Enhanced Financial Reporting for Unfunded Obligations in the US Economy

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ABSTRACT

This article looks at the critical need for better financial reporting on unfunded obligations in the federal government of the United States' budgeting and accounting processes. A more comprehensive view is offered by financial records like the yearly Financial Report of the United States Government (FRUSG) published by the U.S. Treasury, which includes incurred debts and undeclared promises. Actions to alleviate the long-term financial discrepancy can be prompted by including these estimates into the regular budget decision-making procedures. The paper highlights the need of openness in future spending by examining particular cases of undisclosed liabilities and contrasting federal cash-based bookkeeping with accrual accounting methods used by public companies. Therefore, the article proposes an improved reporting framework that promotes responsible financial management, urging decision-makers to make informed decisions about the nation's financial health by carefully examining crucial components and consulting experts on government accounting principles.

Keywords: Governmental accounting**,** Unfunded obligations**,** Federal budgeting**,** Budget transparency**,** Fiscal policy**,** Fiscal gap

INTRODUCTION

Unfunded obligations refer to financial commitments and liabilities that are not adequately accounted for in the current cash-based budgeting and accounting practices of the federal government. These obligations encompass substantial future expenditures, including but not limited to Social Security, Medicare, federal pensions and interest on the national debt. The existing budgeting approach, although effective for short-term financial tracking, falls short in comprehensively addressing these long-term fiscal responsibilities. The presented article explores the necessity of enhanced financial reporting to bridge this gap and ensure a more complete and transparent understanding of the nation's fiscal health (Committee for a Responsible Federal Budget, 2021). The longstanding cash-based budgeting and accounting practices of the United States government have played a foundational role in federal financial management for decades. These practices are good for monitoring short-term spending and income. However, they don't adequately handle significant long-term financial responsibilities like Social Security, Medicare, federal pensions, and national debt interest. These commitments extend far into the future and are absent from current accounting methods, creating an incomplete picture of the federal government's long-term fiscal condition. In essence, enhanced financial reporting is imperative specifically in order to address this insufficiency. It represents a paradigm shift in fiscal stewardship, emphasizing transparency and completeness. This approach aims to bridge the gap between the present and the future, immediate and enduring, accounting for all fiscal obligations, including accrued liabilities and hidden commitments often overlooked in traditional budgeting (Bushman et al. 2016). It serves as a guiding light towards responsible fiscal stewardship within this context of inadequacy. This article passionately advocates for integrating enhanced financial reporting into government budgeting, fostering dialogue among policymakers, financial experts, and citizens. It aims to reshape the US fiscal landscape towards transparency and accountability for responsible fiscal governance.

Aims and Objectives:

The objectives of this research is to:

1. Evaluate the Deficiencies in Current Financial Reporting Practices.
2. Investigate the Impact of Enhanced Financial Reporting on Policymaking.
3. Examine Comparative Accounting Approaches and Potential Implementation Challenges.

LITERATURE REVIEW

Current accounting practices within the federal government that are primarily based on cash-based budgeting and accounting methods exhibit significant deficiencies in capturing the magnitude of impending financial obligations (Weygandt et al. 2018). These practices are inherently short-sighted, focusing on immediate cash inflows and outflows, thereby failing to comprehensively account for the colossal future expenditures looming on the horizon. Supplemental financial reports like the U.S. Treasury's annual Financial Report of the United States Government (FRUSG) serve as a beacon of hope in addressing the limitations of current accounting practices. These reports go beyond the confines of traditional budgeting by encompassing accrued liabilities and commitments that are not formally recognized in the federal budget. FRUSG, in particular, plays a pivotal role in providing a more comprehensive and forward-looking perspective on the government's fiscal health. The significance of including accrued liabilities and commitments in financial reporting cannot be overstated. These unacknowledged obligations represent a substantial portion of the government's fiscal responsibilities, including but not limited to future payouts for federal employee benefits and veterans' benefits. Incorporating these elements in financial reporting is not merely a matter of transparency; it is a fundamental step towards responsible fiscal stewardship (Committee for a Responsible Federal Budget, 2021).

The case study is imperative to underscore the gravity of the issue and the pressing need for enhanced financial reporting (Heritage Foundation, 2022). Let us delve into one such case study by focusing on the staggering $7 trillion in unfunded obligations for federal employee and veteran benefits. By examining this substantial liability and comparing it with the total assets of the US government at that time, we can grasp the immense net liability situation. Furthermore, it is crucial to emphasize that this $7 trillion represents just one facet of the larger issue as there are numerous other unfunded liabilities whose figures have not even been considered yet. This stark comparison sheds light on the urgent necessity for comprehensive and transparent financial reporting, accurately reflecting the government's fiscal state and ensuring informed policy formulation. The Congressional Budget Office (CBO) plays a pivotal role in shaping the fiscal landscape of the United States through its Long-Term Budget Outlook (Rocco, 2021). It is a critical resource that serves as a compass for understanding the potential fiscal challenges and opportunities that lie ahead. One of its primary functions is to project spending, revenue, and debt for the next three decades specifically within the CBO's long term budget outlook. These projections serve as a stark reminder of the significant fiscal pressures that were specifically faced by the U.S. government. The CBO's forecasts provide a sobering insight into the mounting obligations associated with programs like Social Security and

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Medicare, illustrating their substantial impact on the nation's long-term fiscal health (Joyce, 2011: Joyce et al. 2015).

The analysis of the CBO's Long-Term Budget Outlook reveals a deeply concerning and unsustainable trajectory primarily driven by the escalating costs of health and retirement benefit obligations. This trajectory underscores the urgency of addressing these unfunded liabilities and taking decisive action to put the nation on a more sustainable fiscal path. Failure to do so could have dire consequences for future generations, including substantial economic burdens and diminished fiscal flexibility (Capretta, 2013: Congressional Budget Office. 2011). Integrating the CBO's projections into mainstream budget policymaking is a transformative step that could significantly impact the nation's fiscal future (Arnold, 2018). Policymakers gain access to invaluable insights that can inform strategic fiscal planning by incorporating these long-term forecasts into the decision-making process. The potential impact is substantial, as it could motivate policymakers to take proactive measures to close the long-term fiscal gap, including necessary reforms to health and retirement benefit programs. This integration has the potential to foster responsible fiscal stewardship and ensure a more sustainable financial future for the United States. The role of the CBO and its long-term budget Outlook cannot be overstated in the quest for enhanced financial reporting and responsible fiscal management. Integrating these projections into the budgetary process represents a significant step toward addressing the nation's long-term fiscal challenges head-on.

Fiscal Gap and Policy Proposals

The "fiscal gap" is a renowned term that indicates the difference between the government's projected revenue and its projected spending over an extended period, typically 30 years or more. This concept provides a more comprehensive view of the government's financial health beyond the annual budget cycle (Guo& Neshkova, 2018). In recent years, the fiscal gap has grown significantly, mainly due to rising healthcare costs and the aging population (U.S. Department of the Treasury, 2023). The Congressional Budget Office (CBO) projections reveal a daunting fiscal gap that threatens the nation's long-term fiscal stability. Understanding the magnitude of this gap is crucial for policymakers as it highlights the unsustainable trajectory of current fiscal policies (Congressional Budget Office, 2023). Policymakers and experts have put forth various proposals aimed at bringing the government's long-term finances back into balance in order to address the growing fiscal gap. There are two primary approaches that are often considered specifically for addressing fiscal challenges, manage government budgets, reduce deficits, or balance government finances including spending cuts and tax increases. In this regard, the believers for spending cuts argue that reducing government expenditures is necessary to close the fiscal gap. This approach often involves reforms to entitlement programs (Alesina et al., 2019). So, implementing means-testing, raising the retirement age, or adjusting benefits are potential measures to curb spending growth. On the other side another approach is to increase government revenue through taxation. This may involve raising income tax rates, introducing new taxes, or broadening the tax base. Proponents of tax increases argue that a combination of higher revenue and responsible spending can help bridge the fiscal gap (Glomm et al. 2018). Nevertheless, a well-rounded strategy encompassing both expenditure reductions and tax hikes can be pivotal in this scenario. This approach strives to distribute the fiscal adjustment burden fairly while ensuring the protection of vital government programs.

However, each proposed solution for addressing the fiscal gap involves a set of policy trade-offs and important considerations. For instance, while spending cuts have the potential to shrink the overall fiscal gap, they might adversely affect vulnerable populations dependent on government programs. Hence, policymakers should thoughtfully weigh the social and economic ramifications of trimming benefits or altering eligibility criteria. Although increase in tax can generate additional revenue, there are associated adverse economic consequences, such as decrease investment and consumption, potentially affecting economic growth. Hence, it has been seen that the balanced approaches has the potential to mitigate the negative impacts of both spending cuts and tax increases. In this regard, the policymakers should play their crucial role in order to navigate a complex landscape of competing interests and ideologies.

METHODOLOGY

The presented research employed a comprehensive literature review approach. The objective was to investigate the enhanced financial reporting for unfunded obligations within the US economy. The structured approach involves the systematic examination of scholarly articles and reports from reputable institutions. It also included government publications, and peer-reviewed journals by focusing on the areas of accounting practices.

A rigorous search strategy was employed to identify seminal works. In this regard, the peer-reviewed articles, and official reports relevant to the topic are work. Different sources including PubMed and Google Scholar were utilized. Additionally, the government repositories were extensively utilized as they played an important role in data collection. The literature selected for analysis met stringent inclusion criteria. Most of the emphasis is given to the relevance of enhanced financial reporting and federal budgeting. Additionally, the unfunded obligations and comparative accounting methodologies were also in the top searches. A special preference and focus were given to recent studies to ensure currency as last decade's researches were utilized. On top of that, the thematic arrangement facilitated the identification of key concepts, arguments, and gaps within the literature. The review process involved a critical synthesis of findings. Different sources, enable the identification of prevalent viewpoints of the research. The literature review emphasized uncovering challenges. The challenges that were faced by current accounting practices in capturing long-term fiscal obligations.

FINDINGS AND DISCUSSION

Findings

The federal government's budgeting process is based on cash accounting and has long been criticized for its failure to incorporate significant long-term fiscal obligations (Berdine, 2014). Among these are the enormous unfunded liabilities associated with Social Security and Medicare, which remain conspicuously absent from the official budget. One of the most substantial unfunded liabilities is the projected 75-year shortfall for Social Security, estimated at a staggering $59.4 trillion. This shortfall is a result of various factors, including the aging population, increased life expectancy, and a declining worker-to-retiree ratio. The federal budget currently does not fully account for these impending obligations (Heritage Foundation, 2022). Similarly, Medicare faces a substantial unfunded liability, largely due to rising healthcare costs and the same demographic challenges affecting Social Security. Medicare's unfunded liability adds significantly to the fiscal burden particularly over the next 75 years. The failure to acknowledge these obligations in the budget obscures the true financial outlook. It is also essential to delve into the specifics of the projected $59.4 trillion 75-year shortfall for Social Security and Medicare particularly in order to comprehend the gravity of these unfunded liabilities. The primary driver behind this substantial shortfall is the demographic shift in the United States.

Discussions

The retiree count receiving benefits is expected to increase significantly as the baby boomer generation retires. Meanwhile, the working-age population supporting these programs won't grow as quickly. This creates a large funding gap, worsened by the continual rise in healthcare costs, adding to Medicare's fiscal challenges. The strain on Medicare's budget intensifies contributing significantly to the unfunded liability as medical expenses continue to outpace inflation. Similarly, the revenue streams funding Social Security and Medicare, primarily payroll taxes, may prove insufficient to cover the promised benefits (Goss, 2010). This discrepancy between revenue and obligations further widens the fiscal gap. On the other side, acknowledging these liabilities provides policymakers with a more accurate understanding of the fiscal challenges ahead (Sun & Zhang, 2021). This knowledge allows for informed decision-making on how to address these looming issues, whether through revenue enhancements, expenditure reductions, or structural reforms. In the same way, the early recognition fosters the development of long-term plans to ensure the sustainability of social security and medicare. Delaying action only exacerbates the financial strain and limits the range of viable solutions. On the other side, it increases the likelihood of enacting necessary reforms specifically when the public and policymakers are fully aware of the looming fiscal challenges. Public support for changes to these critical programs can be garnered more effectively when the extent of the issue is transparent. Furthermore, recognizing these unfunded liabilities aligns with responsible fiscal stewardship. It ensures that the government addresses its financial commitments honestly and proactively, rather than allowing them to accumulate and potentially lead to a fiscal crisis.

The Build Back Better Act

The Build Back Better Act that was proposed by the United States government that represents a significant legislative initiative aimed at addressing various economic and social challenges facing the nation (Hallegatte, Rentschler & Walsh, 2018). This was specifically introduced with the aim of promoting economic growth, enhancing social safety nets, and addressing the issue of climate change (White House, 2023). It encompasses a broad spectrum of policy measures, including significant investments in infrastructure, healthcare, education, and renewable energy. It also entails adjustments to taxation policies and social programs as part of its key provisions (Hallegatte et al. 2018: White House, 2023). The Build Back Better Act underwent a comprehensive analysis by the Congressional Budget Office (CBO) at the beginning when it was first introduced. This analysis involved evaluating the fiscal impact of the legislation over a 10-year horizon. The official CBO scoring, which is based on traditional budgeting methodologies, indicated that the Act would lead to a decrease in federal deficits over the initial 10-year period (Committee for a Responsible Federal Budget, 2021). This assessment is often a focal point in legislative discussions, as it directly influences political support and opposition to the proposed legislation.

While the official scoring by the CBO offers a valuable glimpse into the Act’s immediate fiscal consequences, it falls short in presenting a comprehensive view of its long-term impacts. This is where the importance of long-term fiscal scoring becomes evident. Enhanced financial reporting, including extended projections, is essential to grasp the Act’s broader financial impact over multiple decades. The long-term fiscal scoring allows policymakers and the public to assess the sustainability of the policies outlined in the Build Back Better Act beyond the immediate budget window (Committee for a Responsible Federal Budget, 2021: Center on Budget and Policy Priorities, 2021). It considers the long-term costs and benefits associated with the legislation, especially those related to entitlement programs and commitments that may extend well beyond the initial 10-year period. This perspective is crucial for making informed decisions about the Act’s feasibility and its impact on the nation’s fiscal health. In addition to this, the Act’s long-term fiscal impact as it is revealed through extended scoring specifically underscores the necessity of enhanced financial reporting. Certain aspects of the Act may have substantial fiscal consequences in the years and decades following its enactment. On top of that, the enhanced reporting mechanisms that are similar to those used in the U.S. Treasury’s annual Financial Report of the United States Government (FRUSG) or the CBO’s Long-Term Budget Outlook can provide a more comprehensive assessment of the Act’s implications. Enhanced reporting offers policymakers and the public a clearer understanding of the Act’s true fiscal impact on the government’s long-term financial condition specifically by incorporating long-term projections and accounting for unfunded obligations that extend beyond the traditional budgeting window.

Accrual Accounting vs. Cash-Based Accounting

The decision between utilizing cash-based accounting or accrual accounting carries considerable significance when it comes to comprehending an entity's financial well-being and commitments specifically within the field of financial reporting (Colbea & Hlaciuc, 2015). The federal government predominantly employs cash-based accounting for its budgetary and financial reporting purposes. But when this methodology is compared to accrual accounting it reveals the strengths and weaknesses that are inherent in each approach (Jones et al., 2013).

The federal government primarily utilizes a cash-based accounting system, recording transactions when cash is received or disbursed. It has the advantage of simplicity, making it easier to track cash flows in and out of the government's coffers (Bushman et al. 2016). However, it falls short when it comes to capturing the entirety of the government's financial obligations. On the other side, Accrual accounting records transactions when economic events occur regardless of when the cash is exchanged. Accrual accounting is generally employed by most public companies and is considered a best practice in financial reporting (Gordon et al. 2017: Abolhallaje et al., 2014).

The accrual accounting offers greater transparency by recognizing expenses when they are incurred even if the cash transaction occurs at a later date. This is particularly crucial in the context of the federal government's unfunded obligations. It provides enhanced clarity regarding impending costs including future liability recognition, long-term planning, budgetary transparency, decision-making and comparability (Christensen & Parker, 2010). Accrual accounting recognizes future liabilities and obligations as they arise. In the case of the federal government, this means recognizing ongoing commitments such as Social Security, Medicare, and federal pensions as they accumulate over time (Flynn et al. 2016). These obligations, often spanning decades, represent a substantial portion of the government's fiscal responsibilities. Similarly, it enables long-term financial planning by accounting for future expenses in the present. This is essential for managing large, long-term liabilities effectively. It allows policymakers to assess the sustainability of current fiscal policies and make necessary adjustments to ensure fiscal responsibility (Flynn et al. 2016: Rahman et al. 2013). It assists policymakers and the public understand the long-term implications of current budgetary decisions, fostering transparency and accountability. Accrual accounting also facilitates better decision-making by offering insights into the real cost of government programs and policies (Cohen et al. 2013). Furthermore, accrual accounting also enhances comparability between different entities whether they are public or private. It enables a uniform evaluation of financial well-being across a range of entities by encompassing government agencies as well.

Lessons from State and Local Governments

State and local governments have pioneered more transparent accounting practices when it comes to reporting unfunded pension liabilities. Their approach offers valuable lessons for the federal government in addressing its own unfunded obligations. The state and local governments typically follow Governmental Accounting Standards Board (GASB) guidelines for reporting pension liabilities (Kim et al. 2022). These guidelines require governments to report their pension liabilities in a more comprehensive manner, providing a clearer picture of their long-term obligations. The state and local governments regularly conduct actuarial valuations of their pension plans. These valuations estimate the present value of future pension benefit payments owed to current and retired employees (Quinby et al. 2020). This practice helps in determining the extent of unfunded pension liabilities. GASB standards mandate comprehensive disclosure of pension-related information in financial statements (Dambra et al. 2023). It includes details on actuarial assumptions, funding policies, and the composition of the pension plan's assets and liabilities. On top of that it is also required to present the funded status of their pension plans prominently in financial reports. It includes reporting the difference between the actuarially determined pension liability and the plan's assets (the unfunded liability). The governments are encouraged to regularly review and adjust their pension funding policies based on the results of actuarial valuations. It ensures that they are making progress towards fully funding their pension obligations.

The federal government can learn several lessons from the reporting practices of state and local governments regarding unfunded pension liabilities. Adopting similar reporting rules for federal unfunded obligations including entitlement programs like Social Security and Medicare, could enhance transparency and fiscal responsibility. In this regard the federal government could implement standardized reporting guidelines similar to GASB standards in order to comprehensively disclose its unfunded obligations. This would involve conducting actuarial valuations, clearly presenting the unfunded liabilities, and disclosing the assumptions used (Martell et al. 2013). Similarly, transparency stands as a fundamental principle. The federal government should provide detailed information about the unfunded obligations by including their nature, magnitude, and long-term implications. It is also crucial that this type of vital information must be readily available to both policymakers and the general populace. It is necessary for the federal government to undertake periodic evaluations of its unfunded commitments.

Expert Opinions on Governmental Accounting

The expertise of professionals and scholars in the field also played a crucial role in order to gain further insights into the challenges and potential reforms related to governmental accounting. So, their opinions and recommendations on governmental accounting practices in the United States is investigated.

Honorable David M. Walker held the esteemed position of the seventh Comptroller General of the United States and led the U.S from 1998 to 2008. Government Accountability Office (GAO). He underscored the pivotal significance of precise and comprehensive financial reporting within both federal and state governments throughout his tenure. His advocacy echoed the vital need for transparency and accountability in our public financial systems. He argues that the lack of transparency in reporting has contributed to budget deficits and debt crises. That is why he suggested that constitutional rights, such as the right to vote, freedom of speech, and due process, are violated when governments fail to provide accurate financial information to the public. In addition to this, Professor Brian T. Fitzpatrick, a legal scholar at Vanderbilt Law School, with expertise in constitutional law and judicial matters, discusses the issues of standing and the political question doctrine concerning lawsuits related to governmental accounting. He pointed out that individuals who have purchased government debt may have standing to sue. He also argues that when both the executive and legislative branches have an incentive to keep financial information from the public, the judiciary should play a vital role in ensuring transparency and accountability (Federal Accounting and Standards Advisory Board, 2023). On the opposing side, Mary Foelster, a well-versed expert in governmental accounting, stresses the importance of transparency in financial reporting. She highlights a limitation of the federal government's current cash-based budgeting approach: it fails to offer a comprehensive view of forthcoming costs. He also highlighted the need to adopt accrual accounting methods in order to offer greater transparency regarding long-term financial obligations. In addition to this, Sheryl Lassiter as he is one of a Senior Manager, AICPA emphasized that state and local governments are already required to report unfunded pension liabilities on their balance sheets. He suggested that similar pension reporting rules should apply to the federal government to provide a more accurate representation of its fiscal health. Her perspective underscores the need for consistency in financial reporting practices across different levels of government (AICPA-CIMA, 2022). These expert opinions underscore the urgency of addressing transparency and accountability issues in governmental accounting. Their insights provide a valuable perspective on the need for reform in financial reporting practices to uphold constitutional rights and ensure responsible fiscal stewardship.

Generational Impacts and Long-Term Solutions

The long-term sustainability of major entitlement programs has significant implications for future generations.

Failure to reform these programs could lead to a dire financial situation for both the government and younger generations. The projections indicate a substantial funding shortfall with the unfunded obligations for Social Security and Medicare alone estimated at a staggering $59.4 trillion over 75 years. This massive unfunded liability poses a substantial burden on future generations. The younger Americans face the possibility of reduced or delayed benefits with higher taxes without reform in order to cover the growing funding gap. The unchecked growth of entitlement spending threatens to crowd out other essential government functions and investments in areas like education, infrastructure, and research. In this regard, the generational accounts would track the lifetime contributions and benefits of individuals across different age groups. The policymakers can better assess the fairness and sustainability of these programs by particularly separating the financial impacts on distinct generations. This approach offers a more transparent view of how current policies distribute benefits and costs across generations. Furthermore, the concept of generational accounts allows for the illustration of each generation's net benefits versus taxes paid into the system. This analysis can expose discrepancies in the treatment of various age groups, underscoring the necessity for reforms. For example, it may show that younger generations contribute more in taxes throughout their lifetimes compared to the benefits they receive. Conversely, older generations may receive more in benefits than what they contributed. So, insights of this nature can shape dialogues aimed at recalibrating entitlement programs to foster enhanced intergenerational fairness.

CONCLUSION

Considering our analysis and discussion, it's crucial to emphasize the need for better financial reporting to ensure responsible fiscal management. The current cash-based budgeting and accounting practices employed by the federal government fall woefully short in capturing the magnitude of unfunded obligations, including those associated with Social Security, Medicare, federal pensions, and the national debt's interest costs. This incomplete fiscal picture obscures the true long-term financial condition of the government. The presented article has illuminated the necessity of integrating holistic financial reports like the U.S. Treasury's FRUSG and the CBO Long-Term Budget Outlook into mainstream budget policymaking. Policymakers should understand the importance of unfunded obligations and include them in annual budgets. This way, they can make smart choices to protect the nation's financial future. It's essential to focus on long-term fiscal transparency and include detailed reports in budgets as this helps in ensuring that fiscal policies are sustainable and fair.

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