



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

JUN 23 1987

Honorable Joseph J. DioGuardi  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Joe:

This is in response to your letter of June 3, 1987, suggesting that the Administration use accrued deficit estimates to compare the record of the Reagan Administration with that of the Carter Administration. You also asked whether there were any problems in applying accrual accounting concepts to the measurement of Federal indebtedness.

It is a pleasure to hear from someone who understands the importance of improving financial management in the Federal Government. As you know, we have been giving high priority to a series of wide-ranging financial management reforms. In this connection, I am pleased to tell you that we will be announcing shortly the appointment of Gerald Riso, Associate Director for Management in OMB, as Chief Financial Officer of the United States. This office is being established to accomplish the needed reforms intended by H.R. 1241, which you introduced. He will serve as a focal point for financial management improvement efforts in the central management agencies, as well as the program agencies, and will ensure that program, budget, and financial management reforms are fully coordinated.

As for shifting the entire budget to an accrual basis using Generally Accepted Accounting Principles (GAAP), we have studied the idea on several occasions during the past two decades, most recently this past year, and the general conclusion has always been that there are more drawbacks than benefits from an across-the-board application of the accrual concept to the budget. The enclosure discusses some of the major problems that would be encountered if the entire budget were shifted to an accrual accounting basis and identifies the current uses of accruals in the budget.

As you probably know, the President's recent proposal to reform Federal credit programs is based on accrual accounting concepts. If the President's credit reform program is enacted, a clear identification of the subsidy elements in Federal credit will be shown, and Federal intervention in the credit market will be minimized. Because of your professional background as a Certified Public Accountant, you are likely to recognize and

than twice the first-term (cash) deficit of \$733 billion (FY 1982-85) reported in the President's budget. A similar point could be made with respect to the relationship between the deficit and gross national product (GNP). The annual average accrual-based deficit for the first Reagan term is more than twice the average annual cash-based deficit. These significantly higher accrual estimates could further complicate relations with our nation's major allies who are concerned with continuing high U.S. deficits.

Although shifting the entire budget to an accrual basis has major drawbacks, there are benefits to selective use of the accrual concept. As a result, accruals are used in three major areas.

1. All major business-type revolving funds (such as the Postal Service and the TVA) maintain cash and accrual records. While net cash outlays are included in quantifying budget outlays for these activities, every year the President transmits to Congress business-type statements on an accrual basis for these Federal business-type operations. These statements are published in the Appendix to the President's budget.
2. Interest on the debt held by the public is recorded on an accrual basis.
3. To the extent that Federal law provides for funding Federal programs on an accrual basis, the budget reflects the accruals. For example, the most recently enacted major Federal employee retirement systems, the Federal Employees' Retirement System (FERS) and military retirement system are on an accrual basis.

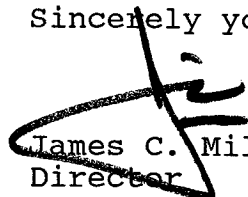
In addition, the President's credit reform proposal was transmitted on the equivalent of an accrual basis in March of 1987.

appreciate the benefits from this type of proposal more readily than others. We hope that we can count on your support in enacting this proposal.

Incidentally, I should point out that the years you have identified as "the Carter years" and as "the Reagan Years" (first term) are not the ones used generally. For purposes of budget attributions, the Carter years are FY 1978 through 1981 and the first term of President Reagan covers FY 1982 through 1985. It appears that using FY 1982-85 for President Reagan's first term might have a significant effect on your conclusions.

Thank you for taking the time and the effort to share your views on these very important matters with me.

Sincerely yours,



James C. Miller III  
Director

Enclosure

Enclosure

## USE OF ACCRUAL ACCOUNTING IN THE PRESIDENT'S BUDGET

The idea of shifting the entire budget to an accrual basis using Generally Accepted Accounting Principles (GAAP) has been studied on several occasions during the past two decades, most recently this past year, and the general conclusion has always been that there are more drawbacks than benefits from an across-the-board application of the accrual concept to the budget.

The additional workload and reporting burden that would be associated with a shift to an across-the-board approach -- especially for Defense, grant programs, and tax receipts -- are major obstacles. Another is that estimates of deficits on an accrual basis will vary considerably depending on the assumptions used to estimate the accrued deficit.

For example, the accrued deficit for fiscal year 1984 is estimated at \$333 billion when Generally Accepted Accounting Principles (GAAP) are applied using Arthur Andersen & Co. assumptions. If the most recent Treasury/General Accounting Office assumptions and GAAP principles are used, the accrued deficit for the same year is estimated at \$140 billion. The cash-based deficit for fiscal year 1984 was \$185 billion. Thus, the Arthur Andersen and Co. approach added \$148 billion to the cash-based deficit, while the Treasury/General Accounting Office approach subtracted \$45 billion from it. If previously published Treasury/General Accounting Office assumptions are used, the accrued deficit estimate for that year is \$215 billion.

The difference of \$193 billion between the highest and the lowest of these GAAP-based deficit estimates underscores one of the major drawbacks of accrual deficits. Accrual deficit outcomes are based upon standards that are not fully developed or agreed upon, and, therefore, are not supportive of our need for consistent reporting. In the atmosphere in which the Federal budget is decided, accrual accounting could easily lead to more -- not less -- confusion in reporting on the deficit.

Because of these differences in standards and the resulting large differences in the estimate of the deficit, the Administration has not used accrual-based estimates to compare the record of President Reagan's first term (FY 1982-85) with the record of the Carter Administration (FY 1978-81). In addition, the estimates based on the Arthur Andersen & Co. assumptions could be viewed in many different ways. For example, the estimates could be used to make the point that the cumulative deficit for the first term of the Reagan Administration on an accrual basis was really more