insurance Liability as a liability on the balance sheet was "dropped at the insistence of the administration, which doesn't want the public to focus on the liability number."

From the first time I heard about the FASAB, I have been concerned about the Board's lack of independence. Governmental officials have the authority to appoint members to the governmental standard setting body. I equivocate this to the auditors and accountants of General Motors determining what General Motors will report on their financial statements.

In 1999 my concerns over the FASAB's independence was echoed by your current chair, Tom Allen, then the head of Governmental Accounting Standards Board; Edmund Jenkins, then the head of the Financial Accounting Standards Board; and Manuel Johnson, then the head of the Financial Accounting Foundation. These well-respected gentlemen stated that the FASAB contained several members who clearly lack independence. Mr. Jenkins stated, "The Treasury is subject to the standards promulgated by FASAB, yet it has veto power over those same standards." He also added that the Treasury, the GAO and the OMB can unilaterally terminate FASAB's authority with 120 days notice. "Where is the independence under this veto power and termination arrangement?" he asked. Some objections were made that if the standards generated by the "non independent" FASAB were considered GAAP, the stature and credibility of all GAAP is being be jeopardy.[1]

During the deliberations of the social insurance standard, my apprehension about the Board's independence was heightened. In the fall of 2006 the FASAB issued a Preliminary Views document on accounting for Social Security, Medicare and other social insurance programs. All six public members of this Board agreed that a social insurance liability should appear on the federal balance sheet and a corresponding expense should appear on the "income statement."

Usually when such a consensus is reached the Board issues an Exposure Draft for public review. It appears that the Preliminary Views document was issued as a part of a stall technique. It also appears that the people in the federal government do not want sunlight to be shed on the fact that last year's federal deficit was not $452 billion as reported in budget documents or $1 trillion deficit as reported on the federal income statement. The true deficit was more than $5 trillion if social insurance costs were reported properly. The process seems to have been stalled until new members could be appointed to the Board. Since the fall of 2006 three of the six "public" or non-federal members have left the FASAB. New members were appointed by FASAB's three principals. Two of the three new Board members are former Deputy Controllers at OMB. These two new Board members also represented that agency on the FASAB.

In November 2008 an Exposure Draft on accounting for social insurance was issued and a public hearing on the Exposure Draft was held. With the new members the Board has switched its position and is now proposing a standard that would **not** report the social insurance liability as a liability on the balance sheet or a social insurance expense on the federal income statement.

---

[1] "Financial Reporting, AICPA Recognizes FASAB as GAAP Standard Setter," Journal of Accountancy-Online Issues March 2000
http://www.journalofaccountancy.com/Issues/2000/Mar/AicpaRecognizesFasabAsGaapStandardSetter.htm

This seems like a form of jury tampering---the deliberate attempt to influence the composition and/or decisions of a jury during the course of a trial to get a desired outcome. Jury tampering undermines the public confidence in the deliberation process, the verdict and the whole judicial system.

The influencing of the FASAB's composition and the attempt to influence the social insurance accounting decision has left me with little confidence in their standard setting process and in the final social insurance standard that will be issued. Such tampering leaving me questioning the whole federal government financial reporting system and the information it produces. It is very disheartening to know that this process is stacked against the most important constituents of the federal financial information --- WE, THE PEOPLE.

Since I am here I will comment.

First the Exposure Draft on Fiscal Sustainability exposure draft. I believe the title of the basic financial statement should be "Statement of Fiscal Sustainability." A balance sheet that included the liability for Social Insurance programs would provide the "financial condition" information.

Paragraph 38 of the exposure draft says that "Information may be provided for a single target debt to GDP ratio, multiple rations or over a continuum ratio". The ED's executive summary mentions the concept of inter-period equity. This concept means that one generation should not have the ability to pass debt onto the next generation. This means that no debt should be passed on. Assuming the GDP grows, then the debt could grow and the debt to GDP ratio would stay the same. This is contrary to the inter-generational concept of no debt being incurred.

As a member of the Fiscal Sustainability Communications Task Force, I must remind the Board to keep the information presented as simple as possible and to avoid overwhelming the reader. Also keep in mind that in this modern day of technology the basic information can be easily linked to more detailed information. I like the Basic Financial "Statement for Long-Term Projections for the U.S. Government," even though I believe it will overwhelm and confuse the unsophisticated reader of the financial reports. The verbiage about the actions that would need to be taken to avoid unsustainable levels of federal debt is good. I always worry about the use of the "GDP", but the simple explanation at the bottom of the proposed basic financial statement is good. I would be hesitant to put specific programs titles in the standard and basic financial statement, because if new or other programs became larger than the specified programs, then they would be reported in a combined number. I would advise you to consider saying something like programs over X% of total receipts and spending need to be detailed separately.
I believe that only the infinite horizon project period should be reported. Politicians have used very creative legislative verbiage to work around budget projection's periods. In the past legislation has been crafted that prescribes expenditures outside budget projection's period (5 or 10 years). This has enabled legislators to promise services or benefits in the future without having a financial impact during the budget projection period. By requiring an infinite time horizon requirement, the standard would not allow such trickery to be used in Fiscal Sustainability Reporting, i.e. legislation that would mandate massive tax increases in year 76 and thereafter, could be used to reduce the fiscal gap.

Now for the Social Insurance Exposure Draft.

I strongly believe that the social insurance "commitment" should be an amount reported as a liability on the Balance Sheet and the related cost should be reported as an expense on the Statement of Net Cost.

Transparency, not translucency, was not the goal the Board set for itself in 2003 when it first committed to improving how these social insurance liabilities are reported. Social insurance benefits are set automatically through continuing appropriations. Congressional action is required to increase or decrease these benefits. Reporting the social insurance liability on the face of the Balance Sheet and related cost on the Statement of Net Cost would allow the public and their elected officials to straightforwardly identify increases or decreases in promised benefits. Then the public could easily evaluate their elected officials' decisions to adjust benefits.

Unfortunately because of Board manipulation, the proposed standard is translucent. Translucent in that it permits light to pass through but diffusing it so that the numbers are not clearly visible. This is what I believe, but someone should do an official survey and ask the public if they believed that Social Security and Medicare are liabilities of the federal government. In my personal survey everyone is dumbfounded when I asked them if these liabilities should be on the government's balance sheet. They can't believe they aren't already. But I usually talk to business people, so I tried to think what the woman on the street would think about this. I assume the woman on the street not being sure what I meant by a liability would whip out their BlackBerry and look up the definition on www.dictionary.com

See Supplemental Document – Definition

A liability is an obligation and an obligation is a promise. The term "entitlements" is used in discussing the social insurance programs. The term "entitlements" is defined by dictionary.com as "the right to guaranteed benefits under a government program, as Social Security or Medicare." A guarantee is a promise. You are proposing using the term "Commitments" at the bottom of the balance sheet, so I looked up the word commitment. Commitment is defined as a promise or an obligation. A liability is also defined as an obligation. You will be eroding public confidence in this process if you insist on playing this cynical, circular game of semantics.

Now back to the discussion about deficits. This is not the time to debate **if** deficits matter, but accounting for deficits **does matter**. A corporation's bottom line or earnings per share is what people pay attention to. As I illustrated at the beginning of my testimony, surplus/ deficit amounts are what attention is given. In his Presidential address last night Pres. Obama noted that he will cut the deficit in half in the next four years. At the Institute we call the deficit amount the marquee number.

The financial statement equivalent to the budget deficit is the "Net Cost." I will call the "Net Cost" the "fiscal deficit." The federal government's "Income Statement" must include the costs accruing for its two largest programs; Social Security and Medicare. By reporting the Social Insurance Commitments below the line on the Balance Sheet the costs related to these enormous commitments are not being included in the government's Net Cost, which is the accrual equivalent to the highly reported and utilized budget deficit amount.

See Supplemental Document - Deficit Calculations and Key Measures

In FYE 2004 Congress and the President made the decision to enact the largest expansion of a federal program since the creation of Medicare. The financial affect of this massive decision was not included in either the $412.3 billion Budget Deficit or the $615.6 billion Net Costs amounts. To not include the $8 trillion effect of the decision to enact Medicare Part D (prescription drugs) in the federal "income statement" and related "deficit" number is unscrupulous. The FASAB "Objectives of Federal Financial Reporting Statement of Federal Financial Accounting Concepts Number 1" states that accountability and decision usefulness is a fundamental value of governmental accounting and financial reporting. How can the federal financial reports be decision useful if they do not clearly identify the financial effect of an $8 trillion decision? How can the federal financial reports assist in determining accountability if they do not clearly identify the financial effect of the decision to pass $8 trillion on to future taxpayers?

As indicated on the Deficit Calculation schedule the Budget Deficit for FYE 2008 was $454.8 billion and the Net Cost was $1,009.1 billion. The Fiscal Deficit, including the change in Social Insurance and other liabilities, was more than $5 trillion. In his State of the Union address President Barack Obama said that he would cut the deficit in half by the end of his first four year term. This number is only the cash basis number. The Internal Revenue Service does not allow a corporation that has revenues of more than $5 million report their financial information on the cash basis. The FASAB members all agree that the social insurance programs are unsustainable. The public should understand the amount that these programs liabilities are growing each year. If the President is going to address these liabilities, then he should be working to cut the Fiscal Deficit in half.

Below the Deficit Calculation schedule is a Table of Key Measures. We recommended that this format be used instead of the format illustrated in Appendix B table of the Exposure Draft.

Also attached is what the Institute fondly refers to as "page 11." When this schedule was included in the MD&A in FYE 2003 and 2004 I considered this a success for truth and transparency in the Federal government. You can imagine my disappointment when this schedule was removed from the MD&A. If you do not properly record the Social Insurance liability in the government's balance sheet, then I would strongly encourage that you require this schedule to be included in the MD&A.

Other comments about the exposure drafts:

The closed group should be used. I don't believe people who are not current participants in the programs should be included in the calculations.
To avoid adding complications to the basic financial statements, such a "statement of changes in social insurance amounts" should be included in Required Supplemental Information.
The "accrued benefit obligation" is the most truthful amount of the Social Security and Medicare "obligation". This amount should be presented on the face of the balance sheet as a liability.

The “present value of future payroll taxes and income taxes to be paid” should not be included in the calculations of the accrued liability and related current year cost. These “earmarked” taxes are “earmarked” in name only. In reality these taxes are just like any other tax, because they are commonly used to pay for non-social insurance benefits and services.

In conclusion I would like to tell you about my experience after I testified before this Board on September 27, 2006. On this date Rick Skiba, an IFTA Expert Advisor, joined me in testifying before the FASAB on its proposed concepts statement, Definition and Recognition of Elements of Accrual-Basis Financial Statements. Steve Goss, Chief Actuary of the Social Security Administration, also testified that morning. My recollection of his testimony was he stated he did not believe Social Security or Medicare should be recorded as a liability on the federal government financial report. In follow up Questions & Answers, I recall that one of the FASAB members asked Mr. Goss if he was saying that the federal government did not owe citizens benefits until benefit checks are printed. Mr. Goss said that was correct.

After these testimonies I returned home to Chicago. Two days later I had the opportunity to attend a breakfast where, then Congressman, Rahm Emanuel was the keynote speaker. After the Hon. Emanuel spoke he was asked about the fact that workers of corporations are losing retirement security because corporations are shifting from defined benefit programs to defined contribution programs. He expressed concern that retirees would not be guaranteed a level of benefits under a defined contribution program. Then he stated that this is why we must keep Social Security strong because it is the only “guaranteed” benefit that retirees can count on. This re-election marketing strategy proliferates through the entire Congress and the President.

The Institute for Truth in Accounting would agree that the Social Insurance promises should not be included as a liability on the federal government balance sheet and the related expense should not be included on the income statement if the following conditions exist:

1) The benefits for Social Security and Medicare are an annual appropriation, instead of a permanent appropriation;
2) There is no indication that taxes taken out of workers pay check are for Social Security and Medicare;
3) Government employees and officials, including members of Congress and the Administration do not use the term “trust fund” to describe funds that the Government has custody and control of and does not take on a fiduciary responsibility to hold in trust for beneficiaries;
4) Personalized annual Social Security Statements of estimated benefits are no longer issued;
5) American workers are told that all taxes taken out of their paychecks are forms of taxation, not “contributions” maintained in separate “trust fund” accounts;
6) The American public and their elected officials are resolutely and repeatedly told that social insurance benefits are not guaranteed and can be canceled or reduced at any time; and
7) There is a law that considers it felony fraud for any Government employee or officials, including members of Congress and the Administration, to imply the continuation of social insurance programs and the solvency of “trust funds.”

I have been working on federal budgeting and accounting issues for fifteen years. During that time I have determined that the number that the media and public regularly pay attention to is the deficit number. Within the government's annual financial report there is a number that corresponds to the deficit number. It is called net costs. If members of FASAB have a problem with calling the Social Insurance obligations "liabilities," then we strongly urge that these obligations are put them on the balance sheet in some other understandable form. More importantly it is imperative that the increase or decrease in Social Insurance obligations is included in the net costs. This information would empower citizens to hold elected officials accountable for changes made to these programs.

The Institute for Truth in Accounting would like to thank you again for the opportunity to comment on these Exposure Drafts. In your deliberation please consider that citizens need to be able to clearly see all of the relevant facts about our country's financial position on a timely basis and in an understandable format.

Thank you for your time and consideration.

Sincerely,

Sheila A. Weinberg, Founder & CEO