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Accrual Accounting in Federal Budgeting:

Retirement Benefits for Government Workers

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I. Introduction

Each year, the Department of the Treasury files a Financial Report of the United States Government which includes a variety of Financial Statements of the United States and other explanatory documents about the government's financial activities. These Financial Statements are calculated and presented largely on an accrual basis, which records revenues when they are earned, and expenses whey they are incurred.[1] Each year, the President, through his Office of Management and Budget (OMB), prepares a budget that aggregates spending and revenues and submits that budget to the Congress, which ultimately passes a budget resolution. The President's Budget accounts for revenue and expenses largely through cash-based accounting, which records revenues when cash is received, and expenses when cash is paid.[2] In the Financial Report, the Treasury includes a table detailing the reconciliation of net operating cost (based on the calculations in the financial report) and the unified budget deficit (based on the Presidential/Congressional budget). Most of the differences between the net operating cost and the budget deficit are attributable to military employee benefits, civilian employee benefits, and veterans' compensation. This paper seeks to understand how the differences arise in these categories, specifically focusing on the differences in accounting and reporting procedures for pension benefits and health care benefits.

As background, the federal government operates three major pension plans. The first is the Civil Service Retirement System (CSRS) which is only available to civilian employees hired before 1984. The newer system for civilians is the Federal Employees'

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[1] David Burd & Takeshi Fujitani, *FASAB & The Financial Statements of the United States: Comparing Budget Aggregates to Financial Statements*, 2, (May 2005), *available online at* http://lawweb.usc.edu/cslp/conferences/fiscal%20challenges/documents/13-FASAB.pdf.

[2] Id. *citing* U.S. Gen. Accounting Office, Budget Issues: Budgeting for Federal Insurance Programs, Testimony by Susan J. Irving, GAO/T-AIMD-98-147 (April 23, 1998), at 2.

Retirement System (FERS) which applies to all employees hired after December 1983. Finally, military personnel are covered under the Military Retirement System (MRS). Civilian employees have their health care provided through the Federal Employees Health Benefits (FEHB) program. Military employees receive health care benefits through the Department of Defense Tricare program.

II. The FASAB Standards for Pensions and Other Retirement Benefits

The Federal Accounting Standards Advisory Board (FASAB) mission is to develop accounting standards and principles for the federal government.[3] The FASAB accomplishes this mission by issuing standards, interpretations, technical bulletins, and technical releases in accordance with policies and procedures approved by the Department of the Treasury, the Office of Management and Budget, and the Government Accountability Office.[4] These three central agencies, referred to collectively as the "sponsors," established the FASAB in 1990.[5] The *Statements of Federal Financial Accounting Standards, Current Text ("Current Text")* is a FASAB Staff document that compiles the original text that currently constitutes the body of accounting standards for the U.S. government in a major topic format.[6] One of the topics in the *Current Text* is Pensions, Other Retirement Benefits, and Other Post-Employment Benefits.

The Pensions, Other Retirement Benefits, and Other Post-Employment Benefits standards go into great detail about what type of actuarial method should be used to calculate the expense, revenue and liability for pension plans and other retirement

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[3] THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD, STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS, VOLUME II, CURRENT TEXT, iii, (June 2004), *available online at* http://www.fasab.gov/pdffiles/voliiv4.pdf.
[4] Id.
[5] Id.
[6] Id.

benefits. The standards also explain how both the administrative entity and the employer entity should account for the expenses and liabilities. The term "employer entity" is an entity that employs federal workers and thereby generates the employee costs, including pension cost.[7] An "administrative entity" is responsible for managing and/or accounting for the pension or the other employee plan.[8] For example, entities that receive "salaries and expense" appropriations are employer entities, while the Office of Personnel Management is an administrative entity because it administers the civilian retirement benefit plans.[9]

A. Pensions[10]

Pension plans provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement.[11] Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features.[12] Federal civilian and military employees are covered primarily under the following three defined benefit retirement plans: Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS), and Military Retirement System (MRS).[13] The FASAB has developed pension plan accounting standards for both the entity that administers the plan (the "administrative entity") and the actual federal employer (the "employer entity").

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[7] OFFICE OF MANAGEMENT & BUDGET, STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS NUMBER 5, ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT, Paragraph 57, (September 1995), *available online at* http://www.fasab.gov/pdffiles/sffas-5.pdf.
[8] Id.
[9] Id.
[10] The FASAB standard for pensions addresses "defined benefit plans," which define the future benefits that will be paid in terms of such factors as age, years of service, or compensation. The amount of benefits depends on a number of future events incorporated in the plan's benefit formula.
[11] FASAB, *supra* note 3, at 432.
[12] Id.
[13] Id. at 434.

The "aggregate entry age normal" actuarial cost method is the method used to calculate the pension expense, the liability for the administrative entity financial statements, and the expense for the employer entity financial statements.[14] "The aggregate entry age normal method is one under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages; and it should be applied to pensions on the basis of a level percentage of earnings. The portion of this actuarial present value allocated to a valuation year is called the "normal cost." The portion not provided for at a valuation date by the actuarial present value of future normal cost is called the "actuarial accrued liability."[15] The FASAB requires assets to be reported separately from the pension liability and states that the assets should be carried at their acquisition cost and adjusted for amortization if appropriate.[16] The FASAB also provides accounting standards for past service costs, which result from retroactive benefits granted when a new plan is initiated, and prior service costs, which result from retroactive benefits granted in a plan amendment.[17] The FASAB requires the administrative entity to immediately recognize all past and prior service costs, without amortization.[18] Similarly, if a plan amendment results in a gain to the extent that previously recognized benefits are reduced, the gain must be immediately recognized.[19] Actuarial gains and losses must also be recognized immediately.[20]

[14] Id. at 435.
[15] Id.
[16] Id. at 436.
[17] Id.
[18] Id. at 437.
[19] Id.
[20] Id.

Using the aggregate entry age normal actuarial method, the administrative entity should account for and report the pension liability.[21] The liability is the actuarial present value of all future benefits, based on projected salaries and total projected service, less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan.[22] The administrative entity should report pension expense, which is the net of the normal cost; the interest on the pension liability during the period; any prior and past service costs from plan amendments (or the initiation of a new plan) during the period; and any actuarial gains or losses during the period.[23] The administrative entity should also report pension revenue for the amounts received from the employer entities (consisting of contributions by the employer and contributions by the employees).[24] The employer entity's contribution is an intragovernmental transfer and should be eliminated for government-wide consolidated financial statements.[25]

B. Other Retirement Benefits

Other Retirement Benefits ("ORB") include all retirement benefits other than pension plan benefits.[26] The predominant benefit in the federal government is retirement health care benefits.[27] Future health care benefits are more difficult to measure than pensions because they depend on a number of changing factors including the price trends for medical care and the patterns of health care utilization.[28] The aggregate entry age normal actuarial cost method should also be used to calculate the ORB expense and liability for the administrative entity's financial statements, and the expense for the

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[21] Id.
[22] Id.
[23] Id.
[24] Id.
[25] Id. at 438.
[26] Id. at 443.
[27] Id.
[28] Id.

employer entity's financial statements.[29] Unlike federal pensions, retiree health care benefits do not depend on future salary levels of individual employees but rather are allocable to each employee on a per person basis.[30] The accrual period should be based on expected retirement age rather than the age when the employee first becomes eligible.[31] Past service costs, prior service costs, and actuarial gains and losses should be recognized immediately, consistent with the treatment for these items in the accounting standards for pensions.[32]

"The ORB plan should be accounted for in a way that is very similar to that described above for pensions. The administrative entity should account for and report the ORB liability in its financial report, using the aggregate entry age normal method. The liability is the actuarial present value of all future benefits less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan."[33] The administrative entity should also report ORB expense and revenue consistent with the treatment of pension expense and revenue.[34]

C. Summary

The liability and associated expense for pensions and other retirement benefits should be recognized at the time the employee's services are rendered. Any part of that cost unpaid at the end of the period is a liability. The aggregate entry age normal actuarial cost method should be used to calculate the expense and the liability for the pension and other retirement benefits for the administrative entity financial statements, as

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[29] Id. at 445.
[30] Id.
[31] Id.
[32] Id.
[33] Id. at 446.
[34] Id.

well as the expense for the employer entity financial statements. Table I depicts the FASAB treatment of employee benefits. Table II is the latest reconciliation between the FASAB-based *Financial Report of the United States Government* and the Unified Budget. Table III shows changes in post-retirement health and accrued benefits as calculated under the FASAB standards and stated in the *Financial Report.* The "increase in military health liabilities" and the "increase in civilian health liabilities" in Table II equal the difference between the total post-retirement health benefits expense and claims paid in Table III.

Table I

Federal Program Category		**Expense**	**Liability**
Employee Benefits	• Federal employee pension and ORB benefits • Military pension and ORB benefits	Recognize expense as employee services are performed	Recognize actuarial accrued liability.
	• VA disability compensation[a] • FECA—workers' compensation • OPEB	Recognize expense when relevant event occurs and program participant is determined eligible for compensation.	Recognize any amount due or the present value of future payments due, which ever is applicable.

[a]Disability compensation is paid to veterans who are disabled by injury or disease incurred or aggravated during active military service in the line of duty. The service of the veterans must have been terminated through separation or discharge under conditions that were other than dishonorable. Monetary benefits are related to the residual effects of the injury or disease. [Department of Veterans Affairs, Federal Benefits for Veterans and Dependents, 1993 Edition].

Source: FASAB, *Statements of Federal Financial Accounting Standards, Volume II, Current Text,* p. 459

Table II

United States Government
Reconciliations of Net Operating Cost and Unified Budget Deficit for the Years Ended September 30, 2005, and September 30, 2004

(In billions of dollars)	2005	2004
Net operating cost	(760.0)	(615.6)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits (Note 11):		
Increase in military pension liabilities	57.7	98.7
Increase in military health liabilities	108.6	42.3
Increase in other military benefits	3.3	2.4
Increase in liability for military employee benefits	169.6	143.4
Increase/(Decrease) in Liability for Veterans Compensation (Note 11):		
Increase/(decrease) in liabilities for veterans	150.1	(39.7)
Increase in liabilities for survivors	47.2	9.6
Increase in liabilities for burial benefits	0.5	0.1
Increase/(decrease) in liability for veteran's compensation	197.8	(30.0)
Increase in Liabilities for Civilian Employee Benefits (Note 11):		
Increase in civilian pension liabilities	43.6	39.8
Increase in civilian health liabilities	24.6	21.7
(Decrease)/increase in other civilian benefits	(5.9)	7.2
Increase in liabilities for civilian employee benefits	62.3	68.7
Increase/(Decrease) in Environmental Liabilities (Note 12):		
Increase/(decrease) in Energy's environmental liabilities	8.1	(1.7)
Increase in all others' environmental liabilities	2.5	1.0
Increase/(decrease) in environmental liabilities	10.6	(0.7)
Depreciation expense	79.7	89.9
Property, plant, and equipment disposals and revaluations	47.8	0.2
Increase in benefits due and payable	14.1	2.9
Increase in insurance programs	31.0	37.0
Increase/(decrease) in other liabilities	15.1	(4.7)
Seigniorage and sale of gold	(0.8)	(0.7)
Increase/(decrease) in accounts payable	7.8	(2.1)
(Increase)/decrease in accounts and taxes receivable	(9.7)	0.3
Components of the Budget Deficit Not Part of Net Operating Cost:		
Capitalized Fixed Assets:		
Department of Defense	(110.2)	(83.2)
Civilian agencies	(36.4)	(28.9)
Total capitalized fixed assets	(146.6)	(112.1)
Increase in inventory	(10.5)	(8.8)
Increase in securities and investments	(18.2)	-
Increase in other assets	(5.0)	(11.7)
Principal repayments of precredit reform loans	9.7	8.5
Net amount of all other differences	(13.2)	23.2
Unified budget deficit	(318.5)	(412.3)

The accompanying notes are an integral part of these financial statements.

Source: The Financial Management Service, *Financial Report of the United States, Excerpt*, p. 116 (March 2006), *available online at* www.fms.treas.gov/bulletin/b2006-1fr-excerpt.doc.

Table III

Change in Post-Retirement Health and Accrued Benefits

(In billions of dollars)	Civilian	Military	Total
Actuarial accrued post-retirement health benefits liability, as of September 30, 2004	266.1	725.3	991.4
Post-Retirement Health Benefits Expense:			
Normal costs	15.0	18.3	33.3
Interest on liability	16.9	45.5	62.4
Assumption change liability	-	53.6	53.6
Other actuarial (gains)/losses	3.4	5.4	8.8
Total post-retirement health benefits expense	35.3	122.8	158.1
Less claims paid	10.7	14.2	24.9
Actuarial accrued post-retirement health benefits liability, as of September 30, 2005	290.7	833.9	1,124.6

Source: The Financial Management Service, *United States Government Notes to the Financial Statements for the Years Ended September 30, 2005, and September 30, 2004*, Note 11, available online at http://www.fms.treas.gov/fr/05frusg/05notes.pdf.

III. Budgeting

A. Current System

1. Pension Benefits (Defined Benefit Plan)[35]

a) Civil Service Retirement System (CSRS)

Federal agencies and departments[36] pay only about 40 percent of the pension costs for employees covered by the Civil Service Retirement System (CSRS).[37] Whether those payments are classified as discretionary or mandatory depends on the account. The remainder (60 percent of the pension costs) is covered by a *mandatory general fund payment* to amortize the unfunded liability.[38] An officials at the Office of Management

[35] This briefing paper focuses on the treatment of *defined benefit pension plans* under CSRS, FERS and MRS.
[36] In this section, "federal agency" also means "department of the governments" unless otherwise indicated.
[37] CONGRESSIONAL BUDGET OFFICE, THE PRESIDENT'S PROPOSAL TO ACCRUE RETIREMENT COSTS FOR FEDERAL EMPLOYEES, 1, (2002), *available online at* http://www.cbo.gov/ftpdocs/35xx/doc3580/Accrual.pdf.
[38] *See* OFFICE OF MANAGEMENT AND BUDGET, FY 2003 FEC BUDGET REQUEST CONGRESSIONAL JUSTIFICATION, Appendix A, (2002), *available online at*

and Budget noted that "a large portion of the liability has been unfunded and the remainder hidden in OPM's mandatory accounts."[39] In essence, federal agencies do not recognize the costs of CSRS on accrual basis.

Under OMB Circular No.A-11, the 40 percent payments from agencies to civil service retirement and disability trust funds are classified as *intragovernmental transfers* (*undistributed offsetting obligations)*.[40] Treatment of intragovernmental transfers will be discussed in the following section

b) Federal Employee Retirement System (FERS)[41]

The costs of pensions for the current worker under FERS are recognized on an accrual basis at the federal agency level, but the recognition of costs is not included in the unified budget. The key to understanding this mechanism is to examine the treatment of "intragovernmental payments" and "undistributed offsetting receipts."

Under the current budget system, federal agencies pay all of the pension costs as those benefits accrue for employees covered by the Federal Employees' Retirement System (FERS).[42] OMB wrote, "[p]ersonnel benefits for current employees consists of the cost to Government agencies for health insurance, life insurance, Social Security (old age, survivors, disability, and health insurance) contributions to the retirement funds to

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http://www.fec.gov/pages/budget/fy2003/20020225justification/app_a.html. *See also* OFFICE OF MANAGEMENT AND BUDGET, CIRCULAR NO. A-11, §83.13, (2005), *available online at* http://www.whitehouse.gov/omb/circulars/a11/02toc.html.

[39] *Hearings Before the House Subcommittee on Treasury, Postal Service and General Government*, (March 14, 2002) (testimony of Michelle Daniels Jr., Director of the Office of Management and Budget).

[40] *See* OMB, CIRCULAR NO.A-11, *supra* note 38.

[41] *See* GOVERNMENT ACCOUNTABILITY OFFICE, PUBLIC PENSIONS: SUMMARY OF FEDERAL PENSION PLAN DATA, 6, (1996), *available online at* http://www.gao.gov/archive/1996/ai96006.pdf. "Differences exist in the funding of federal government defined benefit plans. Of these 34 plans, 28 use trust funds, while 6 of the agency plans are referred to as pay-as-you-go plans. Trust funds are separate accounting entities established to account for government and employee contributions, investments, and benefits paid. The pay-as-you-go plans do not have trust funds to accumulate assets to pay plan benefits. For these six plans, benefits are paid to annuitants from appropriations in the year in which the benefits are due." This section will mainly focus on trust funds.

[42] CBO, *supra* note 37, at 1.

finance future retirement benefits, and other items."[43] To this extent, federal agencies and departments already pay the full accrual cost for their pensions.[44]

One might assume that the U.S. government budget would take into account the costs of retirement benefits on an accrual basis. Accruing retirement costs would result in the increase of payments from federal agencies to the retirement account or trust fund.[45] But agencies' payments as employers into federal employee retirement trust funds — and interest payments from the Treasury — are classified as "undistributed offsetting receipts."[46] Those payments "appear instead as special deductions in computing total budget authority and outlays for the Government rather than as offsets as at the agency level".[47] Thus, such payments do not affect the surplus or deficit at the government level (unified budget).[48] In other words, intragovernmental transfers consist of a "debit" from one government account and a "credit" to another.[49] The accruing costs of FERS are charged to the employing agency (debit), and some or all of these funds are transferred to the federal pension's trust funds (credit: undistributed offsetting

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[43] OMB, ANALYTICAL PERSPECTIVE FY 2007 at.351-352 (2006).
[44] CBO, *supra* note 37, at 2.
[45] Id.
[46] OMB, *supra* note 43, at 385, 395-396.

"**Offsetting receipts** mean collections that are credited to offsetting receipt accounts and *deducted from gross budget authority and outlays*, rather than added to receipts. They are not authorized to be credited to expenditure accounts. The legislation that authorizes the offsetting receipts may earmark them for a specific purpose and either appropriate them for expenditure for that purpose or require them to be appropriated in annual appropriation acts before they can be spent." [*emphasis added*]

"**Undistributed offsetting receipts** mean offsetting receipts that are deducted from the *Government-wide totals for budget authority and outlays* instead of offset against a specific agency and function."[*emphasis added*]

[47] Id.
[48] CBO, *supra* note 37, at 2.
[49] Edwin C. Hustead & Toni Hustead, *Federal Civilian and Military Retirement System, in* PENSIONS IN THE PUBLIC SECTOR 66, 99 (Olivia S. Mitchell & Edwin C. Hustead ed., 2001).

receipt). These two transactions offset each other and have no effect on the federal surplus or deficit.[50]

When the federal pension trust fund receives the income (debit), it must invest its assets in special issue U.S. Treasury securities (credit).[51] Each year the Treasury pays interest (debit) to the trust fund (credit).[52] All of these intragovernmental transfers offset each other.

As a result, only (i) contributions from current workers and (ii) payments of pension benefits to current retirees affect budget surplus or deficits.[53] The budget deficit recognizes the costs of retirement benefits only on a *cash basis*.

Recognizing the accrual cost of pensions and potential health benefits in intragovernmental payments does not provide the government with resources to make payments when they are due.[54] In this sense, current accrual budgeting is different from *prefunding*. [55]

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[50] Id.

[51] Id. *See also* GAO *supra* note 41 at 8-9 "The special issue Treasury securities represent that portion of estimated future retirement benefit obligations of the agency defined benefit plans that the government has recognized on paper by providing budget authority to cover future benefit payments. The unfunded obligation of an agency plan is that portion of estimated future benefit obligations that has no paper backing in the form of special issue Treasury securities. Therefore, because special issue Treasury securities are used, whether the obligation is funded or unfunded has no effect on current budget outlays. Also, *the obligation is not a measure of the government's ability to pay retirement benefits in the future*. The Treasury must obtain the necessary money through tax receipts or borrowing to pay plan benefits to annuitants when those benefits are due for plans having trust funds invested in special issue Treasury securities and for pay-as-you-go plans. This financing approach enables the federal government to *defer* obtaining the money until it is needed to pay the benefits." [*emphasis added*].

[52] Id.

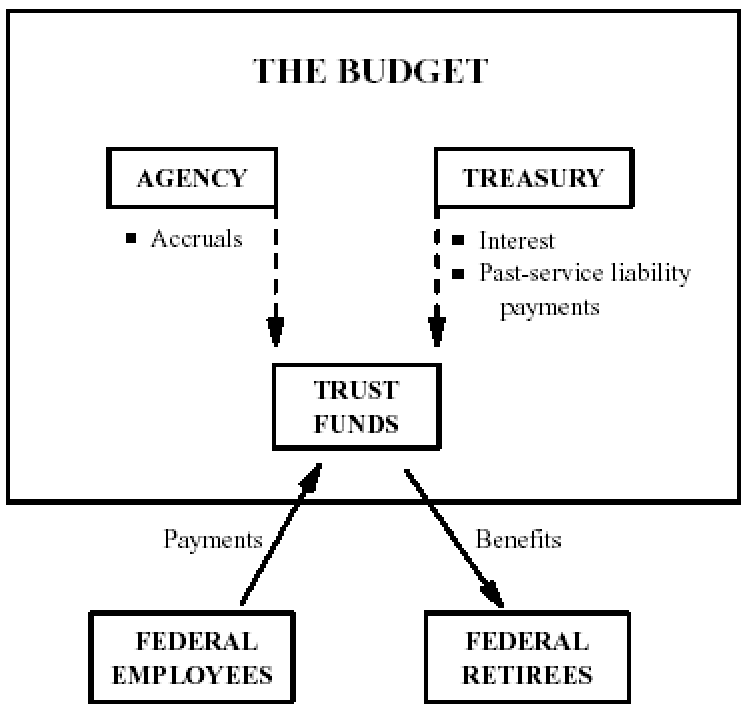
53 Id. at 99 "Although budget flows are unaffected by the purchase of securities by a federal pension trust fund, *this action does increase the gross federal debt and the debt subject to statutory limit*, specifically the portion of the debt held by government accounts. The portion held by public will not change. But the resultant increase in government debt subject to statutory limit tends to be small, likely having only a negligible effect on the timing of the next debt limit increase and the political issues surrounding that legislation." *[emphasis added*].

[54] CBO *supra* note 37 at 5.

[55] Id. The possible role of accrual budgeting is a disclosure to policymakers and citizens of the accumulating obligation to make benefit payments in the future.

Figure 1 illustrates the treatment of federal retirement costs, and those payments do not leave the budget "box" [56] As mentioned above, they do not affect the surplus or deficit.[57] Only payments from current workers and payments to current retirees affect the budget.[58]

FIGURE 1.
THE BUDGETARY TREATMENT OF FEDERAL RETIREMENT COSTS



SOURCE: Congressional Budget Office.

NOTE: Intragovernmental payments (those amounts paid by one part of the government to another) are indicated by dashed lines.

Source: CBO supra note 37 at 4

[56] CBO *supra* note 37 at 2.
[57] Id.
[58] Id.

The following table [Table IV] shows the amounts of undistributed offsetting receipts.

Table 25–13. CURRENT SERVICES OUTLAYS BY FUNCTION, CATEGORY, AND PROGRAM—Continued

(in millions of dollars)

Function and Program	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Interest, other special and revolving funds	–1,686	–1,606	–1,705	–1,695	–1,741	–1,796	–1,880
All other interest	–1,365	–1,851	–1,934	–1,873	–1,916	–1,941	–1,968
Total, Other interest	–3,945	–8,594	–10,457	–12,260	–14,223	–16,348	–19,703
Other investment income:							
Private sector holdings, National Railroad Retirement Investment Trust	–3,425	–870	–1,340	–1,382	–1,400	–1,400	–1,378
Telecommunications fund interest on investments			–30				
Total, Other investment income	–3,425	–870	–1,370	–1,382	–1,400	–1,400	–1,378
Total, Net interest	183,986	218,803	243,713	265,941	283,818	298,012	310,264
950 Undistributed offsetting receipts:							
Mandatory:							
Employer share, employee retirement (on-budget):							
Employing agency contributions, military retirement fund	–16,554	–15,999	–15,625	–15,765	–16,167	–16,652	–17,167
Employing agency contributions, DoD Retiree Health Care Fund	–10,490	–11,072	–11,546	–12,125	–12,824	–13,601	–14,410
Employing agency contributions, Civil Service Retirement and Disability Fund	–13,059	–13,346	–14,365	–15,489	–16,522	–17,638	–18,816
Postal Service contributions, Civil Service Retirement and Disability Fund	–4,382	–4,512	–4,632	–4,732	–4,882	–4,930	–4,990
Contributions to HI trust fund	–3,302	–3,416	–3,488	–3,590	–3,679	–3,797	–3,948
Other contributions to employee retirement and disability funds	–190	–191	–193	–195	–197	–199	–201
Total, Employer share, employee retirement (on-budget)	–47,977	–48,536	–49,849	–51,896	–54,271	–56,817	–59,532
Employer share, employee retirement (off-budget):							
Contributions to social security trust funds	–10,941	–11,677	–12,161	–12,832	–13,459	–14,179	–15,040
Rents and royalties on the Outer Continental Shelf:							
OCS Receipts	–6,146	–9,118	–9,491	–9,234	–9,106	–8,778	–8,753
Sale of major assets:							
Privatization of Elk Hills				–323			
Other undistributed offsetting receipts:							
Spectrum auction	–160	–110	–9,950	–1,150	–100	–100	–100
Spectrum relocation receipts			–9,720	–1,080			
Digital television transition and public safety fund				–11,088	–2,770		
Total, Other undistributed offsetting receipts	–160	–110	–19,670	–13,318	–2,870	–100	–100
Total, Undistributed offsetting receipts	–65,224	–69,441	–91,171	–87,603	–79,706	–79,874	–83,425
Total	2,472,205	2,668,528	2,700,676	2,798,041	2,924,719	3,049,799	3,209,844
On-budget	(2,069,994)	(2,240,451)	(2,250,621)	(2,334,565)	(2,441,055)	(2,543,817)	(2,682,007)
Off-budget	(402,211)	(428,077)	(450,055)	(463,476)	(483,664)	(505,982)	(527,837)

Source: OMB(2006) *Budget of the United States Government Fiscal Year 2007, Analytical Perspectives, Supplement Materials, 25. Current Service Estimates, Table 25-13 at.17 (only available on CD-ROM)*[59]

c) Military

Since 1985, the Department of Defense (DoD) has budgeted for the costs of military pensions on an accrual basis.[60] DoD administers and funds the military's

[59] NOTE: This table is only available on CD-ROM or at OMB's website, http://www.whitehouse.gov/omb/budget/fy2007/pdf/ap_cd_rom/25_13.pdf.

noncontributory defined benefit plan that covers the Army, Navy, Marine Corps and Air Force. Under accrual budgeting, DoD is charged the costs of the future benefits payable to those people who are currently providing military service.

Before 1984, the military retirement system was operated on a pay-as-you-go basis.[61] There was no trust fund, and the DoD budget consisted of payments made directly to retirees.[62] PL 98-94 created the Military Retirement Fund in order to change the military retirement system from a pay-as-you-go to a funded system.[63] The military budget was charged with the accruing retirement costs of the current active-duty and reserve forces by using the aggregate entry-age normal method.[64] The General Fund of the Treasury made payments on past-service liabilities to the trust fund.

Any gains or losses to the trust fund are born by the Treasury, not by DoD.[65] Net gains or losses results either from (i) inaccuracy of assumptions or (ii) legislative changes.

Like FERS and CSRS, accrual receipts by the trust fund from DoD are classified as undistributed offsetting receipts. And such intragovernmental transfers offset each other.

2. Health Care Benefits

a) Civilian

The costs of retiree's earned health care benefits are *all* paid by the government, but none of those costs are recorded until they are paid.[66] Agencies do not recognize any

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[60] CONGRESSIONAL BUDGET OFFICE, ACCRUAL BUDGETING FOR MILITARY RETIREES' HEALTH CARE, 3, (2002), *available online at* http://www.cbo.gov/ftpdocs/33xx/doc3307/AccrualBudgeting.pdf.
[61] HUSTEAD *supra* note 49 at 94.
[62] Id. *See also* OLIVA S. MITCHELL & EDWIN C. HUSTEAD, PENSIONS IN THE PUBLIC SECTOR, Chapter 4.
[63] Id. at 95
[64] Id.
[65] CBO *supra* note 60 at 5.

costs of postretirement health care in their annual budget/account. Instead, those costs are attributed to the Office of Personnel Management (OPM), which pays the government's share of the Federal Employee Health Benefits (FEHB) program for retirees.[67]

b) Military

In 2003, the Department of Defense began to budget on an accrual basis to pay for medical care for beneficiaries who are eligible for *Medicare*.[68] In accrual budgeting, the costs of medical benefits for retirees are recognized when the employees are working, not when the benefits are actually paid. However, costs of *other military retirees' health care* are recognized when the benefits are actually paid — on a cash basis.[69] DoD is required to make its annual payments to the accrual fund out of funds appropriated to the Defense Health Care Program, which is not part of the individual military services' budgets.[70]

In the appendix, the President's budget states:

> "[A]ppropriations finance the personnel costs of the active, reserve, and guard forces of the Army, Navy, Air Force, and Marine Corps. They include pay and allowances of ... *accruing retirement and health benefits*, … Over the past several years, significant pay increases, coupled with new requirements to *accrue funds*

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[66] CBO *supra* note 37 at.2.
[67] Id.
[68] 10 U.S.C. §111 *See also* CBO *supra* note 60 at 7. The National Defense Authorization Act for Fiscal Year *2001* did not budget two important categories of medical benefits for retirees on an accrual basis — (1) the care provided in DoD's own treatment facilities to Medicare-eligible retirees, and (2) the care offered to military retirees who are not eligible for Medicare, whether the care is purchased or provided in DoD's facilities. In the National Defense Authorization Act for Fiscal Year 2002, accrual budgeting was extended to (1) the in-house care provided to Medicare-eligible retirees. This put the costs of purchased and in-house care on equal footing and this arrangement would provide DoD with incentive to seek the most cost-effective mix of care. But (2) the medical care provided to military retirees who are not eligible for Medicare is not covered by accrual budgeting. DoD continues to pay those costs on a cash basis (As of 2002).
[69] CBO *supra* note 60 at 7.
[70] Id.

for future health benefits, have significantly increased the requirements of these appropriations."[71] [*emphasize added*]

Table V summarizes how the current budget system treats each retirement benefits.

Table V

	Civilian		Military (DoD)
	FERS (since 1985)	CSRS (before 1984)	MRS
Pension Benefits (Defined Benefit)	**Agency level → accrual budgeting** (Full costs have been recognized on an accrual basis since 1985) **Government level →** kind of "**cash budgeting"**	**Agency level →** Only 40% of costs are recognized on an accrual basis The remaining 60% costs (paid by the Treasury) are **amortized** **Government level → cash budgeting**	**Agency level → Accrual budgeting (since 1985)** Old pension (before 1984) → amortized by Treasury
Health Care	**Agency level**: No costs are recognized **Government level**: Cash basis (pay-as-you-go)		(1) Only medical costs for Medicare-eligible retiree are recognized on accrual basis (2) Other costs of health benefits are recognized on accrual basis

B. *Critiques and Reform Proposal*

1. The President's Budget FY 2003

a) Contents of Proposal

The President's 2003 budget proposed that federal agencies pay the full costs of their employees' *pension benefits* and *health benefits* in retirement on an accrual basis.[72] The purpose of this proposal was to provide policy makers and agency managers with "a

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[71] OFFICE OF MANAGEMENT AND BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2007, APPENDIX: DEPARTMENT OF DEFENSE - MILITARY, 245, (2006), *available online at* http://www.gpoaccess.gov/usbudget/fy07/pdf/appendix/mil.pdf.
[72] Cf. The Managerial Flexibility Act of 2001 Title II. [S.1612] This bill was not passed by Congress.

more complete measure of the cost of providing current services."[73] The bill (the Managerial Flexibility Act of 2001) requires charges for:

i. the full accruing cost of the Civil Service Retirement System (CSRS) and the parallel Foreign Service and CIA pensions,
ii. retired pay for the small uniformed services (Coast Guard, Public Health Service, and NOAA)
iii. retiree health benefits for civilian employees in the Federal Employee Health Benefit Program(FEHBP), and
iv. retiree health benefits for the seven uniformed services. For the latter, accrual of health benefits for those 65 and over would start in 2003 under existing law, and accrual of benefits for younger retirees was proposed to start in 2004.

Under this proposal, the existing liability would be amortized by mandatory payments from the general fund over 40 years, and benefits payments would be classified as mandatory spending.[74] The proposal states:

> The bill does not change total budget outlays or the surplus/deficit; it shifts costs from central mandatory accounts to increase the affected discretionary accounts on the civilian side by $9.2 billion. The additional discretionary amounts were treated as an adjustment in this Budget….
>
> This legislation would fully fund the employer share of all Federal pensions, retired pay, and retiree health benefits by agency payments to the retiree benefit funds each year as they are earned by employees. It would amortize past unfunded liabilities on a regular schedule by payments from Treasury to the retiree benefit funds.
>
> The legislative language requires the appropriate amounts to be paid out of all salary and expense appropriations, just as they are now for the Federal Employee Retirement System (FERS) and the Military Retirement System (MRS).
>
> These charging practices would go a long way to close the gap between current budgetary cost and uniform full operating cost so that cost and results can be compared with each other and across programs.[75]

The following table illustrates the amount of intragovernmental payments that federal agencies would make to the government's retirement accounts or trust funds under the proposed accrual budgeting.

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[73] CBO *supra* note 37 at 1.
[74] OMB *supra* note 38 at 13. *See also* The Managerial Flexibility Act of 2001 Title II.
[75] Id.

TABLE 1.
EFFECT OF THE PRESIDENT'S PROPOSAL ON PAYMENTS TO RETIREMENT FUNDS, FISCAL YEAR 2003 (In million of dollars)

Retirement Plan	Current Payment	Proposed Payment	Increase
Civil Service Retirement System			
Non-Postal Service workers	2,593	6,319	3,726
Postal Service workers	4,830[a]	4,830[a]	0
Federal Employees' Retirement System			
Non-Postal Service workers	8,354	8,354	0
Postal Service workers	2,301	2,301	0
Thrift Savings Plan	4,408	4,408	0
Federal Employees Health Benefits			
Non-Postal Service workers	0	5,602	5,602
Postal Service workers	1,032[b]	1,032[b]	0
Total	23,518	32,846	9,328

SOURCES: The Congressional Budget Office for the estimates of current payments; *Budget of the United States Government, Fiscal Year 2003: Appendix* for the current payment figure for the Thrift Savings Plan; and the Office of Personnel Management for the estimates of increased payments under the President's proposal.

a. Like most other agencies, the Postal Service contributes 7 percent of pay--$929 million in 2003--for current Civil Service Retirement System (CSRS) employees. In addition, it makes a series of other annual payments--totaling $3,901 million in 2003--for cost-of-living adjustments for annuitants and increases in liabilities associated with growth in annual salaries for CSRS-covered employees.

b. The Postal Service pays the government's share of premiums for current annuitants.

From CBO *supra* note 37 at 3.

Under this proposal, gains or losses to the trust funds resulting from re-estimates of pension benefits and health care costs for retirees would also be amortized through changes in Treasury payments, but over a shorter period.[76]

b) Implications of the Proposal

The advantages of the President's proposal are to provide policymakers with "more comprehensive information about cost".[77] The deferred recognition of costs of retirement benefits hides a number of problems until they become really serious.[78] More accurate cost measures make it possible for the Congress to compare costs among programs and assess performance more accurately. Also, accrual budgeting would make it easier for policymakers to compare the costs of alternative retirement benefits plans, including early retirement incentive packages, which differ in the timing and the amount of future benefits.[79]

It could enable agency managers to seek *cost-effectiveness*. The current budgeting system understates labor costs and may encourage managers to rely too heavily on labor and to delay substituting more efficient capital technology and equipment.[80] Accrual budgeting could help agency managers allocate resources by choosing the lowest cost combination of labor and capital.[81]

One problem with the President's proposal is that it would still "hide" the actual costs of current services and true budget deficits in each year. This is because accrual

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[76] CBO *supra* note 37 at 4.
[77] Id. at 5.
[78] Murray Petrie, *Accounting and Financial Accountability to Capture Risk, in* GOVERNMENT AT RISK: CONTINGENT LIABILITIES AND FISCAL RISK 59, 61 (Hana Polackova Brixi & Allen Schick eds., 2002). Nonrecognition of retirement benefits results in the incomplete or inaccurate measurement of current public services
[79] CBO *supra* note 37 at 5.
[80] Id. at 5-6.
[81] Id.

recognition of retirement costs at the agency level would be offset at the government budget level as intragovernmental transfers. Retirement liabilities are already disclosed in the Financial Report of the United States on an accrual basis *without offsetting intergovernmental transfers*. However, the general public might be unaware of those disclosures.[82] To make the general public aware of those costs, it would be helpful to recognize and disclose costs of retirement benefits on an accrual basis *at the government level*, not just the agency level.

2. Accruing Health Care

One advantage of accrual budgeting is that it can provide better information for personnel decisions by taking into account the full cost of personnel for the decision maker.[83] Policymakers could compare each program, and it would help agency managers seek more cost-effective combinations of labor and capital.[84] In addition, accrual budgeting would influence the allocation of resources to retirees and to each agency.[85] Payments for health care benefits from the funds are classified as *direct spending* and do not need annual appropriations.[86] This could help protect retirees' medical benefit from annual competition for appropriated funds. However, to fully protect retirees' benefits, pre-funding would be preferable.

The current accrual budgeting for *military health care* bears three weaknesses. First, "the charges that DoD pays on behalf of different types of military personnel do not reflect the expected future costs of their retirement benefits."[87] The only distinction in

[82] CBO *supra* note 37 at 7.
[83] Id. at 5.
[84] CBO *supra* note 60. at.3
[85] Id.
[86] Id.
[87] Id. at 4.

current accrual budgeting is between the payments for full-time service members and those for part-time reservists.[88] Since the probability that part-time service members reach retirement is much lower, the accrual charges for them is only about one-fifth as high as the charges for full-time personnel.[89] The budget system uses only these two per capita charges.

The current system fails to take other factors into account — such as an individual's branch of service and status as an officer or enlisted member — that affect the relative costs and accrual charges per capita.[90] The current accrual budgeting, which ignores those differences, distorts the relative costs of different types of personnel.[91]

Second, gains or losses to the actual fund — that result from legislated changes in the retirement system, from changes in assumptions, or from DoD's policy decisions — are currently born by the Treasury and not reflected in DoD's budget.[92] The fact that a decision maker does not bear the costs of its decisions in its own budget reduces the incentive to make cost-effective decisions.[93]

Under accrual budgeting, the accrual charges depend on projections of future costs and interest on the funds' balances.[94] If the projections turn out to be accurate, a fund's receipts (contributions) and its interest earnings can cover the costs of future benefits. If the projections are not accurate, the fund has gains or losses. The fund has a net gain when the contributions and interest on them are expected to exceed the

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[88] Id.
[89] Id.
[90] Id. at 4-5. For example, active-duty Air Force officers "are about four times more likely to qualify retirement benefits than are enlisted Marines. As a result, the expected future medical costs in retirement associated with a year of service by an Air Force officer are several times grater than those associated with a year of service by an enlisted Marine."
[91] Id. at 5.
[92] Id.
[93] Id. at 4.
[94] Id. at 5.

associated future benefits.[95] The fund has a net loss when the contributions and interests are not enough to cover the expected benefits.[96] Deviation from the predictions can result from (1) factors outside the control of DoD (ex. assumptions turned out to be inaccurate because of unexpected inflation) and Congress or (2) factors within their control (e.x. changes in legislation or policies).[97]

In the current system, DoD appears not to be credited for any gains and not to be charged for any losses regardless of the reason for those gains or losses.[98] "Instead, all of the gains and losses would be applied to, respectively, decrease or increase the contributions made by the Treasury, which is responsible for paying off the unfunded liabilities for benefits earned before 2003. That arrangement is consistent with the treatment of gains and losses under the accrual system for military retirement pay, a system that has been in use since 1985."[99] The Treasury amortizes gains and losses that arise from unexpected deviations from the projections over which DoD and Congress have little control.[100]

However, insulating DoD's budget from gains and losses that result from factors within the control of DoD or the Congress can reduce the incentives that decision makers who are responsible for DoD's spending have to control the costs for the government as a whole.[101]

To solve this problem, CBO suggests following the example of federal credit basis.[102] Under the Credit Reform Act of 1990, the Treasury bears the savings or costs associated with unavoidable errors in financial projections. However, if the costs of credit programs change because the terms of existing loans are modified, the agency that is responsible bears the expenses (the net loss). CBO states "[i]f DoD's health care programs for retirees followed that precedent, the Treasury would not amortize gains and losses that arose from legislated changes or DoD's policy changes. Instead, DoD would bear those costs in its budget in the year in which the changes became effective."[103]

Third, as mentioned earlier, current accrual budgeting for retirees' health care only covers the costs of beneficiaries who are eligible for Medicare. DoD's health care costs for Medicare-*ineligible* retirees is still budgeted on a cash basis.

IV. Differences between Accounting and Budgeting

A. Treatment of Actuarial Charges

One of the important differences between the FASAB standards and the current budgeting procedures is that pursuant to SFFAS-5, in the *Financial Reports of the U.S. Government*, "net operating costs" shows the accrual costs (actuarial costs) of retirement benefits for all federal employees — even if the actuarial methods need to be improved. On the other hand, in the *President's Budget of the United States*, the item of "unified deficits" does not include any accrual costs of retirement benefits. As mentioned in the previous section [III.A.1(b)], the current budget system partly recognizes those costs on an accrual basis *only at the agency level*, but *not at the government budget leve*l. The

[102] Id. at 6.
[103] Id.

budget would still recognize costs of retirement benefits on a *cash basis* as well as other costs.[104]

1. The Agency Level

Under current budgeting methods, each federal agency (department) recognizes the full costs of pension benefits under the Federal Retirement System (FERS) and the Military Retirement system (MRS) on an accrual basis. But for the costs of pension benefits under the Civil Service Retirement System (CSRS), each agency recognizes only 40% of those costs on an accrual basis. The remaining 60% of those costs are born by the Treasury and amortized. Furthermore, none of the costs of health care for retirees are recognized at the agency level. In the *Financial Report of the U.S. Government* (accounting), each agency recognizes all costs of those retirement benefits on an accrual basis.

2. Government Level

In the government budget, the accrued charges of pension benefits are treated as "intragovernmental transfers". In other words, unified budget deficits do not include those accrual costs. As mentioned in the prior section, intragovernmental transfers consist of a "debit" from one government account and a "credit" to another.[105] The accruing costs of FERS are charged to the employing agency (debit), and some or all of these funds are transferred to the federal pension's trust fund (credit: undistributed offsetting receipt). These two transactions offset each other and have no effect on the federal surplus or deficit.[106] For unfunded liabilities (i.e. 60% costs of CSRS) the

[104] Under the *Federal Credit Reform Act*, the budget is required to recognize costs of federal loans and loan guarantees on an accrual basis.
[105] Hustead & Hustead, *supra* note 49 at 99.
[106] Id.

Treasury is responsible for payments on the unfunded liabilities (debit) to the trust fund (credit).[107] When the federal pension trust fund receives the income (debit), it invests its assets in special issue U.S. Treasury securities (credit).[108] Each year the Treasury pays interest (debit) to the trust fund (credit).[109] All of these intragovernmental transfers offset each other. As a result, only (i) contributions from current workers and (ii) payments of pension benefits to current retirees affect budget surplus or deficits.[110] The budget deficit recognizes the costs of retirement benefits only on a *cash basis*.[111] The public cannot see the true costs government services from the unified budget. Under the unified budget, the accrual costs of retirement benefits for federal employees are "hidden costs."

On the other hand, in the *Financial Report of the U.S. Government*, net operating costs include the full costs of retirement benefits on accrual basis. The components of the "net operating cost not part of the budget deficit" includes pension and health insurance liabilities.[112]

B. Treatment of Net Gains or Losses

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[107] Id.
[108] Id.
[109] Id.
[110] Id.
[111] The President's Budget discloses the amounts of undistributed offsetting receipts in *Supplemental Materials of Analytical Perspective*. However, that information is contained only on CD-ROM, not in hardcopy. And it would be impossible for most citizens to recognize that information. Most people would only care about budget deficits or surpluses in the unified budget through newspapers or broadcasts. As a matter of accountability, the current budget mechanism would — intentionally or not — "hide" those costs from the public.
[112] *2005 Financial Report of the U.S. Government* at 33, 99. The item of "liabilities for civilian employee benefits" [in the table at 33] includes (i) pension liabilities, (ii) health liabilities and (iii) other civilian liabilities. (i) Civil pension liabilities include liabilities under CSRS and FERS but exclude Thrift Saving Plan (TSP) Fund — defined contribution plan like 401(k) plan — because the employees own its assets. (ii) "the post-retirement civilian health benefit liability is an estimate of the Government's future cost of providing post-retirement health benefits to current employees and retirees."

Another important difference between the budgeting methods and the accounting standards is the treatment of net gains or losses of trust funds (or retirement accounts). In the *Financial Report*, net gains and losses for trust funds (or retirement accounts) are *immediately* recognized by trust funds (retirement accounts). But in budgeting, net gains (losses) would result in the decrease (increase) of contributions by the Treasury.[113]

	Financial Report (SFFAS-5)		**Budget**	
	Civilian	Military	Civilian	Military
Pension Benefits (Defined benefit)	Immediate recognition by trust		Amortized by the Treasury	Amortized by the Treasury (over 30 years)[114]
Health Care	Immediate recognition by trust		None	Amortized by the Treasury

C. Treatment of Past Service Liabilities (Unfunded Liabilities)

In the *Financial Report*, past service liabilities are recognized immediately under accrual accounting. In the US government budget, such past service liabilities of pension benefits are not recognized immediately, but amortized by the Treasury.

	Financial Report		**Budget**		
	Civilian	Military	CSRS	FERS	Military
Pension Benefits (Defined benefit)	Immediate recognition (accrual basis)		Amortized by the Treasury (60%)	None	Amortized by the Treasury
Health Care	Immediate recognition (accrual basis)		None	None	

V. Standards for State & Local Governments

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[113] Regarding health care for civilian retiree, there would be no recognition through amortization by the Treasury. *See also* OMB, CIRCULAR A.11, *supra* note 38.

[114] *See* Hustead & Hustead, *supra* note 49 at 78. In 1996, the Board of Actuaries "affirmed that a surplus could be held against future losses rather than credited over a thirty-year period, but at the same time that group confirmed that a net surplus would cancel all outstanding amortization payments."

A. Pensions

The Governmental Accounting Standards Board (GASB) issued statements in 1994 establishing standards for the measurement, recognition, and display of pension expenditures and expense and related liabilities and assets for state and local governmental employers.[115] Reporting requirements for pension trust funds of employers are included in two related Statements: Number 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Number 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. "Statement 25 governs financial reporting standards for plan sponsors, including required supplemental information. Statement 27 establishes rules for valuing pension assets and liabilities and determining annual contributions."[116]

Under Statement 27, employers that participate in defined benefit pension plans are required to measure and disclose an amount for annual pension cost on the accrual basis of accounting, regardless of the amount recognized as pension expense on the modified accrual or accrual basis.[117] Annual pension cost should be equal to the employer's annual required contributions to the plan.[118] Annual required contribution is defined as the employer's required contributions for the year, calculated in accordance with certain parameters.[119] The parameters include requirements for the frequency and

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[115] GOVERNMENTAL ACCOUNTING STANDARDS BOARD, STATEMENT NUMBER 27, ACCOUNTING FOR PENSIONS BY STATE AND LOCAL GOVERNMENTAL EMPLOYERS, Issued November 1994,
[116] Joseph D. Mason, *Reversal of Fortune: The Rising Cost of Public Sector Pensions and Other Post-Employment Benefits,* Fitch Ratings, September 18, 2003, *available online at* http://www.rigfoa.org/pdf/FitchPensions.pdf
[117] GASB, SUMMARY OF STATEMENT NO. 27, ACCOUNTING FOR PENSIONS BY STATE AND LOCAL GOVERNMENTAL EMPLOYERS, Issued November 1994, *available online at* http://raw.rutgers.edu/raw/gasb/st/index.html.
[118] Id.
[119] Id.

timing of actuarial valuations as well as for the actuarial methods and assumptions that are acceptable for financial reporting.[120]

A net pension obligation is the cumulative difference between annual pension cost and the employer's contributions to a plan.[121] If an employer has a net pension obligation, it must add one year's interest on the obligation to the annual required contribution in order to measure annual pension cost.[122] A liability balance in the net pension obligation should be recognized in the general long-term debt account group in the financial statements.[123]

Statement 25 establishes financial reporting standards for defined benefit pension plans of state and local governmental entities.[124] The standards apply for pension trust funds included in the financial reports of plan sponsors or employers as well as for the stand-alone financial reports of pension plans or the public employee retirement systems that administer them.[125]

> "This Statement establishes a financial reporting framework for defined benefit pension plans that distinguishes between two categories of information: (a) current financial information about plan assets and financial activities and (b) actuarially determined information, from a long-term perspective, about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due. Plans should include information in the first category in two financial statements: (a) a statement of plan net assets that provides information about the fair value and

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[120] Id.
[121] Id.
[122] Id.
[123] Id.
[124] GASB, SUMMARY OF STATEMENT NO. 25, FINANCIAL REPORTING FOR DEFINED BENEFIT PENSION PLANS AND NOTE DISCLOSURES FOR DEFINED CONTRIBUTION PLANS, Issued November 1994, *available online at* http://raw.rutgers.edu/raw/gasb/st/index.html.
[125] Id.

composition of plan assets, plan liabilities, and plan net assets and (b) a statement of changes in plan net assets that provides information about the year-to-year changes in plan net assets. Information in the second category should be included, for a minimum of six years, in two schedules of historical trend information that should be presented as required supplementary information immediately after the notes to the financial statements. The required schedules are (a) a schedule of funding progress that reports the actuarial value of assets, the actuarial accrued liability, and the relationship between the two over time and (b) a schedule of employer contributions that provides information about the annual required contributions of the employer(s) and the percentage of the annual required contributions recognized by the plan as contributed. Note disclosures related to the required schedules should be presented after the schedules and should include the actuarial methods and significant assumptions used for financial reporting."[126]

B. Other Postemployment Benefits

In June 2004, the GASB adopted Statement Number 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and a related statement, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new GASB standards are modeled after the GASB standards on pensions described above. The standards recognize that Other Postemployment Benefits (OPEB) is deferred compensation and their objective is to achieve accrual of benefit costs and liabilities during periods when employees render services.[127] The first fiscal year affected by the standards will be the fiscal year beginning in December 2006. The

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[126] Id.
[127] Stan Wisniewski, *State Government Retiree Health Benefits: Current Status and Potential Impact of New Accounting Standards*, 1, July 2004, *available online at* http://www.aarp.org/research/work/benefits/aresearch-import-883-2004-08.html.

changes in the accounting standards will be reflected in the Comprehensive Annual Financial Report (CAFR) of the state, or the CAFR of the state's retirement plan.

Currently, information about OPEB is disclosed in a note disclosure in the state's CAFR.[128] Unlike pensions, governments have not been required to report their obligations for these benefits and most do not set aside reserves to cover those future costs.[129] As of 2001, 30 states that reported providing some contribution towards retiree health insurance financed these costs on a pay-as-you-go basis, while only 11 states percent reported a prefunding arrangement.[130] Most of the other states reported no state contributions to retiree health insurance premiums.[131] The new standards will impact states that are recording costs on the pay-as-you-go method by requiring them to accrue the future costs during the years of active service of their employees for financial reporting purposes.[132] The new standards will also affect the discount rates used in valuations, and will require actuaries to consider evidence other than just written plan documentation when determining the benefits provided by the plan.[133]

It is important to note that the standards set by the GASB impact a state's financial statements, but do not control how a state chooses to recognize these costs in its budget. The vast majority of states have underfunded pension systems – the ratio of actuarial assets to actuarial liabilities is below 75% and some states are making employer

[128] Id. at 10.
[129] Donald Boyd, *Retiree Pensions and Health Benefits: State and Local Governments Face New Budget Challenges,* 2006 ROCKEFELLER INSTITUTE REPORTS ON STATE AND LOCAL GOVERNMENT FINANCES, 5, April 2006, *available online at* http://rfs.rockinst.org/exhibit/9053/Full%20Text/GovtFinancesBriefPensions1.pdf.
[130] Wisniewski, *supra* note 127 at 11.
[131] Id. at 10.
[132] Id. at 17.
[133] Id. Currently, actuaries are only required to look at the state's written plan document, which may minimize costs because it doesn't take into account other communications between the employer and employees and the employer's historical pattern of sharing costs with the employees.

contributions that are well below actuarial requirements.[134] While the states are reporting the actuarial accrued costs of the pensions in their financial reports, they are not budgeting for these costs in their annual budgets. Additionally, the new OPEB standards will not require governments to set aside reserves.[135] However, those that continue on a "pay-as-you-go" basis generally will have to report a rapidly growing liability.[136]

VI. Entitlement to Retirement Benefits

Are federal civilian and military employees entitled to the retirement benefits provided through CSRS, FERS, and MRS? Title 5, Chapter 83 of the U.S. Code sets out the provisions for retirement benefits for government employees. The Office of Personnel Management (OPM) makes the original determination of the rights of those applying for benefits.[137] OPM also has the authority to adjudicate all claims arising under Chapter 83.[138] Many of the claims are for rights to annuities or survivor benefits. An administrative action or order affecting the rights or interests of an individual or of the United States may be appealed to the Merit Systems Protection Board.[139] "The Merit Systems Protection Board (MSPB) is an independent quasi-judicial agency established to protect Federal merit systems against partisan political and other prohibited personnel practices and to ensure adequate protection for employees against abuses by agency management."[140] One of the roles of the MSPB is to adjudicate appeals of administrative decisions affecting an individual's rights or benefits under CSRS or FERS.[141] Title 5, Chapter 77, Section 7703(a)(1) allows any employee or applicant for employment

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[134] Boyd, *supra* note 129 at 4.
[135] Id. at 5.
[136] Id.
[137] 5 U.S.C. §8347.
[138] Id.
[139] Id.
[140] U.S. Merit Systems Protection Board. *Agency Mission*, (2006), *at* http://www.mspb.gov/index.html.
[141] Id.

adversely affected or aggrieved by a final order or decision of the MSPB to obtain judicial review of the order or decision.[142] In *Lindahl v. Office of Personnel Management*, the Supreme Court held that retirees whose appeals are rejected by the MSPB do not need to file a Tucker Act suit, but instead are reviewable in the first instance by the Federal Circuit pursuant to the jurisdictional grants in 5 U.S.C. § 7703(b)(1) and 28 U.S.C. § 1295(a)(9).[143] The Court also held that the Civil Service Retirement Act only prevents the courts from reviewing the factual determinations made by the MSPB, not whether there has been a substantial procedural error, misconstruction of governing legislation, or some like error going to the heart of the administrative determination.[144] In general, the courts affirm a decision of the MSPB unless it is arbitrary, capricious, an abuse of discretion, not in accordance with the law, or unsupported by substantial evidence.[145] Therefore, as long as Title 5, Chapter 83 remains in place, civilian and military employees will be entitled to their retirement benefits unless they fail to meet one of the requirements set out in the law (such as type and length of service, conviction of certain offenses, etc.)

VII. Conclusion

The discrepancy between the deficit reported in the Financial Report of the United States and the President's Budget can largely be attributed to differences in accounting methods for retirement benefits for government workers. The Financial Report shows retirement benefits accruing at both the agency and government levels. In the President's Budget, retirement benefits at the agency level are accrued, but at the government level

[142] 5 U.S.C. §7703(a)(1).
[143] Lindahl v. Office of Personnel Management, 470 U.S. 768, 799 (1985).
[144] Id. at 785.
[145] McLaughlin v. Office of Personnel Management, 353 F.3d 1363, 1366 (Fed. Cir. 2004).

only cash payments and receipts are recognized. They accrued retirement benefits are seen as an intergovernmental transfer, with the employing agency being debited for the accrual costs and the pension trust fund being credited. Thus these costs are remaining "in" the budget box and are not reflected in the President's Budget deficit. Additionally, net gains and losses from past service liabilities, prior service liabilities, and actuarial changes are immediately recognized in the Financial Report, but amortized in the President's Budget. It appears that under current law, federal employees are "entitled' to their retirement benefits when they become eligible. Thus the federal government may want to make sure they understand the true costs of hiring employees when they make employment decisions.

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