1997-SE-011200

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ACTION

October 19, 1997

MEMORANDUM FOR SECRETARY ROBERT E. RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **DON LUBICK** DL
ACTING ASSISTANT SECRETARY (TAX POLICY)

SUBJECT: Mandated Report to Congress Regarding Trust Fund Accounting

ACTION FORCING EVENT

During the past three years, errors were made in depositing excise taxes into the Highway Trust Fund and the Airport and Airways Trust Fund. Language was included in the House Report accompanying the Department's fiscal year 1998 appropriation bill that requires the Secretary of the Treasury to provide to the Treasury, Postal Service and General Government Subcommittee on Appropriations, within thirty days of enactment, a report that identifies the specific corrective actions that will be undertaken to ensure timely and accurate trust fund accounting, as well as effective communication with the Department of Transportation.

BACKGROUND

There are four offices within the Department of Treasury involved in depositing and accounting of transportation trust fund receipts: the Bureau of Public Debt (BPD), the Financial Management Service (FMS), the Internal Revenue Service (IRS), and the Office of Tax Analysis (OTA). Initially, OTA prepares monthly estimates of excise tax receipts for the transportation trust funds. FMS authorizes transfers from the General Fund to the trust funds based upon OTA estimates, by issuing a warrant. Based upon the FMS warrant, BPD transfers funds between the General Fund and trust funds and invests trust fund monies. Subsequently, the IRS certifies actual excise tax liabilities dedicated to the trust funds. FMS determines the necessary correcting adjustment to reconcile initial transfers (that were based upon OTA monthly estimates) with IRS quarterly certifications of trust fund liabilities. The BPD then makes the correcting adjustment to the balances of the trust funds and General Fund.

RECENT ACCOUNTING ERRORS

Since 1994, two significant errors involving the accounting of transportation trust fund receipts have been attributed to the Department of the Treasury. First, a clerical error resulted in crediting $1.5 billion to the Highway Trust Fund in fiscal year 1995, rather than in fiscal year 1994. More recently, without informing OTA or the FAA, the IRS provided an opinion to major air carriers that had the effect of deferring $1 billion in tax collections dedicated to the Airport and

Airways Trust Fund. In addition the Department of Transportation also has expressed concerns regarding the accuracy of recent transfers to the Mass Transit Account.

A PROPOSAL

Recent trust fund deposit and accounting errors are largely attributable to the lack of coordination between the offices within the Treasury Department responsible for trust fund accounting. Absent a single coordinating authority, the diffusion of responsibility and information results in poor communication both within Treasury and between the Treasury Department and the Department of Transportation. For example, the $1.5 billion clerical error involving the Highway Trust Fund resulted from a lack of coordination between IRS and FMS. Poor communication between IRS and OTA resulted in the unanticipated deferral of $1 billion in receipts into the Airport and Airways Trust Fund, and the failure to inform the Department of Transportation, in a timely manner, of the delay.

There is a clear need to designate a central authority within Treasury with responsibility to oversee and coordinate the activities of BPD, FMS, IRS, and OTA. I recommend the establishment of an intra-departmental task force that includes BPD, FMS, IRS, OTA and General Counsel's Office that is charged with 1) designating an authority within Treasury responsible for oversight and coordination of trust fund administration, and 2) preparing a report to Congress identifying the specific corrective actions that will be taken by the Department with regard to trust fund accounting and administration.

____________ Agree   ____________ Disagree   ____________ Let's Discuss

cc: Karl Scholz
Ed Knight
Mike Dolan
Jerry Murphy
Joel Platt

1997-SE-011710

DEPARTMENT OF THE TREASURY
WASHINGTON

October 30, 1997

ASSISTANT SECRETARY

MEMORANDUM FOR LAWRENCE H. SUMMERS
DEPUTY SECRETARY OF TREASURY

THROUGH: John D. Hawke, Jr. JDH
Under Secretary for Domestic Finance

FROM: Gerald Murphy GM
Fiscal Assistant Secretary

SUBJECT: Social Security -- Accounting Disclosure Issue

The Federal Accounting Standards Advisory Board (FASAB) is working on an exposure draft for public comment that may include some controversial disclosure requirements. Since the Secretary is the managing trustee, I wanted to alert you in advance.

The attached paper provides some background and explains the issue. We have shared the paper with Economic Policy and would like to meet with you to discuss it further.

Attachment

cc: David Wilcox
John Hambor

SOCIAL SECURITY -- ACCOUNTING DISCLOSURE ISSUE

BACKGROUND

OMB, Treasury and GAO set up a nine member Federal Accounting Standards Advisory Board (FASAB) in January 1991, to overcome a long-standing jurisdictional dispute between OMB and GAO. There are 6 Federal and 3 non-Federal members of the Board which recommends accounting standards after extensive due process including public hearings. The Secretary, Director of OMB and the Comptroller General must unanimously approve the Board's recommendations. While each of the principals has a veto, every standard recommended over the past seven years has been approved. (A veto would probably have to be accompanied by a public explanation.)

FASAB has been quite successful in developing a comprehensive set of accounting standards for agency use in preparing audited financial statements required by law. The board has accomplished a great deal in a relatively short period of time (especially compared to FASB and GASB) and has considerable credibility in the Federal financial community.

FASAB is presently addressing the appropriate disclosures for Social Insurance Programs -- Social Security, Medicare, Railroad Retirement, Black Lung and Unemployment Insurance. Recognizing that these programs have complex characteristics that do not fit traditional accounting models, FASAB previously issued an exposure draft (E.D.) that would only require recognition of a liability on the Balance Sheet for benefits currently due and payable (i.e no long term unfunded liability based on actuarial projections). However, supplementary disclosures would also be required to allow an assessment of the program's long term sustainability. (NOTE: Many respondents to the E.D. and some members of the Board favor inclusion of an actuarial liability on the Balance Sheet.)

SOCIAL SECURITY DISCLOSURES

The Board is in agreement on a number of disclosures to be required, including (1) program description, (2) cash flow projections showing "crossover" points where outflows start to exceed inflows and where assets are exhausted, (3) cash flows as a percent of taxable payroll and as a percent of GDP and (4) the "dependency" ratio -- number of covered workers per beneficiary. All of the above measures are currently developed by SSA and included in the trustees' annual report. The actuarial estimate of cash inflows and outflows would be based on what the trustees refer to as the " open group population," i.e. all persons who will participate in the program as contributors or beneficiaries or both over the next 75 years. Thus, it includes payments from, and on behalf of, employees who will enter the workforce during the next 75 years as well as those already in it. Stated in terms of actuarial present value the excess of projected benefits over contributions for the next 75 years would be about $3.1 trillion.

CURRENT ISSUE

While Board members acknowledge that SSA is a pay-as-you-go income transfer program that can and has been changed many time by Congress, they also recognize the strong political commitment to the program and the strong expectation of future benefits by many contributors who have paid into the program for years. Therefore, many Board members feel that it fits the definition of a liability -- "a probable future outflow as a result of past transactions or events". They may still go along with the "due and payable" liability recognition, but only if an additional disclosure is required which reflects their view that contributors "earn a right to future benefits" and that, at any given point in time, the Government has an accumulated obligation to current participants that should be disclosed. They argue that this obligation represents a reasonably good measure of the net responsibility of future participants to pay benefits to current participants and provides an intergenerational perspective.

The obligation would be calculated using the so-called "closed group" basis presenting the actuarial present value of the excess of future benefit payments to all current participants over future contributions paid by them (i.e. it excludes contributions made by future participants under the pay-as-you-go approach). This produces a larger dollar amount that the open group approach. (The closed group number calculated by SSA in FY'94 was $8.4 trillion. I assume that it would probably be up to $9 or $10 T today.)

Social Security is strongly opposed to use of the closed group number which they believe is inappropriate under current law since it ignores the pay-as-you-go nature of the program. They feel that the financial health of the program is best evaluated in terms of the open group members use by the trustees. They also assert they the Actuarial Standards Board has been drafting a standard for social insurance programs and apparently feel that social insurance valuations should be based on the program's financing plan.

I have been supporting the SSA position because I view the closed group calculation as a "liquidation" number -- the amount the

Government would have to pay to honor its commitment under present law to all current particiants while closing the program to all future participants. While changes in the program are being discussed, no one envisions that scenario! It may represent some measure of integenerational impact, but the number it produces is at best not useful and at worse misleading.

STATUS

FASAB Chairman, Dave Mosso (a former Treasury Assistant Secretary and 10 year member of FASB) recently sent a memo to Board members attempting to find some middle ground that would preserve the Board's credibility. The closed measure is so contentious that the Board (and the principals) will probably be criticized regardless of what we do. There may still be a compromise solution and I am exploring options with OMB prior to future discussion with SSA. I will keep you posted on developments.

1998-SE-003420

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
March 17, 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Gerry Murphy *GM*
David Wilcox *DW*

SUBJECT: FASAB Recommended Accounting Standards for Social Insurance

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The Federal Accounting Standards Advisory Board (FASAB) has recently released a proposal for how Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance should be treated in agency financial statements and in the *Consolidated Financial Statements of the United States* (*CFS*) produced by the Financial Management Service. This memorandum describes this proposal and summarizes our plans for responding to it.

- FASAB proposes to calculate the liability associated with each of these programs as the amount due and payable at year end—approximately one month's worth of benefits. It also proposes to show both "open-group" cash-flow projections and a "closed-group" measure of the long-term actuarial liability in notes.
  - The "open-group" cash-flow projections mimic information provided in the Social Security and Medicare Trustees' Report, and would include both inflows and outflows into each of these programs during a specified period.[1] The proposal leaves optional disclosure of a summary measure of either program's actuarial balance; such a measure would counterbalance the closed-group number.
  - The "closed-group" actuarial trust-fund balance measures the present value of contributions from *current participants* in the program, plus the current value of the trust fund, minus the present value of benefits to this same group. Current participants include both current beneficiaries and current workers.
- For Social Security, the proposed treatment would essentially return to disclosures made in the prototype *CFS* prior to 1995. For Medicare, the proposed treatment would represent a net expansion of available information, because the closed-group measure of liability has never before been published for that program.

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[1] The inflows would be presented with and without interest on investments in Treasury securities. Both inflows net of interest and outflows would also be presented as percentages of payroll and GDP. FASAB does not specify the number of years over which the open-group balance should be calculated, but it does imply that 75 years is sufficient. (The report says estimates should cover "a sufficient number of years subsequent to the balance sheet date to illustrate long-term sustainability (*e.g.*, traditionally . . . OASDI has used a period of . . . 75 years for long-term projections.") In recent years, the Treasury's prototype *CFS* presented values calculated over a 75-year horizon for OASDI and a 25-year horizon for Medicare.

POSITION OF VARIOUS PLAYERS

A majority of the Board favors putting the closed-group measure directly on the balance sheet, but they were persuaded to adopt the above-described compromise rather than risk a veto from Treasury or OMB. Treasury (represented by Murphy) argued against disclosure of the closed-group figure, citing that it is not especially useful (the Trustees make open-group calculations) and is potentially misleading (since it represents the cost of terminating the program). SSA, which does not have a seat on the Board, has also strongly opposed the compromise. They argue that a closed-group calculation is inappropriate for a pay-as-you-go system, and that open-group measures, including the 75-year actuarial balance of the type published in the Social Security Trustees' Report, address the need for a long-term representation of the system's financial status. SSA is very concerned that those who might want to privatize the system could misuse the closed-group estimate.

PROCESS GOING FORWARD

FASAB is now seeking public comments on the proposal. The comment period will last 120 days, until roughly June 20. After the close of the comment period, the Board will hold a public hearing, and then engage in final deliberations. A recommendation to the three principals (Treasury Secretary, Director of OMB, and the Comptroller General) will probably be made in about September. The principals have an unlimited amount of time to act on any recommendation. Each of the principals has the power to veto a recommendation, although this power has never been exercised. If approved, the proposal would be implemented in the *CFS* for FY-1999, which would appear in early 2000.

ASSESSMENT AND RECOMMENDATION

The proposed compromise is a substantial improvement over the true sentiment of the FASAB majority. Absent support, the compromise could unravel and a much less favorable outcome result. Going forward, the most important step for us to take will be to coordinate our strategy with OMB and SSA. Our understanding is that OMB has reservations about the closed-group measure but is looking for a compromise solution. We want to understand their concerns; we also want to understand SSA's position.

<u>Our initial recommendation, subject to further consultation with OMB and SSA that we will be conducting in the near term, is to support the compromise, in light of the downside risk in the event the compromise collapses.</u> We would also be inclined to recommend that disclosure of the open-group actuarial balance be required rather than optional. Key decisions yet to be made include whether Treasury should comment officially, and whether we should ask to appear before the Board at their public hearing.

BACKGROUND

RATIONALES FOR THE OPPOSING POINTS OF VIEW

A substantial majority of the members of FASAB—at least 7 of the 9 members—believes that the current accounting treatment is inadequate. They believe that the Social Security and Medicare programs have characteristics that require that liabilities be recognized long before obligations are due and payable. These characteristics include (1) the contributory nature of the program, (2) the establishment of "insured" status, (3) the specification of benefits in law, and (4) the existence of a trust fund subject to long-range financing. The majority feels that the closed-group actuarial balance should probably be recognized *on the balance sheet itself* in light of these characteristics, but is willing to compromise provided the amount is disclosed in the notes.

The opposite view is that, since Social Security and Medicare operate on a pay-as-you-go basis, (1) insured status confers no rights to benefits, (2) the accrual of rights would rob the system of its flexibility, and (3) benefits are uncertain. SSA also argues that the closed-group number exaggerates the financial problems in the OASDI system.

OUR ANALYSIS

Neither the open-group nor the closed-group calculations give the most accurate reading on the long-term liability associated with social insurance programs.

- The strongest argument for the 75-year, open-group cash flows for the OASDI system is that they are also presented in the Trustees' Report. A disadvantage is that the choice of horizon is arbitrary aside from its association with the Trustees' Report. A shorter horizon would imply a smaller net liability; indeed, under the current projection, a horizon extending only through 2029 would give no net liability at all. By contrast, extending the horizon beyond 75 years would increase the implied liability. Requiring that a net liability be calculated would parallel the closed-group proposal and make the open-group disclosure more informative.
- The main disadvantage of the closed-group actuarial balance is that it is designed to measure the adequacy of funding.[2] Since neither Social Security nor Medicare is pre-funded, the closed-group measure is not appropriate for a balance sheet.
- Pushing the horizon out to infinity would arguably result in the most appropriate basis for calculating net present values for a balance sheet. It would also avoid the artificial result under current SSA procedures whereby the net cash flow deteriorates each year, other things equal, as we add another deficit year at the end of the calculation period.

These issues are not simply arcana. The most recent SSA estimate of the closed-group liability in OASDI is $7.9 trillion, more than 2½ times the $2.9 trillion estimate for the 75-year open-group liability. However, an open-group liability estimated over an infinite horizon is likely to be much closer to the closed-group estimate (and, at this late date, may

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[2] These projections are made under current law; therefore, the closed-group figure can be interpreted as measuring the transfer of resources from future cohorts to current participants that would be required if current law were to be maintained with respect to current participants. This makes more sense for a funded (public or private) social insurance program than for a pay-as-you-go program.

TREASURY CLEARANCE SHEET

NO. ______
Date 3/17/98

MEMORANDUM FOR: ☒ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Gerry Murphy and David Wilcox
THROUGH: ______
SUBJECT: FASAB Recommended Accounting Standards for Social Insurance

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Robert Gillingham		3/17/98	Deputy Assistant Secretary for Economic Policy	622-2220
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______
☐ Executive Secretary ______ Date ______

1999-SE-004686

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

May 6, 1999

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

THROUGH: GARY GENSLER
UNDER SECRETARY FOR DOMESTIC FINANCE

FROM: DONALD V. HAMMOND
FISCAL ASSISTANT SECRETARY

SUBJECT: An Overview of the History and Structure of Financial Accounting Standards

In order to provide you with more context on the evolution and meaning of financial accounting standards, a brief summary of their history and application follows. Additionally, some select documents are attached which provide additional detail on the subject. Wendy Comes of the Federal Accounting Standards Advisory Board and Warren Gorlick from OASIA were particularly helpful in pulling this information together.

History While accounting and independent accountants have existed for centuries, the development and application of "generally accepted accounting principles" or GAAP is a relatively recent development tracing its origins to the 1930's and the strong national interest in providing reliable assurances about the operations and results of public utilities and publicly traded companies. Legislation that arose from the events of the late 20's and early 30's provided first the Federal Trade Commission and then the Securities and Exchange Commission with a federal responsibility for ensuring that certain entities fairly reported their financial condition and results. These laws set out legal requirements for audited financial information. Additionally, the McKesson and Robbins inventory scandal in the 30's is credited with creating more pressure for reliable financial information.

In the 30's, the accounting profession was self-regulated and represented by two rival associations. The events of this period raised the specter of federal control of financial accounting. The accounting profession responded by merging the two associations to form the predecessor to the current American Institute of Certified Public Accountants (AICPA). In addition, a committee was established in 1935 to review and revise the current state of accounting procedures and practice codified in the Federal Reserve Bulletin. The committee's goal was to establish the rationale for general reporting principles with the understanding that it would necessarily be reviewed and approved by the SEC. In essence, this was the precursor to modern GAAP.

Since this time, accounting standards have been developed by a series of entities starting in 1939 with the AICPA's Committee on Accounting Procedure which evolved twenty years later into the Accounting Principles Board (APB). In response to the perceived need for increased independence from the accounting profession in the development of accounting standards, the Financial Accounting Standards Board (FASB) was created. The FASB differs from the APB in two important ways. First, FASB includes representation from statement users in addition to professional accountants. Second, FASB members are employed full-time and have severed all relations with their firms or universities. Throughout this time and continuing today, the SEC maintains a general oversight role over accounting standards and reporting. In essence, the process of setting accounting standards is conducted by the private sector with a general governmental oversight.

The Meaning of GAAP Quoting from the literature, GAAP "encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. The standard ... includes not only broad guidelines of general application, but also detailed practices and procedures." The principles range from a broad definition of what constitutes an asset or a liability and the timing for the recognition of revenue and expenses to the treatment of specific transactions or circumstances such as the measurement of the liability for pension obligations. These principles are judged on their general acceptability by preparers and users of accounting reports. Auditors verify the proper application of GAAP by a reporting entity when expressing an opinion on the entity's financial statements.

A body of accounting pronouncements have come into existence in the more than 60 years that more formalized, uniform guidance has been issued by the various professional organizations and standard setting entities. This body of accounting practices and procedures is collectively referred to as GAAP. In order to give order to this body of information, a hierarchy has been developed for the application of the standards and to help resolve the inevitable conflicts that may arise between forms of guidance that have been issued by different entities at different times. The hierarchy provides the relative priority of the different sources of GAAP used by auditors to judge the fairness of presentation in financial statements.

The GAAP hierarchy sets out four levels of established accounting principles. The highest level is composed of Statements of Accounting Standards issued by the FASB, APB Opinions, FASB Interpretations and Accounting Research Bulletins. These standards are given precedence over guidance from other sources. The other levels assign priorities to other guidance issued primarily from AICPA and other professional sources.

Current Standard Setting Since 1973, the FASB has been the body responsible for the development of financial accounting standards. The Board is composed of seven, full-time, paid members appointed for five year terms. It is funded by the private sector through contributions and is an independent organization, though the SEC has separate authority to establish accounting standards for the companies under its jurisdiction. Overwhelmingly, the SEC has deferred to the private sector in the establishment of accounting standards. The Board is chartered to be responsive to the needs and viewpoints of the entire economic community and must follow a public "due process" in developing accounting standards. The process is multi-step and involves public notice and involvement at various stages, usually including a public hearing, on any new statement under consideration. In order for a statement to be issued and become a standard, it must be approved by five of the seven Board members. The effective date for a new standard is established at the time of its issuance and varies based on the complexity and impact of its implementation. Once effective, the new financial accounting standard becomes GAAP.

cc: W. Gorlick

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This information is from Prof. Gary John Previts, Case Western Reserve University and Prof. Thomas R. Robinson, University of Miami

The Formation of Self-Regulatory Auditing Standards in the Post-1930's: The Role of Samuel J. Broad

by Gary John Previts, Case Western Reserve University
and Thomas R. Robinson, University of Miami

February 1995

We would like to thank Edward Coffman and Daniel Jensen for supplying the collected writings of Samuel Broad and the KPMG Peat Marwick Foundation for providing the funding which enabled this project. The Formation of Self-Regulatory Auditing Standards in the Post-1930's: The Role of Samuel J. Broad

During the Great Depression of the early 20th century, New Deal Regulatory Agencies achieved statutory authority over reporting requirements for publicly held companies. In addition, the role and function of the independent public accountant as auditor were being formulated. Under whose jurisdiction were auditing standards and procedures to be established? In the aftermath of the McKesson and Robbins scandal, the Securities and Exchange Commission held unprecedented hearings in New York opening the issue to public debate. The initial witness at these hearings, Samuel J. Broad, selected because of his integrity and influence, was instrumental in crafting the process which ensued from these hearings empowering the CPA profession in unique ways.

A study of Broad's career, to include his writings, his committee work and his role as a leader in the public accounting profession, assists in gaining an understanding of the role of private sector associations in addressing potential areas of government intervention. Business historians have previously focused on agency pioneers such as Francis Adams, or progressive leaders such as Louis Brandies, or New Deal Regulators such as James Landis. This paper considers the role of a practicing accountant who was also an association leader.

The authors conclude that Broad served an important role by being a role model whose efforts assisted in establishing a "social contract" between the government and a national professional organization.

Introduction

The decade of the 1930's was an era of both opportunity and crisis for the public accounting profession. The securities acts of 1933 and 1934 called for audits by independent accountants creating a legal demand for the services of public accountants. These acts, along with subsequent legislation, also brought about the potential for increased legal liability and reduced autonomy for the profession.*(1)* A crisis in public accounting was provided by the celebrated McKesson & Robbins case. McKesson & Robbins, Inc., whose financial statements had been audited by Price Waterhouse & Co., had inflated inventory and receivables by $19 million dollars through falsification of supporting documents.*(2)* With the subsequent investigation by the Securities and Exchange Commission, "[t]he entire accounting profession was, in effect, on trial."*(3)*

Samuel John Broad was involved as much as any single individual among his peers in shaping the policies and content of professional standards for both financial reporting and auditing in the wake of the 1930s economic depression and the controversies and investigations concerning the fraudulent reports of McKesson & Robbins thereafter. Broad was one the most active members of the accounting profession from the 1930s until his retirement in 1959. He was the first individual to testify before the Securities and Exchange Commission in the matter of McKesson & Robbins and the first chairman of the American Institute of Accountant's(AIA))*(4)* standing Committee on Auditing Procedure. Later Broad also served as the Chairman of the Committee on Accounting Procedure, then the American Institute's senior authoritative body promulgating financial reporting standards. He is the only person to have chaired both of these Institute Committees and additionally to serve as the Institute's chief executive. He was president during 1944-45.

This review of Broad's speeches and writings is intended to assist in achieving a wider consideration of his views in the context of the times in which they were developed and to invite attention to a deeper and continuing consideration of his efforts.

Our review is developed in four parts. First we provide a brief biographical synopsis. Next, we address the principal role that Broad played in the development of generally accepted accounting principles. Then we consider his contribution to auditing. The final section provides a synopsis of the variety of ways that Broad employed analogy in discussing various topics, a pervasive and distinctive element of all of his writings. We conclude our considerations with an interpretation of Broad's writings and work consistent with a contemporary perspective.

Biographical Profile

Broad was born September 4, 1893 in England. His family later migrated to Canada, where in 1916, Broad received a bachelor's degree from Queen's University. Also in 1916, Broad joined the firm of Peat Marwick Mitchell & Co. (PMM). He was admitted to partnership in the United States in 1926. He served the firm as Deputy Senior Partner from 1947 to 1959. By the time Broad was becoming a national figure, in the late 1930s, PMM had grown to the point where Broad was one of the best known of the firm's 25 partners. During his tenure as Deputy Senior Partner, Broad was the firm's chief representative dealing with the profession and regulators.

Broad was extremely active in public practice holding CPA certificates in many states including New Jersey, New York, Pennsylvania, and Ohio. He served the profession both at local and national levels. In the New York State Society of CPA's (NYSSCPA), where he had become a member in 1922, Broad served on several committees including the Committee on Publications which merged the society's quarterly publication and informal monthly bulletin into a monthly journal during his term as chairman. He also served as a member of the New York State Committee on Grievances and served as a member of the NYSSCPA's Board of Directors. In 1915, Broad became a Chartered Accountant (CA) in Canada and he was a member of the Dominion Association of Chartered Accountants. At the national level, Broad served at various times as president, vice president, and treasurer of the American Institute of [Certified Public] Accountants and vice president of the American Accounting Association. Broad served on and chaired numerous AI[CP]A committees including the Committee on Auditing Procedure and Committee on Accounting Procedure. Broad was one of the organizers of the AI[CP]A's Fiftieth Anniversary Celebration held in New York City and an active participant in the event's technical round table sessions.

Broad married Gladys Bowes in 1917. He spent much of his retirement in Scarsdale and passed away in White Plains Hospital on October 10, 1972. Broad was survived by a brother, Charles, his three children and three grandchildren.

Accounting Principles

Broad did not begin to regularly publish his writings until well after his involvement with the American Institute Committee that was charged with rewriting the Federal Reserve Bulletin. This Committee conducted its efforts in the midst of changing conditions. As noted below, in 1935 the CPA profession was still divided between two national organizations, and the Federal Government's securities laws had established the authority of Commissions, first the Federal Trade Commission [1933] and, then, the Securities and Exchange Commission [1934] to establish the basis for publicly held company reports. The accounting profession, as it was in those days, numbered fewer than 10,000 CPAs and the principal accounting firms, comprised at most two or three dozen partners each located in only the most major population centers. Their principal auditing role was performed by "seasonals" who were used only during the busy period of auditing and then released. College recruits were beginning to be employed on a regular basis, but this was the exception, not the rule. The authority for a decision about use of an accounting principle or position was debatable, beyond the established judgment of the individual CPA.

Over the next two decades of the 1930s and 1940s a "classical" arrangement of accounting institutions and teaching materials would come into being, which would affect the profession throughout the post World War II period and even until today. This arrangement came in response to the question of what was an acceptable principle, and reflected the reunification of the practice community which had occurred by the time of the 50th Anniversary of the Institute. The rival activities of the Institute and the American Society which had fractured the profession of public accounting during the early 1930s ended with the reunion of CPAs under the auspices of the Institute. United in this fashion the practice community had a new document prepared by the Committee to Revise the Federal Reserve Bulletin, a document that sought to establish the profession's rationale for general reporting principles. Broad's assignment as Chairman of this key committee, and his position as full time observer participant in the Institute's Special Committee on Auditing Procedure, which addressed the issues resulting from the McKesson & Robbins episode, suggest his important role in the events of the time.*(5)*

Reporting on the Progress of the Committee to Revise the Federal Reserve Bulletin in September 1935, a report published in the Institute's 1935 Year Book notes that*(6)*:

> Our present aim is to complete the work this fall and, upon completion, to obtain the approval of the executive committee of the American Institute of Accountants; then to take it up with the federal reserve board for the purpose of obtaining their sponsorship and thereafter **to secure the approval of the securities and exchange commission**. [emphasis supplied].

This statement provides evidence of the attempt of the Committee to establish the profession's authority and role in matters relating to reporting principles soon after the SEC was formed.*(7)* The 1936 revision of the "Bulletin" was the first pronouncement of this era to seek the Securities and Exchange Commission's endorsement as an authoritative document.*(8)* And while the American Accounting Association was also ·oducing an important document advocating the historical cost basis in accounting, its document was not ..kely to affect immediate practice decisions.

Broad's British upbringing is evidenced by his reference to the second revision of the Federal Reserve document as "Common Law" for accountants.*(9)* This second revision of the Federal Reserve's original publication was spurred in part by the stock market crash and subsequent establishment of government involvement in accounting and reports. The publication of the Special AI[CP]A Committee's document in 1936 under the name Examination of Financial Statements by Independent Public Accountants was important for, as Zeff notes, the revised bulletin was "probably the first Institute publication in which the term 'generally accepted accounting principles' appears."*(10)* In Broad's discussion of the bulletin he stresses the importance of judgment in the preparation of financial statements and the related professional requirements of competence and integrity.*(11)* Broad felt that some guidelines are helpful for accountants but cannot supplant individual judgment. Having received his education and initial training in the British system, Broad's emphasis on the use of professional judgment versus detailed rules is not surprising.

At the same time Broad was espousing a "common law" approach, he also supported the primacy of income determination in his commentary on a paper by Paton, Broad related its importance to valuation as follows:*(12)*

> Earning power, moreover, is of crucial importance for valuation purposes and past performance **must** be used as a basis for measuring prospective earning power. [Emphasis in the original].

Further, Broad accepted that accounting is a discipline linked to economic judgment. He begins a part of his commentary by using the example, akin to an analogy, of real estate value to address the issue of measuring the value of an industrial enterprise.*(13)*

> To make my point clear let me use as an example a very simple form of property real estate and illustrate by reference to an imaginary piece of property, say on the lower East Side of Manhattan Island.
>
> If we go back far enough, we can visualize an attractive countryside, green grass, hedges, and a few trees. The land, if used, was of value for cattle grazing or, perhaps, as the scene of Sunday evening strolls. As time passed the town spread northward; attractive residences were built with plenty of land around them. People continued to move north, the limited amount of land available necessitated increased utilization of what land there was. Values went up and with them perhaps taxes. The owner was forced to sell part of his plot as the limited use of it for a single two story residence was uneconomic. Several houses were built on the land formerly occupied by one.
>
> Our attractive residence, though constructed to stand the ravages of time, was no longer **suitable to the changed conditions**. [emphasis supplied]. It lost value as a residence as stores and factories moved into the neighborhood. All this time the land was the same land but it had increased tremendously in value; the residence had declined. to make greater utilization of the space possible, buildings of several stories necessarily took the place of the two story residence. The land reached its zenith but with the movement of population still further north fewer people passed the stores, or perhaps the economic status of the neighboring population changed. The rental value of the property decreased as its utilization declined and the land went down in value as a result.

> I have used this example to bring out the point that intrinsically the land and our original residence remained the same but their value went up or down relatively to the **degree of utilization** to which the land could be put and the ability of the building to provide that utilization. If the building did not measure up it became uneconomic and lost value. Objectively the property was unchanged but subjectively its value was dependent on ability to render service or utility and this in turn was measured in terms of money by earning power, the return expected to be realized from the use of the property.

Classical accounting value theory and its relationship to income determination is succinctly stated in this, one of Broad's earliest writings. The analogy represents influential practice thinking during changing times. In addition, the publication setting in which it appears, namely as a response in the Accounting Review to Paton's important 1936 paper on valuation is further evidence of its importance and significance.*(14)*

During the post World War II period several accounting problems emerged. Among the most challenging was that of dealing with inflation. Broad, who had advocated the historical cost basis of accounting began to change his view under the circumstances of the postwar inflation and advocated a form of price-level adjustment, particularly in matters of depreciation. The Committee on Accounting Procedure, [CAP] with which Broad was associated, however, maintained its commitment to the historical cost basis. Zeff notes that when the Committee voted to reaffirm its opposition to price-level depreciation, Broad became the only chairman in the committee's history [1939 59] to dissent from a committee pronouncement."*(15)*

The difficulties of inflation accounting in this era were accommodated by the rapid adoption of LIFO techniques in inventory and the implicit endorsement of accelerated depreciation on the cost basis by Earle King, then Chief Accountant of the SEC. These measures in tandem preserved the historical cost basis of statements while affecting an adjustment to matching of revenues and costs in periods of rising prices. Broad supported the use of indexing to convert depreciation expense computed on an historical cost basis to current terms.*(16)* A host of issues, relating mostly to the balance sheet consequences of such actions remained unresolved however. Since these techniques tended to leave the oldest and lowest costs on the balance sheet, corporations values tended to be stated on an almost extremely conservative basis given replacement values. This asset understatement was aggravated by the further fact that many of the long term plant assets constructed as emergency facilities during the World War II period had been fully depreciated within a 60-month period allowed under wartime regulations for tax and book purposes and, therefore, were not reflected in reports, even though there were debates about "restoring" values for such fully depreciated assets. Conservative valuation prevailed, indeed to a fault some might say.

Income statement issues were contested not only on the valuation point of historical cost versus adjusted values, but also on the broad concept of the continued propriety of all-inclusive versus current operating content structure. The CAP voted in 1947 to support the current operating approach and issued *Accounting Research Bulletin No. 32 (ARB 32)* to this end. The SEC, as announced by Chief Accountant Earle King, opposed this approach. King cited the traditional view of all inclusive statements as consistent with full disclosure and so advised the profession in a special letter published in the January 1948 issue of the Journal of Accountancy.*(17)* This impasse led to a continuing skirmish until many years later when the Accounting Principles Board ratified the "modified all inclusive" approach. Broad was a member of the CAP when ARB 32 was approved, and subsequently in 1948 became chairman succeeding George D. Bailey.

Contributions to Auditing Procedure and Literature

Broad's writings on auditing appear coincident to his activities related to the McKesson & Robbins fraud. His initial testimony in the SEC's New York City hearings of 1939 suggests the importance given to his views on the subjects related to the scope and conduct of an audit and application of auditing procedures, recruiting of and duties assigned to auditors, supervision of engagements, organization and training of staff, and importantly to the notion of developing a specific list or number of accepted auditing standards. Broad was quoted in the New York Times as stating that: "the securities acts place very substantial responsibilities on auditors and also very substantial liabilities" and, he also noted that the laws "no wheer [sic] implement these by giving the auditors any power or authority such as is given by legislation in other countries to enable him most effectively to meet his responsibilities."*(18)* In the late 1930s, he also wrote on particular auditing procedures subjects relating to receivables and inventories, two major areas in the McKesson audits.

As the initial chairman of the Institute's Committee on Auditing Procedure, Broad was a proponent of setting auditing standards that are more specific than "general principles" yet more general than "detailed specifications." Broad used a medical analogy to convey the point:*(19)*

> The standard of due care in an operating room requires absolute cleanliness, but it does not dictate what instruments a surgeon shall use or the exact length of the incision. The standard of cleanliness also applies in the hospital ward, but the procedures masks, gowns, gloves, etc. are not so meticulous because the risk of infection is less.

More importantly, Broad set out in the above text of a speech made at an Institute annual meeting, a preliminary list of auditing standards for consideration by the profession. Broad continued to emphasize the importance of "due care" as a basis for auditing and he advocated that auditors give careful consideration to "materiality" and the "relative risk" of various accounts in designing an audit.

As the War was ending in 1945, the Institute published a text for the purpose of both updating accountants returning from the War, and educating the influx of veterans as students expected to enter accounting. Broad, finishing his year as Institute President wrote the chapter on auditing, entitled "Trends in Auditing and Reporting". It is the most concise representation of Broad's accounting and auditing thought and may be the best single item if one is to be selected as representative of his writing before the post war era. It summarizes a great deal of Broad's ideas concerning auditing including his list of suggested auditing standards. Broad's written works show evidence of the shift of importance among issues. In matters of practice planning during the War years, Broad was instrumental in working with the New York Stock Exchange to obtain an extension of filing requirements for firms necessary due to a lack of accounting staff caused by the war. He also led efforts to revise the standard audit report form.

On the important subject of objective judgment, Broad would compare the role of the independence of an auditor in a competitive economy to that of a baseball umpire:(20)

> Some time ago I was watching a baseball game. It was an important big league game and the standing of the two teams in the pennant race depended on the result. Much money was undoubtedly wagered on the outcome. The score was tied in the last half of the ninth inning and everything was tense. The pitcher threw the ball. There was a crack of the bat and the whole field sprang into activity. The runner on third base raced for the home plate and the spectators couldn't tell whether he arrived ahead of the ball or not. It was a close decision but a little man wearing a dark cap and a chest protector waved the batter safe....

Analogous Reasoning

Although an active practitioner for many years, Broad's published writings do not appear until he takes up is national professional committee assignments by which time he was in his forties. His writings indicated a habit of using analogies to inform and/or persuade the reader or listener to a way of thinking. In one of the earliest of his known publications, Broad remarks that financial statements are most useful for stewardship purposes but that additional information is necessary for investment purposes. In pointing out that investors should be aware that reliance on historical financial statements is no guarantee of future profitability, Broad compares a business with a ship:*(21)*

> An industrial enterprise is much like a ship. The ship may be well constructed, her cargo carefully stowed and her navigation perfect. She may be sailing a well charted sea in all serenity. But suddenly a cloud appears on the horizon, a storm arises, the ship is buffeted and beaten. She may be thrown off her course, be delayed or possibly disabled. If the storm is severe enough she may, perhaps, be wrecked. So with an industrial enterprises.

The McKesson Robbins scandal of the late 1930's provided Broad an opportunity to use analogy as a witness before the SEC. In describing the CPAs role as an auditor, both during his testimony and in a subsequent publication, Broad likened the accountant to a policeman:*(22)*

> Perhaps I can illustrate his attitude by a homely example; a policeman walks along the street and as long as everything is quiet he is doing his duty by being watchful and alert; if a crime is committed, however, he does what is immediately necessary and then reports it and a detective is assigned to the case. Similarly, when suspicious circumstances arise, the auditor steps out of his role as policeman into the role of sleuth....

Broad used similar analogies in his other publications at this time regarding advances in auditing. Regarding changes to the auditor's report:*(23)*

> Commenting on the old standard form in Cincinnati last fall, I said: 'The patient is not ill, he does not require a major operation; but some minor correctives are needed.' I think those correctives have been applied and that the patient is greatly improved.

And, with regard to auditing programs he observed: "Auditing can no more be done by rote than can all bridges be built from a standard blueprint or a lawsuit be tried by formula."*(24)*

Broad continued the use of analogies throughout his writings on various topics. Stating his opposition to negative assurance confirmations related to officers' life insurance, he noted:*(25)*

> One is reminded of the story of the first mate who was addicted to excessive enjoyment of the cup that cheers. Following warnings, and threats to do so, the captain finally entered in the log a statement that "The first mate was drunk today." On the next occasion when the log was the first mate's responsibility he retaliated by an entry to the effect that "The captain was not drunk today." Probably the negative statement was more damaging than the positive statement. I can see some advantage in having the auditor undertake to make inquiries regarding "side agreements" and to report when they are found to exist. I am inclined to doubt the advisability or necessity for reporting when none exist [1942].

Concerning the exercise of due care:*(26)*

> The established standards of what constitutes due care are influenced by the number of people affected by the risk.

> Automobile speed limits are lower in congested districts than in the open country; fire escapes are found in apartment houses but not in private houses; employees' liability insurance is required where the number of employees exceed a minimum [Broad 1941, p. 390].

To Broad, the standard of reasonable care seem to be influenced also by materiality, as well as the degree of the risk involved:*(27)*

> The risk of a wreck is no greater to a passenger train than to a freight train, but what is risked is human life instead of property; hence the raising of the standard by the substitution of metal for wooden passenger cars; safety devices required for machinery increase where the danger to life and limb of employees is greater [Broad 1941, p. 390].

In the same paper he compared an audit opinion to a jury verdict:*(28)*

> Even the conclusion of the twelve men of a jury occasionally results in the miscarriage of justice. Though we sympathize with the unfortunate victim, we do not hold the jury accountable [Broad 1941, p. 391].

Analogies were the common thread of Broad's style of explanation and his unique metaphor. Broad used them characteristically as vehicles to simplify and demonstrate essential points about the complex role of CPAs in the economic setting of capital markets and the changing times which included the years spanning the depression era, World War II, and the post war economy.

Summary Interpretation

Broad was brilliant in his practical skills, and effective in his leadership among peers in the profession and in his firm. When he began taking up his interest in matters of public policy he showed evidence of vision at a higher level. He was clearly a product of his education and his upbringing. He espoused classical economic and property rights views. and adapted them effectively, inspiring and persuading others as to their efficacy in the immediate domain of events. "Accounting," Broad said in his 1938 paper on the Surplus Account, "is a branch of the science of economics and represents an attempt to measure and show by means of figures economic facts. transactions and results."*(29)* His theory of accounting was consistent throughout his career with that view. When post depression economic events challenged the traditional balance sheet statement emphasis he was among those who, like Paton, addressed these concerns seeking to provide income determination or earning power information sought by investors in public companies in a manner consistent with traditional classical economic notions of property. Broad's contributions were many and important in their practical significance. One might say, using the analogy of military leaders, that he was a brilliant tactician if not necessarily a strategist, in the profession.

His awareness and concerns about the public policy aspects of accountancy, are evident in his later writings, such as in his 1945 speech as President of the Institute. these writings are not visionary - in a strategic sense, but are importantly representational - portraits of their time. He seemed to enjoy working hard and he appeared to live comfortably and was, at least by what testimony is available. not a stuffed shirt, or merely a cardboard figure Marquis' Who's Who, 1962-63]. One of his sons David responded to the call of a religious vocation.*(30)* Broad was well mannered and well liked, and was apparently blessed with good health. He was, in a word, a man capable of making decisions and convincing others of the propriety of them. He was indeed a man of his times.

To him an interest in public policy ran to business concerns over taxes, not the equity of the tax burden per se. His energies were fully absorbed in building the profession internally. This was a daunting challenge. It vould fall to others in succeeding generations, it can be said, to address the public policy matters effectively.

Broad's many contributions to the profession were recognized when he received the American Institute's Gold Medal in 1952 and was inducted into The Ohio State University Accounting Hall of Fame in 1954. In identifying the small group of individuals who have been instrumental in developing the CPA profession over the past century, Zeff included Broad as one. In "Leaders of the Accounting Profession: 14 Who Made a Difference."*(31)* Zeff recognizes that Broad made important contributions to the development of accounting principles, in service to the profession and was instrumental in the development of auditing standards.

This review cannot consider all of the aspects to Broad's many contributions. Those who wish to examine his writings more closely take full advantage of the volume of Broad's collected writings provided by Professors Jensen and Coffman. These writings avail thoughtful accountants the opportunity to consider Broad's writings and to compare them with those other collections already in print, including the works of George O. May, Eric L. Kohler, Paul F. Grady, William W. Werntz, Andrew Barr and Carman Y. Blough among others who were Broad's contemporaries. By such study and consideration each generation of accounting practitioners, professors, and students can be continually enriched in an awareness of the origin of issues, challenges and thoughts which serve in part to form the traditions and literature of our discipline.

Footnotes

1. Previts, G.J. and B.D. Merino, *A History of Accounting in America*, New York, 1979, pg 241,256.
2. J. L. Carey, *The Rise of the Accounting Profession* [Two Volumes], Volume 2-1970. pg. 23.
3. Ibid, pg. 25.
4. The American Institute of Accountants (AIA) was the precursor to the American Institute of Certified Public Accountants (AICPA).
5. The Report of the Special Committee on Auditing Procedure appears on page 170 of the Institute's 1939 Year Book. This committee addressed the sensitive peer aspects of the McKesson & Robbins financial fraud. The footnote to the report states: "Samuel J. Broad, chairman of the special committee to revise the bulletin Examination of Financial Statements by Independent Public Accountants, and Edward Kracke, chairman of the special committee on inventories, participated in all the meetings of the committee." *American Institute of Accountants Year Book 1939*, New York, 471 pp.
6. *American Institute of Accountants Year Book 1935*, New York, pg. 326.
7. In 1917 the Federal Reserve Board published Uniform Accounting: *A Tentative Proposal Submitted by the Federal Reserve Board*. This bulletin was revised by a special committee of the Institute in 1929 and titled Verification of Financial Statements. After the formation of the SEC, Broad chaired an Institute committee which again revised the bulletin. The revision was titled Examination of Financial Statements by Independent Public Accountants.
8. No detailed research about why the committee failed to receive the sought endorsement is known to have been undertaken. Apparently the attempt was unsuccessful. Not until 1938, when Accounting Series Release No. 4 was issued, did the Commission announce its policy with regard to the basis of generally accepted accounting principles.
9. Previts and Merino, op. cit., pg. 256.
10. S. A. Zeff, "Leaders of the Accounting Profession: 14 Who Made a Difference," *Journal of Accountancy*, 163, May 1987, pp. 46-50, 52-54, 56,58-62, 66-68, 70-71.
11. S.J. Broad, "Examination of Financial Statements by Independent Public Accountants," Presentation to March 23, 1936 meeting of NYSSCPA, 1936a, pp. 23-26.

12. S.J. Broad, "Comments on Professor Paton's Paper: Valuation of the Business Enterprise," *Accounting Review*, Volume 11, Number 1, 1936b, pg. 34.
13. Ibid, pg. 33.
14. W.A. Paton, "Valuation of the Business Enterprise," *The Accounting Review*, Volume 11, March 1936, pp. 26-32.
15. Zeff, op cit., pg. 59.
16. Broad, S.J., "The Effects of Price Level Changes on Financial Statements," *in National Association of Cost Accountants, 1948 Proceedings of the Twenty-Ninth International Cost Conference*, New York, 1948, pp. 7-25.
17. E.C. King, "SEC May Take Exception to Financial Statements Reflecting Application of Bulletin No. 32," text of a letter dated December 11, 1947 reprinted in full in *Journal of Accountancy*, January 1948, p. 25.
18. New York Times, "M'Kesson Hearings Reviewed by SEC," September 15, 1939, p. 36.
19. S.J. Broad, "Auditing Standards," *Journal of Accountancy*, November 1941, pg. 392.
20. S.J. Broad, "Why do we need Accountants?" *Journal of Accountancy*, October 1945, pg. 267.
21. S.J. Broad, 1936b, op cit., pg 35.
22. S.J. Broad, "Can Audit Programs be Standardized," *Accounting Ledger*, 5, April 1939a, pg, 21.
23. S.J. Broad, "The Accountants Report and Certificate," *Journal of Accountancy*, 68, July 1939b, pg. 22.
24. S.J. Broad, 1939a, op cit., pg. 24.
25. S.J. Broad, Letter addressed to Philip F. Gray, Irving Trust Company, published in *Robert Morris Associates Monthly Bulletin*, August 1942, pp. 74-76.
26. S.J. Broad, 1941, op cit., pg. 390
27. Ibid.
28. Ibid, pg. 391.
29. S.J. Broad, "Some Comments on Surplus Account," *Journal of Accountancy*, 66, October 1938, pg. 215.
30. New York Times, "Samuel J. Broad," Obituary, October 12, 1972, pg. 50.
31. Zeff, 1987, op cit.

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Marquis Who's Who, Inc., "Samuel John Broad," *Who's Who in America*, Volume 32, 1962-63, pg. 376.

New York State Society of Certified Public Accountants Year Book 1938, NYSSCPA, New York, July 1938.

New York State Society of Certified Public Accountants Year Book, 1939, NYSSCPA, New York, July 1939.

United States of America Before the Securities and Exchange Commission in the matter of McKesson & Robbins, Inc.: Testimony of Expert Witnesses Washington D.C. GPO: 1939. REPRINT EDITION New York: Garland Press, 1982. 638 pp.

T.A. Wise, *Peat, Marwick, Mitchell & Co., 85 Years*, privately printed, New York: 1982. 107 pp.

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ABOUT THE GAAP HIERARCHY

The meaning of the term *generally accepted accounting principles* (GAAP) has varied over time. Originally, GAAP referred to accounting policies and procedures that were widely used in practice. As standards-setting bodies and professional organizations increasingly became involved in recording practices and recommending preferred practices, the term came to refer more and more to the pronouncements issued by particular accounting bodies, such as the Committee on Accounting Procedure and the Accounting Principles Board, both committees of the AICPA, and more recently the FASB. Today, many different series of authoritative literature exist, some of which are still in effect but are no longer being issued, like APB Opinions and AICPA Accounting Research Bulletins. Others—such as FASB Statements and Interpretations—continue to be issued by accounting organizations.

To better organize and make clear what is meant by GAAP, Statement on Auditing Standards (SAS) No. 69 (The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles" in the Independent Auditor's Report) established what is commonly referred to as the GAAP hierarchy. The purpose of the hierarchy is to instruct financial statement preparers, auditors, and users of financial statements concerning the relative priority of the different sources of GAAP used by auditors to judge the fairness of presentation in financial statements. While the GAAP hierarchy appears in the professional auditing literature, its importance goes beyond auditors: preparers, users, and others interested in financial statements must understand the sources of GAAP that underlie those statements.

SAS-69 defines the GAAP hierarchy by outlining four categories of established accounting principles. Because these sources of accounting principles arose over five decades and were promulgated by different groups, some conflicts exist among them. The four categories of GAAP as set forth by SAS-69 correspond to these principles' relative authoritativeness. Sources of accounting principles in higher categories carry more weight and must be followed when conflicts arise. When two or more sources of GAAP within a given level of the hierarchy disagree on the accounting for a particular type of transaction, the approach that better portrays the substance of the transaction should be followed.

In addition to the four levels of established accounting principles, the GAAP hierarchy recognizes other types of accounting literature that may be useful in resolving financial reporting problems when issues have not been covered in established sources of GAAP.

The following figure displays the GAAP hierarchy's four levels of established principles that are supported by authoritative accounting literature, as well as the additional sources of GAAP. The *Miller GAAP Guide* is based on Category A, which is the highest level of the established accounting principles.

Hierarchy of Generally Accepted Accounting Principles

Level A	• FASB Statements of Financial Accounting Standards (FAS)
	• FASB Interpretations (FIN)
	• APB Opinions (APB)
	• Accounting Research Bulletins (ARB)
Level B	• FASB Technical Bulletins (FTB)
	• AICPA Industry Audit and Accounting Guides
	• AICPA Statements of Position (SOP)
Level C	• Consensus Positions of the Emerging Issues Task Force (EITF)
	• AICPA AcSEC Practice Bulletins (PB)
Level D	• AICPA Accounting Interpretations (AIN)
	• FASB Implementation Guides (FIG)
	• Industry practices widely recognized and prevalent

Other Accounting Literature

- FASB Concepts Statements (CON)
- APB Statements
- AICPA Issues Papers
- International Accounting Standards Committee Statements
- GASB Statements, Interpretations, and Technical Bulletins
- Pronouncements of other professional associations and regulatory bodies
- AICPA Technical Practice Aids
- Accounting textbooks, handbooks, and articles

CHAPTER 4

What does "the establishment of accounting principles" mean?

BEFORE A JUDGMENT can be arrived at as to how accounting principles should be established, it is necessary to inquire about the scope and nature of the task. What does "the establishment of accounting principles" mean?

"Accounting principles" has proven to be an extraordinarily elusive term. To the nonaccountant (as well as to many accountants) it connotes things basic and fundamental, of a sort which can be expressed in few words, relatively timeless in nature, and in no way dependent upon changing fashions in business or the evolving needs of the investment community. Yet the APB (despite the prominence in its name of the term "principles") has deemed it necessary throughout its history to issue opinions on subjects which have almost nothing to do with "principles" in the usual sense. For example, Opinion No. 19 ("Reporting Changes in Financial Position") deals with a financial statement considered appropriate for inclusion when the balance sheet and income statement of a business are reported upon; portions of the two Omnibus Opinions (Nos. 10 and 12) deal purely with matters of disclosure; and Opinion No. 15 ("Earnings Per Share") deals with methods of calculating and presenting the net earnings on a per share basis. Projects on the agenda of the APB include matters far removed from the domain of "principles," such as the makeup of interim financial statements and the disclosure of accounting policies followed in the preparation of financial statements. Other examples of the work of the APB could be given for which the term "principles" is at best inappropriate, but the point has been sufficiently illustrated.

Why has the term "principles" persisted in describing the work of the APB? How could the nature of its task be described with greater clarity and comprehensiveness?

To answer such questions we must go back to the year 1932 when the accounting profession in the United States took a major step toward improving standards of financial accounting for publicly held corporate enterprises. On September 22 of that year, a date which has been described as perhaps the most important in the recent history of accounting, a committee of the American Institute of Accountants (the predecessor body of the AICPA), headed by the late George O. May, recommended to the New York Stock Exchange that audit certificates for listed companies should state that the financial statements were prepared in accordance with "accepted principles of accounting" and recommended five basic principles to be followed in the preparation of such financial statements.[1]

Less than two years after the report of the May Committee, Congress adopted the first of the Federal Securities Acts, an event which heralded a period of great expansion for the accounting profession in America. An increased sense of responsibility accompanied this expansion, stimulated by the seminal work of May and his colleagues, and manifested by an increasing effort to develop professional norms. This effort has followed two paths. There has been the attempt to establish a body of fundamental accounting concepts, whether by logical deduction from a few basic premises or by induction from experience, or both. This attempt faltered in the early 1960s. At the same time (and increasingly since the mid-1960s) the profession mounted an effort to develop more specific standards of financial accounting and reporting without reference to any systematic theoretical foundation, but with at least three practical goals in view: (1) to discourage practices in specific areas which experience indicated might be employed in such a way as to mislead public investors; (2) to encourage practices which could be expected to make financial statements more informative; and, (3) to reduce the use of alternative accounting methods not justified by factual or circumstantial differences.

[1] The history of this event and its aftermath are discussed in Dr. Reed K. Storey's *The Search for Accounting Principles* (New York: AICPA, 1964).

The effort to formulate a body of fundamental concepts

At the time the APB was first organized, it was widely hoped that one of the first results of its labors would be a "grand design" of accounting theory upon which all else would rest. The Charter of the Board states that "pronouncements on financial accounting and reporting are expected to encompass (a) fundamentals of financial accounting, (b) definitions of 'terms of art' used in financial accounting, (c) applications of the fundamentals in specific areas of financial accounting, and (d) the form and content of financial statements, including the nature and extent of appropriate disclosures therein." Primacy was given to fundamentals with applications following along behind. In the 1958 report of the AICPA's Special Committee on Research Program,[2] which contained the blueprint for the APB, the importance of developing the fundamentals of accounting was given even greater prominence:

> The broad problem of financial accounting should be visualized as requiring attention at four levels: first, postulates; second, principles; third, rules or other guides for the application of principles in specific situations; and fourth, research.
>
> Postulates are few in number and are the basic assumptions on which principles rest. . . . The profession . . . should make clear its understanding and interpretation of what they are, to provide a meaningful foundation for the formulation of principles and the development of rules or other guides for the application of principles in specific situations. . . . A fairly broad set of co-ordinated accounting principles should be formulated on the basis of the postulates. . . . The principles, together with the postulates, should serve as a framework of reference for the solution of detailed programs.
>
> Rules or other guides for the application of accounting principles in specific situations, then, should be developed in relation to the postulates and principles previously expressed. . . .

If these early hopes have not been borne out, it has not been for want of trying. Accounting Research Study No. 1, written by Professor Maurice Moonitz in 1961, and Accounting Research Study No. 3, written by Professors Robert Sprouse and Maurice Moonitz in 1962, were devoted respectively to basic accounting postulates and broad accounting principles. Both were disavowed by the APB as "too radically different . . .

[2] *The Journal of Accountancy* (December 1958), pp. 62–68.

for acceptance at this time"[4] although, in the decade since they were published, they have had a considerable effect on accounting thought.

The failure of this first effort to win support did not signal abandonment by the APB of the attempt to develop a conceptual foundation for its work. Accounting Research Study No. 7, published in 1965 and written by Paul Grady, Director of Accounting Research of the AICPA at the time his study was being prepared, consisted of a compilation of the "principles" which could be deduced from current accounting practice. Because accounting practice is not always consistent, the "principles" compiled by Grady were not always consistent. His inventory was descriptive, not normative. It did not result in a statement by the APB itself.

In the same year, the AICPA's Special Committee on Opinions of the Accounting Principles Board, commonly referred to as the Seidman Committee, again sought to emphasize the need for a conceptual base for the work of the APB:

> Nevertheless, it remains true that until the basic concepts and principles are formulated and promulgated, there is no official benchmark for the premises on which the audit attestation stands. Nor is an enduring base provided by which to judge the reasonableness and consistency of treatment of a particular subject. Instead, footing is given to controversy and confusion. . . .
>
> • • •
>
> What is meant by the expression "generally accepted accounting principles"? . . . Where are they inscribed, and by whom?

The Committee's first recommendation called upon the Board to set forth its views on the purpose of financial statements and the attest function, to enumerate and describe the basic concepts to which accounting principles should be oriented, to state the accounting principles to which practices and procedures should conform, and to define a number of widely used terms.

The Board's response to this recommendation is embodied in its Statement No. 4 ("Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises"), issued in October 1970. Like Accounting Research Study No. 7, which preceded it by five years, the Statement analyzes current accounting practice but stops short of asking how well practice serves the objectives of accounting. To quote

[4] Statement No. 1 of the Accounting Principles Board (New York: AICPA, April 1962).

the Statement itself, it "is primarily descriptive, not prescriptive. It identifies and organizes ideas that for the most part are already accepted. . . . The description of present generally accepted accounting principles is based primarily on observation of accounting practice. Present generally accepted accounting principles have not been formally derived from the environment, objectives, and basic features of financial accounting."

Unlike Paul Grady's "Inventory," which as a research study had only the authority of its author's reputation, Statement No. 4 was a Board pronouncement. It did little to appease the Board's critics; in fact, the Board's present Chairman, Philip L. Defliese, has made it clear that he does not regard it as more than an important step along the road. This aspect of the Board's work, which has proven to be so elusive, has now passed, for the time being, into other hands with the formation of the Accounting Objectives Study Group, the members of which represent a broad cross section of the financial community. This group has been given the challenging assignment of considering the basic objectives of financial statements, the methods or bases of measurement which should be used in their preparation, and the forms of presentation which would be most useful in achieving those objectives.

The effort to establish more detailed standards of financial accounting and reporting

With the passage of the Federal Securities Acts in 1933 and 1934, the work of the May Committee was terminated. The Acts gave a government agency the power to prescribe the financial reporting practices to be followed by a substantial proportion of publicly held businesses. As discussed in greater detail later in this Report, the SEC requires companies subject to its jurisdiction to follow accounting practices certified as generally accepted by independent public accountants. Only rarely has the SEC found it necessary to use its power to prescribe financial accounting or reporting practices.

In 1939, the Institute took the initiative in identifying acceptable accounting practices by appointing a Committee on Accounting Procedure (the "Committee"). The Committee adopted a practical problem-by-problem approach in identifying generally accepted accounting practices to guide those involved in the preparation and certification of financial statements.

The Committee was active for 20 years and issued 51 bulletins. Throughout its existence, the Committee focused its efforts on identifying accepted practices including alternatives. While some questionable practices were gradually eliminated, the Committee did not make firm choices between "acceptable" alternatives, and it did not seek to proscribe widely used (hence "accepted") methods even though they were in conflict with its recommendations. As a result, there continued to exist a superabundance of "acceptable" alternatives for accounting for specific types of transactions.

Toward the latter part of the 1950s, the accounting profession was subjected to a barrage of criticism—much of it from within the profession itself—for permitting the existence of widely divergent alternative accounting practices, all within the broad framework of "generally accepted accounting principles." It was alleged that financial statements lacked comparability as a result of these alternatives, and that investors and other users of financial statements were thereby in danger of being misled. The response of the profession was to organize the APB to replace the Committee on Accounting Procedure.

During the early years of the APB, when its efforts in the more theoretical sphere were being emphasized, the SEC was encountering increasing practical difficulty with certain financial accounting practices which created problems for public investors. Urged by the SEC to confront these problems, the APB began in 1964 to issue opinions dealing with particular accounting practices considered to be in need of immediate attention. Since that time, work along this path has gained in momentum. In 1964 and 1965 three opinions were issued. In the next three years, six opinions were issued. During the three years ended December 31, 1971, the APB issued nine opinions. At present, there are fifteen projects on the APB's active agenda, each of which could lead to an opinion.

It is worth noting that a number of these opinions dealt with matters of particular concern to the SEC. Prior to the issuance of Opinion No. 9 ("Reporting the Results of Operations") the staff of the SEC had drafted the outline of a Commission rule dealing with the presentation of earnings per share. This draft was aimed at the elimination of potentially misleading "bottom line" calculations not reflective of the potential dilution of per share earnings arising from increasingly complex corporate capital structures. Opinion No. 9 proved in practice to be inadequate as a solution to the problem. A new effort was made which resulted in Opinion No. 15.

The SEC was also known to feel an urgent need for an opinion dealing with accounting for business combinations. Extraordinary efforts were put forth by the APB and its staff to solve this problem—the most difficult, by far, in its history—culminating in Opinions Nos. 16 and 17. Recently expanded SEC requirements for interim financial reports highlight the need for an opinion (presently on the APB's active agenda) dealing with this subject. Action by the SEC in 1969, dealing with "line of business" financial data in registration statements under the Securities Act of 1933, and again in 1970, requiring similar data in reports on Form 10-K, has stimulated efforts to develop standards relating to these data (the "diversified companies" project on the APB's agenda). Suggestions made years ago by the May Committee regarding disclosure of methods of accounting used in particular financial statements lie behind the "accounting policy" item on the APB's agenda.

Thus, in recent years, encouraged by the SEC and by the 1964 special action of the governing Council of AICPA (discussed on pages 41–42 below), the APB has actively sought to narrow the areas of difference in accounting practice by dealing with pressing issues on a problem-by-problem basis.

Financial accounting standards

The history of the APB's efforts, briefly outlined above, provides background for the Study's recommendation that the name "Financial Accounting Standards Board" be given to the new board proposed in Chapter 8 of this Report. In the Study's judgment, the word "standards" is more descriptive of the majority of the Board's pronouncements as well as the great bulk of its ongoing effort. The term "financial accounting" has become widely accepted as referring to external reporting, as contrasted, for example, with management accounting.

The need for a fundamental conceptual foundation has been much debated in accounting circles for many years. We believe this debate may have produced more heat than light. Financial accounting and reporting are not grounded in natural laws as are the physical sciences, but must rest on a set of conventions or standards designed to achieve what are perceived to be the desired objectives of financial accounting and reporting. We understand the primary work of the Accounting Objectives Study Group to be the development of such objectives and some guidelines for their achievement.

The work of the ongoing standard-setting body should be to develop standards for preparing financial accounting information that will be consistent with these objectives. Such standards will, in some cases, be funda-

BANKRUPTCY

1998-SE-005101

DEPARTMENT OF THE TREASURY
WASHINGTON

April 23, 1998

MEMORANDUM TO: DEPUTY SECRETARY SUMMERS

FROM: JONATHAN GRUBER JG

RE: Consumer Bankruptcy Reform

Action Forcing Event

The House and Senate are moving over the next week on consumer bankruptcy legislation. The administration is trying to figure out, belatedly, its position on the two major competing approaches to ensuring that individuals with substantial financial resources file for Chapter 13 rather than Chapter 7. This issue will be discussed briefly at tonight's NEC meeting, and in more detail at an NEC meeting next Monday. Sally Katzen and/or Gene Sperling may be calling you on this as well.

Substantive Background

While there are a number of issues in consumer bankruptcy reform, the central issue which is the focus of current legislation is needs-based bankruptcy reform: attempts to ensure that debtors with the financial resources to pay their debts end up paying something in Chapter 13, rather than being excused from their debts in Chapter 7. There are two competing proposals:

- The Gekas bill in the House contains a formulaic approach to determining whether individuals should be presumptively forced to file under Chapter 13: if their incomes exceed 75% of median income, and if they have sufficient "net income" to pay back 20% or more of their unsecured debts over a five-year period. The latter criterion defines net income as gross income minus secured debt service minus IRS standards for regional average expenses. If individuals meet these criteria, they must pay back all of their net income to unsecured debtors for five years. According to a recent analysis, 15% of those filing under Chapter 7 would meet this criterion - moving roughly $9 billion of debt from Chapter 7 to Chapter 13.

  There is a provision to allow for appeals of this formulaic approach for special circumstances. Nevertheless, this approach has been widely criticized by consumer groups, lawyers, and even the chair of the National Bankruptcy Review Commission that reported in October. This approach is supported by the creditor groups, who essentially wrote this bill.

- The Grassley-Durbin bill in the Senate would modify Section 707(b) of the bankruptcy code, under which judges can decide if there is abuse of Chapter 7. They would do so by changing the standard from the current "substantial abuse" to "abuse," providing guidelines on when abuse is present (e.g., ability to repay more than 20% of one's debts from net income), and by allowing creditors with standing to file a 707(b) complaint (although they would have to pay the debtor's attorney's fees and costs if the complaint were not "substantially justified"). This approach would very likely have a much less significant effect on the distribution of bankruptcies across Chapters 7 & 13, and would involve much higher administrative costs. It has been widely criticized as insufficient by the creditor groups.

There are a number of additional issues involved in considering these alternative approaches:

- While there is broad policy agreement that the best solution to the problem of abusive bankruptcy filings would be to greatly limit asset exemptions under Chapter 7 (which are set by states and can be quite high, even unlimited), there is little political will for interfering with states rights on this matter. Durbin-Grassley does impose a cap on state exemption levels of $100,000, which caps the several most egregious state practices; even this, however, is going to be an uphill battle. Another interesting idea that has been introduced has been to not allow exemptions for substantial transfers of assets to protected categories (e.g. homesteads) within one year of filing. This will also have some effect on the most egregious abuses, but little effect in aggregate.

- There has been some discussion of pro-debtor steps that could be taken to offset pro-creditor actions on needs-based reforms. The only substantive idea that has emerged is to crack down on credit card minimum balance policies that set payments so low that the debtor will never pay off his card balance.

- There are a number of other differences, such as dischargeability of different forms of debt from bankruptcy, about which Treasury does not feel strongly but other agencies do - for example whether child support payments will continue to be dischargeable.

Analysis

The formulaic approach appears to be a much more effective means of ensuring that individuals who can pay their debts do so.

- The discretionary approach in Grassley-Durbin will most likely lead to weak and uneven reform, as different judicial standards around the nation determine the extent to which debtors are held responsible for paying their debts in bankruptcy.[1] Moreover, this will be

[1] Currently, the judicial interpretation of Section 707(b) varies widely among circuit courts. For example, the Eighth and Ninth Circuits have held that ability to pay a significant percentage of debt out of future income is grounds for substantial abuse. The Fourth Circuit, on the other hand, has held that a debtor's ability to repay, in itself, is not sufficient grounds for find substantial abuse.

a very administratively costly approach for those judges that do take it seriously, as opposed to a simpler formulaic approach (although the appeals provisions in Gekas may end up being just as costly). The guidelines in Grassley-Durbin will help, but even here the definitions are problematic - in particular the fact that resources are defined as income net of expenses as reported by the debtor (so that those that eat out a lot have to pay less back in bankruptcy).

- The formulaic approach is preferable in theory, but there are a lot of problems with the particulars of Gekas. This approach would be a lot more politically saleable and probably not much less effective if individuals could define resources directly as income net of actual medical and (perhaps capped) mortgage expenses. And having a 100% tax rate beyond the exemption level is not sensible, compared to a more modest tax rate.

<u>Internal/External Politics Background</u>

A subcommittee of the House Judiciary Committee is marking up today the Gekas bill, which provides for a formulaic "needs-based" approach to bankruptcy reform. The Senate Judiciary Committee will be considering the Grassley-Durbin bill next week. At that markup, Hatch will offer an amendment to turn Grassley-Durbin into a formulaic approach. The concern of some in the administration is that Hatch will win, and that we will only have a formulaic approach of one type or another from which to choose. At that point, the key question is whether the President will veto the final legislation under pressure from consumer and other groups.

The question at hand is whether the administration sends some signal in advance of the Senate markup as to our preferences between the different approaches. There is strong sentiment from outside the Economic agencies to throw our weight firmly behind Grassley-Durbin, and run away from a formulaic approach. The economic agencies, and in particularly Treasury, have stated that we would prefer a formulaic approach.

Even from our perspective, however, remaining silent could be costly: if the formulaic approach wins, and the President vetoes, then we will have gotten no needs based reform at all (as opposed to at least the modest reform in Grassley-Durbin). On the other hand, if we throw our weight strongly behind Grassley-Durbin, we may be locking ourselves into a position of vetoing Gekas. Moreover, we may be taking ourselves out of the position of improving what formulaic approach does emerge; for example, Gekas could be improved to deal with many of the "sympathetic" cases by allowing the debtor to subtract actual medical expenses and (capped) mortgage expenses from net income, rather than doing all expenses by formula.

The current NEC position, with the economic agencies dissenting, is to strongly support Grassley-Durbin. I attach a draft memo on this position, which has four features:

- Support for Grassley-Durbin like discretionary approach (and maybe not even including the ability of credit card companies to challenge Chapter 7 claims).

- Support for limitation on state exemptions at $100,000
- Disallowance of bankruptcy claims for "abusive extensions of credit", defined as having a minimum payment which doesn't fully amortize within 15 years.
- Protections on dischargeability provisions to ensure protection of child support payments (the WH is getting lobbied hard on this point by womens' groups).

Recommendation

My recommendation would be that we argue for a letter which presents our dissatisfaction with a strictly formulaic approach, but which does not lock us into opposition to this model. We could, for example, point out the major problems with a rigid formula approach (doesn't sufficiently take into account exceptional circumstances such as high medical spending, 100% tax rate), but note that we are also concerned about features of Grassley-Durbin (guidelines are too weak, shouldn't use self-reported expenses). Given that Grassley-Durbin have stuck their necks out on exemption levels, we should be sure to support this feature of their bill.

Ultimately, a good compromise might be to have strong judicial presumptions without a rigid formula. This would take the Grassley-Durbin framework, and strengthen it considerably - while leaving much more discretion than is in Gekas. I will discuss further this possibility with both the Justice Department and our GC office.

Consumer Bankruptcy: Discussion Draft of Proposed Administration Approach
April 23, 1998

There is great controversy over the cause of the rapid increase in bankruptcies; it seems likely that the increase results from a variety of causes. The lack of definitive information and analysis cautions against a radical departure from our historic Bankruptcy system or taking steps whose consequences cannot be predicted with confidence. Nonetheless, the growing number of filings, examples of abuse of Chapter 7 and state exemptions, and evidence of imprudent extensions of credit warrant some appropriate changes to the consumer bankruptcy laws. The Administration believes there is merit in going forward with a package that included four pieces.

1. A discretionary approach to needs-based bankruptcy

- Modify Section 707(b) by changing "substantial abuse" to "abuse"
- Provide factors to consider in determining whether abuse is present to include:
  - whether the debtor's income is less than a certain level (to be determined) suggesting no abuse or exceeds a certain level (to be determined) counseling further scrutiny of whether there is abuse
  - the debtor has and is expected to have sufficient "disposable income" defined as the ability to pay a reasonable percentage (to be determined) of their unsecured, nonpriority debts over a reasonable period (to be determined)
  - the movement of more than $50,000 into exempt assets within one year of the bankruptcy filing
  - other factors from existing body of law
- [Give creditors standing to file a 707(b) complaint against borrowers whose incomes are above some level (to be determined), sufficient that there is a great enough likelihood of meaningful recovery to outweigh the danger that the motion was brought for the purposes of coercing the debtor to waive a right; but authorize a court to hold a creditor liable for the debtor's costs and damages in defending the 707(b) motion unless the creditor's position in filing the motion was "substantially justified"]

2. Limitations on abusive use of state exemptions

- Prohibit the use of state or local exemptions to shield more than $100,000 of real or personal property (other than a family farm)

3. Disallowance of bankruptcy claims for abusive extensions of credit

- Disallow claims in bankruptcy if the repayment terms (e.g., minimum payment) would not amortize the debt over a 15-year period (applicable only to debt incurred after passage of the act)

4. Protections to ensure that other changes had no adverse impact on payment of child support

TREASURY CLEARANCE SHEET

NO. ______
Date 4/23/98

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Jonathan Gruber
THROUGH: ______
SUBJECT: Consumer Bankruptcy Reform

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
- ☐ Enforcement
  - ☐ ATF
  - ☐ Customs
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  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
- ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
  - ☐ Savings Bonds
- ☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Jonathan Gruber		4/23/98	Office of Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

1998-SE-010101

DEPARTMENT OF THE TREASURY
WASHINGTON

ACTION

June 15, 1998

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: JONATHAN GRUBER

RE: **Bankruptcy - Urgent Action**

Action Forcing Event

The NEC is sending in a memo to the President today on bankruptcy reform. The memo reflects in most areas the consensus recommendations of the NEC working group, recommendations which Treasury has been instrumental in shaping. Thus, I am satisfied with most of the features of the memo. **The draft memo (with my editorial changes included) is attached.**

But there remain four potential problems. I need your immediate guidance as to how to handle these cases. **Comments on the memo are due at 10 a.m. on Monday, so expediency on this matter would be greatly appreciated.**

Background

While the NEC working group has been working hard to forge a sensible set of consensus recommendations on personal bankruptcy reform, there is still some unease about whether the President will agree with his advisors on our position. Thus, the purpose of this memo is to inform him of where we have come out, and to see if he is comfortable with this outcome. If he is, we will begin work with the Senate to try to push this proposal.

The fundamental elements of the proposal were largely shaped by Treasury, within the context of interagency compromise, and are therefore acceptable at this point:

- Presumptive guidelines for trustees and creditors to file motions under Section 707(b) of 100% of median income, and either (a) a 30% ability to repay, or (b) at least some minimum amount of ability to repay (e.g. $5000/year). The latter is a clever new feature added by CEA, which would deal with the case of an individual who has substantial ability to pay, but tries to circumvent these guidelines by running up his debt.

- Credit card debt that arose from paying off nondischargeable debts would not itself become nondischargeable, as in the Congressional proposals, but would instead trigger a presumption for Chapter 13. This is a sensible compromise in this area because there is deep-seeded opposition in some quarters to ever making credit card debt nondischargeable (on moral grounds), and this seems a more reasonable punishment to fit the crime.

- Credit card debt incurred in the last 90 days before bankruptcy to pay for (court-defined) "luxuries" would be nondischargeable. Unlike either the Senate or House bills, we would not make non-luxury credit card debts dischargeable (these bills do so above some floor, either $250 in House or $400 in Senate).

- Creditors who did not disclose the amortization period for minimum payments on credit cards would have their standing subordinated in bankruptcy.

But there are some other elements which do not reflect interagency position. Some reflect remaining uncertainties from the process, and some (particularly the most problematic) were added by the NEC over the last day or two. It is these issues on which I need your views:

- I would recommend adding another condition on credit card debt in the last 90 days before bankruptcy: even for unsecured debt that was not for luxuries, if it exceeds some large dollar total (e.g. $1000), then it triggers a presumption for Chapter 13. This strikes me as a sensible way to catch abuse that isn't captured in bankruptcy courts with a loose definition of "luxuries". This is a new idea, however, that has not been vetted in interagency process.

- **Most importantly,** the NEC is recommending that creditors who did not check on the debt burden of the debtor when issuing a credit card would be subordinated (would have lower standing) in bankruptcy. It is impossible for creditors to realistically evaluate the amount of "active" debt outstanding for a person when they extend credit. And it would be arbitrary for courts to start deciding that creditors hadn't done a good enough job in checking out the creditworthiness of a debtor when deciding to extend credit. This type of policy could seriously hamper the access to credit of low income individuals. This type of idea was also considered and definitively rejected by the working group. **I strongly object to this recommendation, that was inserted by NEC at the last minute.**

- I want to finalize with you your position on the idea of requiring minimum amortization periods. I think that this is actually a reasonably sensible idea, in theory, and I would like to discuss in more detail why (as I understand it) you are opposed. The question is whether we allow the memo to represent us as considering this policy, and I vote that it should (although I have edited it to not do so, reflecting your expressed view).

<u>Recommendation</u>

1) That we support the notion of a presumption for Chapter 13 for individuals with large credit card bills in the last 90 days before bankruptcy

_____ Agree _____ Disagree _____ Let's Discuss

2) That we oppose in strong terms subordination of debt for those creditors not checking on the debt burden of debtors when issuing credit cards.

_____ Agree _____ Disagree __✓__ Let's Discuss

3) That we allow the memo to represent Treasury as at least considering further the notion of requiring a minimum amortization period for credit cards, with length to be determined.

_____ Agree _____ Disagree _____ Let's Discuss

Attachment

NOTE TO REVIEWERS. THIS EXCEEDS 4-PAGE LIMIT BY ½ PAGE. ALL ADDITIONS MUST BE MATCHED BY DELETIONS OF EQUAL LENGTH. ADDITIONAL EDITS TO SAY SAME IN FEWER WORDS WOULD BE MUCH APPRECIATED. SEND COMMENTS BY 10:00 AM MONDAY AT LATEST.

June __, 1998 – Draft

MEMORANDUM TO THE PRESIDENT

FROM: GENE SPERLING

RE: BANKRUPTCY REFORM LEGISLATION

On June 10th, the House passed, by a veto-proof majority of 306-118, a bankruptcy reform measure that your administration "strongly opposes." A better, but still flawed, bill (voted out of the Judiciary Committee 16-2) may be taken up by the Senate before the July 4th recess. Both bills were changed markedly of late to address concerns that you and the First Lady, among others, have raised about their impact on debtors' capacity to pay child support and alimony; however, some problems remain in this regard.

After a comprehensive, NEC-led, review of all the issues, your advisors have reached a consensus that some bankruptcy reform is not only appropriate but important. However, the current bills need significant changes to satisfy our objectives and concerns. We propose to advance quickly an Administration plan in hopes of influencing the Senate bill on the floor and giving the Administration greater leverage in conference to shape the final legislation. The proposal would address three issues: (1) limitations on access to Chapter; (2) nondischargeable debts and their impact on child support and alimony payments; and (3) new provisions to protect against coercive creditor behavior and require greater responsibility on the part of creditors in extending credit.

I. BACKGROUND

During the 1996 campaign, Senator Dole was able to point (without effective rebuttal) to only one blemish on your economic record -- rising consumer bankruptcies. Despite what Goldman Sachs recently called "the best economy ever," personal bankruptcies have continued to rise sharply, from roughly 300,000 per year in the early 1980s to nearly 1.4 million in 1997.

nThere is much dispute about the causes of this increase; no definitive answer has been found. Growing levels of consumer debt make consumers more vulnerable to unexpected events that push a family over the financial edge. Rising bankruptcy rates track closely rising levels of unsecured debt. However, one cannot assign proportional responsibility for higher debt levels between, on the one hand, consumer taste for consumption and willingness to live with greater debt and, on the other hand, the practices of creditors offering credit to even heavily leveraged and unsophisticated borrowers without an evaluation of their capacity to repay. Nor do we know what role, if any, reduced social stigma and lawyer advertising play in bankruptcy filings.
An effective industry campaign, including contributions exceeding those made by tobacco and highway bill interests, as well as legislators' fear of being labeled a protector of deadbeats, partially explain the popularity of reform legislation. However, these bills also garnered support because the bankruptcy system is vulnerable to abuse. Under current rules, debtors with significant income can walk away from their debt entirely, even when they have the capacity to repay at least a portion of those debts; debtors can file repeatedly without any intention of completing bankruptcy, for the purpose of delaying bona fide collection activities; and generous state exemptions (including unlimited homestead exemptions in eight states and exemptions for goods like race

horses and silver spoons in Virginia) prompt some to shift assets to exempt categories prior to a bankruptcy filing to avoid making payment to any unsecured creditors.

However, regardless of who is to blame, **higher levels of debt charge-offs raise the cost of credit for everyone.** One study suggests that bankruptcies cost every American household between $300-400 per year. While credit card interest rates did not always rise and fall with market rates, the industry is now competitive, so that reduced bankruptcies will translate to increased access to credit for those that pay their bills. The median income of families that have a balance on their credit cards is below the national median. Thus, higher credit costs disproportionately fall on lower income families.

II. LIMITATIONS ON ACCESS TO CHAPTER 7 BANKRUPTCY

Both the House and Senate bills would limit access to Chapter 7's full and immediate discharge of debt (usually without any payments to unsecured creditors) and require those with the capacity to repay a proportion of their debt to do so under a Chapter 13 plan. We reject the House approach as rigid and inflexible, unable to take into account the unique circumstances which debtors in bankruptcy may face.

The Senate approach has more promise. It builds on a test already in use in some circuits which says that it is "abuse" of the system to file for a Chapter 7 discharge if one has the capacity to repay over three years 20% of one's unsecured debts, after taking into account all necessary expenses. The Senate bill would authorize a bankruptcy judge to apply this test to any debtor with income above the median and allow, for the first time, creditors to file the motion seeking a determination of abuse. Creditors would have to pay debtors' attorneys fees and costs if their filings were not substantially justified or if the motion was brought for the purpose of coercing a debtor to waive a right. [SARAH - I think that your description mixes current law and the Senate proposal - I don't believe that the current system has a 20% rule - please check with Fran]

Under the Administration's variation, the bankruptcy court would have discretion to determine whether or not a debtor's use of Chapter 7 is "abuse"; however, if a debtor has an income above the median and the capacity to repay at least 30% of their debts or some amount (such as $5000) over three years, use of Chapter 7 would be presumed to be abuse. (We would offer higher thresholds initially, for negotiating purposes, to achieve this outcome.) These presumptive guidelines could be overcome, for example, if the court determined that the debtor could not be expected to maintain reliably his or her current level of income or that unusual but necessary expenses would be incurred. Such presumptive guidelines have proven to be highly effective in promoting uniformity and fairness in establishing child support award amounts. Since the average debtor under Chapter 13 repays 20% of their debts, and has income below the national median, those who meet this higher threshold are those who are most likely to be able to succeed under a repayment plan.

We also would provide that, if a debtor moved more than $50,000 from nonexempt to exempt assets within one year prior to the bankruptcy filing, she would be subject to a presumption of abuse, regardless of income. However, no debtor would be denied access to Chapter 7, unless she had the ability to repay a minimum of $50 a month in unsecured, nonpriority debt. ~~Any lessor amount would mean that the debtor would be repaying less than $1800 over three years, an amount insufficient to merit the administrative costs and risk the possibility that the creditor was pursuing the motion to coerce the debtor to forego another right in bankruptcy.~~ (Additional new protections against coercive reaffirmations also would be required. See Part IV below.)

III. NONDISCHARGEABLE DEBT AND ITS IMPACT ON CHILD SUPPORT AND ALIMONY

The House and Senate bills still have provisions that would expand categories of nondischargeable credit card debt under current law, although the largest new category has been dropped. These expanded categories of nondischargeable debt raise two questions: (1) The Bankruptcy Code generally makes debts nondischargeable only where there is an overriding public purpose, as with debts for child support and alimony, educational loans, tax obligations, or debts incurred by fraud. Do the additional debts made nondischargeable by these bills rise to that same level of public priority? (2) What impact does the protection of new categories of debt have on the ability of the debtor, post-bankruptcy, to repay existing categories of nondischargeable debt (e.g., child support and alimony, educational loans, and taxes)?

The first category expanded is debts incurred to pay other nondischargeable debts. Under current law, if a debtor uses a credit card to pay federal taxes, the credit card debt is nondischargeable. The House and Senate bills make the debt incurred to pay <u>any</u> nondischargeable debt nondischargeable, although the Senate effectively eliminates the provision if the debtor is a single parent or owes child support and/or alimony. We would propose instead that the current law provision remain unchanged; however, if a debtor paid a nondischargeable debt with a credit card, it would create the presumption that the debtor's use of Chapter 7 was abuse and the debtor should be required to repay what she can under a Chapter 13 repayment plan.

The second category expanded is debts incurred in the period immediately before bankruptcy. Under current law, debts for luxuries over $1000 to a single creditor within 60 days of bankruptcy are nondischargeable. However, there is some evidence of abuse, as debtors run up credit knowing that a discharge is likely. Even the pro-debtor Bankruptcy Review Commission recommended making all debts incurred within 30 days of the filing nondischargeable. The House and Senate bills would make all debts incurred within 90 days of bankruptcy for luxuries be presumptively nondischargeable. In addition, these bills would make presumptively nondischargeable debt above ($250 in the House; $400 in the Senate) for necessaries during the same period. It seems reasonable to make debt for luxury goods and services within 90 days of bankruptcy presumptively nondischargeable; however, any cap on necessary expenses incurred prior to bankruptcy is inappropriate and must be stuck from the final legislation. One can easily imagine a family, in the months prior to bankruptcy, paying for rent, school clothes, and even groceries on their credit card. Courts can easily compare current spending patterns to prior spending and determine whether charges are truly for necessary expenses.

<u>IV. ADDITIONAL CONSUMER PROTECTIONS AGAINST PREDATORY CREDITOR PRACTICES</u>

Your advisors are particularly concerned about the unequal bargaining power of the creditor and the debtor and how the changes in bankruptcy rules could further shift the balance and create opportunities for coercion and consumer harm. The greatest risk is that debtors will be pressured into reaffirming their debts, despite a right to have them discharged in bankruptcy. Although current law has some protections against coercion, a recent survey reported that 52% of debtors reaffirmed one or more debts. After recent litigation against Sears for coercing reaffirmations, Judge Fenning said she scrutinized her court records and found evidence of widespread coercive reaffirmations. The National Bankruptcy Review Commission recommended precluding reaffirmation of unsecured debt. We would propose the same, as well as increased penalties on attempts to enforce invalid reaffirmations and clarification that the automatic stay bars threats to file abuse motions and solicitations of reaffirmations.

We also believe that some signal should be sent to creditors that it is abusive to offer credit to borrowers who have no capacity to repay. The First Lady suggested, and we recommend, insisting on a provision that would subordinate debt owed to a creditor who offered it without first checking the repayment capacity of the debtor, including their level of debt outstanding. In addition, we would propose also subordinating debt if the creditor did not disclose clearly to the debtor the time period over which the debt would amortize at the minimum payment level. (Creditors are increasingly offering minimum payment plans that amortize debt over decades, if at all. Most debtors believe that by paying the minimum payment they are slowing working off their debt. However, depending upon the interest rate, they may be falling further and further behind.) The subordinated debt would only be paid, in a Chapter 13 plan or a Chapter 7 liquidation, after all other unsecured, nonpriority debt.

We also are exploring whether there are other non-bankruptcy steps we can take to clamp down on predatory lender practices and better help consumers to understand their own borrowing. Treasury would endorse a proposal that requires that lenders disclose the period of time over which debt is amortized by minimum payments. ~~the minimum payment on all debt would amortize the debt, at the applicable interest rate, over some set period of time~~. This proposal, and others under review, are not germane to the bankruptcy bills and fall under the jurisdiction of other committees. Thus, it is not feasible to insist that Congress include these or similar proposals in the bankruptcy legislation at this time. However, we might unveil these proposals in connection with an administration campaign to educate consumers about the use of credit, using the bully pulpit much the way we have done to encourage retirement savings.

V. ADVISORS' RECOMMENDATIONS

[KEY AGENCIES AND WH OFFICES MAY DRAFT A NO MORE THAN TWO-LINE PHRASE TO GIVE THE PRESIDENT A BETTER SENSE OF YOUR REASONING. LANGUAGE BELOW IS ILLUSTRATIVE ONLY, MY ATTEMPT TO CHARACTERIZE YOUR VIEWS. FEEL FREE TO REPLACE OR EDIT.]

All your advisors recommend we proceed as described, including CoS, Counsel, Public Liaison, Legislative Affairs, OMB, DoJ, Treasury, Commerce, and Education (???). I (Gene Sperling) believe that offering a plan that requires greater responsibility of both creditors and debtors is the best way to address the "unclean hands" of some of the legislation's proponents. Treasury and CEA emphasize that, by lowering credit card interest rates through reduced charge-offs, the plan described here will transfer costs from below-median debtors (those more likely to carry credit card balances), who continue to meet their financial obligations, to above-median income debtors in bankruptcy, able but unwilling to pay some of their bills. DoJ stresses that other provisions of these bills, like the cap on state homestead exemptions, measures to discourage bad faith repeat filings, and provisions to improve data collection and audit procedures, are important reforms. The WH Office of Public Liaison warns that we will not win the support of consumer advocates that oppose any reform, but by insisting there is no harm to child support and alimony payments, we remain faithful to a core priority of your Administration. Finally, Legislative Affairs stresses the popularity of bankruptcy reform and advises that we advance proposals that have a realistic prospect of inclusion, or we may find ourselves faced with overwhelmingly popular legislation that fails to satisfy our announced concerns.

VI. DIRECTION

_____ **PROCEED AS DESCRIBED**

_____ **LET'S DISCUSS**

TREASURY CLEARANCE SHEET

NO. ______
Date 6/15/98

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Jonathan Gruber
THROUGH: ______
SUBJECT: Bankruptcy - Urgent Action

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for International Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Jonathan Gruber	JG	6/15/98	Deputy Assistant Secretary for Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

NCC to LS (ACTION)
6/15 9AM

NCC cc to MF
SS
NCDC/PT/AK

Please log In

TREASURY CLEARANCE SHEET

NO. ____________
Date 6/15/98

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____________

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Jonathan Gruber	JG	6/15/98	Deputy Assistant Secretary for Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ____________ Date ____________

☐ Executive Secretary ____________ Date ____________

1998-SE-007345

DEPARTMENT OF THE TREASURY
WASHINGTON

INFORMATION

June 18, 1998

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: **JONATHAN GRUBER** JG

RE: **Bankruptcy Reform Update**

Summary

Attached is a next to final draft of the memo that is being sent in to the President on personal bankruptcy reform. The memo reflects the consensus recommendations of the NEC working group, recommendations which Treasury and CEA were instrumental in shaping. If the President approves these recommendations, the Administration will begin to engage the Senate on this topic, in the hopes of influencing their bankruptcy legislation before it goes to the floor.

Background

While the NEC working group has been working hard to forge a sensible set of consensus recommendations on personal bankruptcy reform, there is still some unease about whether the President will agree with his advisors on our position. Thus, the purpose of this memo is to inform him of where we have come out, and to see if he is comfortable with this outcome. If he is, the Administration will begin work with the Senate to try to push this proposal.

The position espoused in this memo was largely driven by the input of Justice, Treasury, and CEA. We are therefore fairly comfortable with the outcome, given the existing political constraints (subject to some minor editorial comments on the memo). The fundamental elements of the proposal are:

Needs-Based Reform: The credit card companies have collected data that demonstrates that a substantial share of individuals in bankruptcy can pay a large share of their debts, motivating a "needs-based reform" approach that would shift debtors from Chapter 7 (where there is generally no payment of unsecured debt) to Chapter 13 (where there is some repayment from income). We would propose presumptive guidelines for trustees and creditors to file motions under Section 707(b) to shift the debtor from Chapter 7 to Chapter 13. These guidelines are that the debtor must be above 100% of median income, and have either (a) disposable income sufficient to repay 30% of his debts, or (b) at least some minimum amount of ability to repay (e.g. $5000/year). The latter condition deals with the case of an individual who has substantial absolute ability to pay, but tries to circumvent these guidelines by running up his debt so that his percentage ability to pay looks small.

- This proposal positions us nicely between the House and the Senate. The House uses a formula to determine access to Chapter 7, which the Administration has criticized as "too rigid". The Senate bill expands Section 707(b), but doesn't provide sufficiently clear guidance to bankruptcy judges as to when individuals should be shifted to Chapter 13.

Nondischargeability: Currently, debts which are viewed as a public priority (child support, tax payments, wages to employees) are nondischargeable in bankruptcy. Both the House and Senate bills would propose to make unsecured credit card debt nondischargeable as well in two cases: if the credit card debt arose from paying off a dischargeable debt; and if the credit card debt was run up in the last three months before bankruptcy. These proposals have been criticized on the grounds that making credit card debt nondischargeable will "crowd out" other socially worthwhile debts that are being paid from post-bankruptcy income. There has been particular attention paid to the child support issue.

- We would propose that credit card debt that arose from paying off nondischargeable debts would not itself become nondischargeable, as in the Congressional proposals, but would instead be a factor in consideration of moving the individual to Chapter 13.

- We would propose that credit card debt incurred in the last 90 days before bankruptcy to pay for (court-defined) "luxuries" would be nondischargeable. Unlike either the Senate or House bills, we would not make non-luxury credit card debts dischargeable (these bills do so above some floor, either $250 in House or $400 in Senate).

- Both bills also include a host of particular "sweeteners" on child support, which probably make the bill on net a win for child support payments. In addition, pure needs-based reform is by itself beneficial for child support, in that increases judicial supervision of these payments.

Creditor Reforms: There was a strong desire within the Administration for some creditor reforms that could be counterbalanced against the reasonably strong pro-creditor features of our position. Most ideas in this area were much more dangerous than helpful, in potentially confounding the debtor-creditor relationship in harmful and costly ways. But we have managed to determine two areas where there is clear potential for creditor abuse and some reform is probably helpful.

- The first is reaffirmations of unsecured debts. These are petitions by the debtor to continue to make payments on some debts, while discharging others. There is a clear case for reaffirmations of secured debts, where the debtor might otherwise lose his collateral. In the case of unsecured debts, the benefits are more dubious (maintaining access to a credit line), and there is substantial anecdotal evidence of unsecured creditors pressuring debtors into reaffirmations that are not in their interest. The Administration would propose that all unsecured reaffirmations be reviewed by the courts, rather than simply approved if they have an affidavit from the debtor's attorney.

- The second is the disclosure of amortization periods for minimum payments on credit cards. Many credit cards have minimum payments that are sufficiently small that they do not amortize the debt on the card for fifty years or more, so that unsophisticated debtors may think that they are making progress in paying off their bills when in fact they are falling deeper into a hole. The Administration would propose the subordination in bankruptcy proceedings of the debt owed to credit cards that did not disclose the amortization period. This would effectively mean that these creditors would not get paid in bankruptcy, providing a strong motivation for credit cards to disclose the underlying amortization period.

Attachment

June __, 1998 – Draft

MEMORANDUM TO THE PRESIDENT

FROM: **GENE SPERLING**
SALLY KATZEN

RE: **BANKRUPTCY REFORM LEGISLATION**

Last week, the House passed, by a veto-proof majority, a bankruptcy bill that your administration said it "strongly opposes." A better, but still flawed, bill (voted out of committee 16-2) may be taken up by the Senate before the July 4th recess or soon thereafter. Both bills were changed recently to address concerns that you, the First Lady, and others have raised about their impact on debtors' capacity to pay child support and alimony, although some problems still remain.

After an NEC interagency review, your advisors have reached a consensus that some bankruptcy reform is important. These bills contain many provisions that are beneficial, including a cap on state homestead exemptions, debtor education pilots, penalties for unjustified creditor activities, measures to discourage bad-faith repeat filings, and provisions to improve data collection and audit procedures. However, certain controversial provisions of the current bills need significant changes to satisfy our objectives and concerns. **We propose to advance quickly an Administration proposal in hopes of influencing the Senate bill on the floor and giving the Administration greater leverage in conference.** The proposal would address three issues: (1) limitations on access to Chapter 7; (2) new nondischargeable debts and their impact on child support and alimony payments; and (3) new provisions to protect against coercive creditor behavior and to require more responsibility from creditors in extending credit. The group also has identified alternatives to parts of this proposal on which we could compromise, if necessary.

I. BACKGROUND

Rising Consumer Bankruptcies: Despite what Goldman Sachs recently called "the best economy ever," personal bankruptcies have continued to rise sharply, from roughly 800,000 in 1994 to nearly 1.4 million in 1997. Recent figures for the first quarter of 1998 showed another 20 percent increase over 1997's pace.

Disputed Causes: There is much dispute about the cause of this increase, but little definitive evidence. Creditors assert that lawyer advertising, reduced social stigma, and increased information about the financial advantages of bankruptcy have encouraged an increasing number of consumers to walk away from debts they could pay back. Consumer advocates argue that lenders have irresponsibly extended too much credit to families who are ill-prepared to handle it, and that most bankruptcies happen when unexpected events push such a family over the financial edge; indeed, rising bankruptcy rates track closely rising levels of unsecured debt, although causation cannot be proven.

Potential for Abuse: Under current rules, some debtors with high incomes walk away from their debts entirely, even when they have the capacity to repay at least a portion of those debts; other debtors file repeatedly without any intention of completing bankruptcy, for the purpose of delaying bona fide collection activities; and generous state exemptions (including unlimited homestead exemptions in eight states and exemptions for items like race horses and silver spoons in Virginia) prompt some to shift assets to exempt categories prior to a bankruptcy filing to avoid making payment to any unsecured creditors. Consumer advocates argue that these cases are not the norm and should not prompt limits on those who genuinely need bankruptcy's fresh start.

Consumer Impact: Regardless of who is to blame, **higher levels of debt charge-offs appear to raise the cost of credit for everyone.** One industry study suggests that bankruptcies cost every American household between $300-400 per year. Higher credit costs disproportionately fall on lower-income families, since they are more likely to carry a balance on their card. While in the past credit card interest rates did not always rise and fall with market rates, the industry is now more competitive, so that reduced bankruptcies are likely to translate to lower interest rates and increased access to credit for those who pay their bills.

Legislative Momentum: The popularity of these bills can be explained by the system's vulnerability to abuse and the apparent consumer costs, as well as an extremely effective and well-financed industry campaign and legislators' fears of being labeled protectors of deadbeats.

II. LIMITATIONS ON ACCESS TO CHAPTER 7 BANKRUPTCY

Current Law: Today, there is little limit on debtor's access to Chapter 7's full and immediate discharge of debt (usually with no payments to unsecured creditors); however, in some circuits, courts find, on their own motion, that it is "substantial abuse" for a debtor with the ability to repay 20% of their unsecured debts over three years, after taking account of all necessary expenses, to go through Chapter 7 rather than a Chapter 13 repayment plan,

House and Senate Bills: Both bills would require those with the capacity to repay a portion of their debt to do so under a Chapter 13 plan. We opposed the House bill because it determines access to Chapter 7 under a rigid "means test" that does not take into account the unique circumstances of individual debtors. The Senate approach is more flexible, building on the abuse test in use in some circuits. The Senate bill would authorize a bankruptcy judge to apply this test to any debtor with income above the median and, for the first time, allow creditors to file the motion seeking a determination of abuse. Creditors would have to pay debtors' attorneys fees if their filings were not 'substantially justified' or were brought to coerce a debtor to waive a right.

Administration proposal: We propose a variation on the Senate bill whereby **the bankruptcy court would have discretion to determine whether or not a debtor's use of Chapter 7 is abuse; however, there would be a presumption of abuse if a debtor has an income above the median and the capacity to repay either at least 30% of her debts or some specified amount (such as $5000) over three years.** (No debtor would be denied access to Chapter 7 unless she had the ability to repay a minimum of $50 a month in unsecured, nonpriority debt. Any lesser amount is too small to merit the Chapter 13 administrative costs or to risk the chance that the creditor was pursuing the motion to coerce the debtor to forgo another bankruptcy right.) We also would provide that, if a debtor moved more than $50,000 from nonexempt to exempt assets within one year of the filing, she would be subject to a presumption of abuse, regardless of income. In determining a debtor's capacity to repay, we propose to explicitly exclude luxuries (e.g., expensive cars or boats) from necessary expenses.

These presumptive guidelines could be overcome if the court determined, e.g., that the debtor faced unusual but necessary expenses or could not be expected to maintain reliably her current level of income. Such presumptive guidelines have proven to be highly effective in promoting uniformity and fairness in establishing child support award amounts. Since the average debtor under Chapter 13 repays 20% of her debts and has income below the national median, those who meet this higher threshold are the most likely to succeed under a repayment plan.

III. NONDISCHARGEABLE DEBT AND ITS IMPACT ON CHILD SUPPORT AND ALIMONY

The Bankruptcy Code makes debts nondischargeable only where there is an overriding public purpose, as with child support, alimony, educational loans, tax obligations, or debts incurred by fraud. The House and Senate bills have provisions that would broaden the categories of nondischargeable credit card debt, although the largest new category has been dropped and the two remaining categories narrowed. These provisions raise two questions: (1) Do the additional debts made nondischargeable by these bills rise to the same level of public priority as other nondischargeable debts? and (2) What impact does the protection of new categories of debt have on the ability of the debtor, post-bankruptcy, to repay existing categories of nondischargeable debt (e.g., child support and alimony, educational loans, and taxes)? They also force us to recognize that consumers use credit cards today for many purposes that were inconceivable only a few years ago (e.g., groceries or paying student loans). This Administration envisions -- and, in fact, encourages -- greater use of electronic commerce.

Debts incurred to pay other nondischargeable debts.

Current law: If a debtor uses a credit card to pay federal taxes, the credit card debt is nondischargeable.

House and Senate bills: Both make a debt incurred to pay <u>any</u> nondischargeable debt nondischargeable, although the Senate effectively eliminates the provision if the debtor is a single parent or owes child support and/or alimony.

Administration Proposal: We propose that the **current law remain unchanged**; however, if a debtor paid a nondischargeable debt with a credit card, it would be a factor in determining whether the debtor's use of Chapter 7 was abuse.

<u>Debts incurred in the period immediately before bankruptcy.</u>

Current Law: Debts for <u>luxuries</u> over $1000 owed to a single creditor within 60 days of bankruptcy are nondischargeable. There is some evidence that this provision and other anti-fraud provisions do not prevent some debtors from running up debt knowing that a discharge is likely.

House and Senate Bills: Both would make all debts incurred within 90 days of bankruptcy for <u>luxuries</u> be presumptively nondischargeable. In addition, they would make presumptively nondischargeable debt above ($250 in the House; $400 in the Senate) per credit card for <u>necessaries</u> during the same period.

Administration Proposal: We propose to agree to make **debt for <u>luxuries</u> within 90 days of bankruptcy presumptively nondischargeable; however, a cap of $250 or $400 on <u>necessary</u> expenses incurred prior to bankruptcy is inappropriate.** One can easily imagine a family, in the months prior to bankruptcy, paying for rent, school clothes, and even groceries on their credit card. Courts can easily compare current spending patterns to prior spending and determine whether charges are truly for necessary expenses.

<u>Child Support and Alimony Considerations</u>

We should note that the current bills have seven different new provisions designed to either mitigate the impact of the additional nondischargeable debt on payment of child support and alimony or to give child support and alimony <u>additional protections in and after bankruptcy</u>. Some experts we have consulted argue that the benefits provided by these additional provisions outweigh any modest harm to child support and alimony payments that remains from the nondischargeability provisions. On the other hand, the women's groups continue their opposition to these bills. Moreover, these provisions, which focus only on child support and alimony, do not address our policy concern that new nondischargeable debt will now compete with other types of existing nondischargeable debts, such as educational loans. For these reasons, the Administration proposals described above would allow only one small category of new nondischargeable debt (luxuries purchased 90 days before bankruptcy) where there is a policy argument against allowing run-up prior to bankruptcy; for the remaining categories, we would leave current law or address the problem a different way.

IV. ADDITIONAL CONSUMER PROTECTIONS AGAINST PREDATORY CREDITOR PRACTICES

Your advisors are particularly concerned about the unequal bargaining power of the creditor and debtor and how the changes in bankruptcy rules could further shift the balance and create opportunities for coercion and consumer harm. To address this concern, and to ensure legislation requires responsibility of both debtor and creditor, we propose new consumer protections.

Reaffirmations of Unsecured Debt

Although debtors in Chapter 7 have a right to have their unsecured debts discharged, some debtors reaffirm one or more debts. While there may be some circumstances in which it is in the debtor's best interest to do so (e.g., as a condition of obtaining a line of credit needed for a small business), those cases are few. The risk is real, however, that debtors are pressured into reaffirming their debts by aggressive creditors. After Sears recently paid large penalties for such practices, another Bankruptcy Judge (Fenning) said she scrutinized her court records and found evidence of widespread coercive reaffirmations. Since debts reaffirmed survive bankruptcy, they compete with child support and alimony in a post-bankruptcy world. Eliminating coercive reaffirmations also would help to reduce the current level of competition child support and alimony payments face.

Current Law: Disclosures are required and the court must determine that a reaffirmation does not impose an undue hardship on the debtor or a dependant and is in the debtor's best interest; however, an affirmation of the debtor's attorney to that effect suffices.

House and Senate Bills: No related provisions.

Administration Proposal: We propose to require the court itself to find that there was a compelling reason for the debtor to reaffirm a debt, without reliance on counsel affidavits. We also propose to bar reaffirmation of debts that add attorneys' fees and costs to the debt, to increase penalties on attempts to enforce invalid reaffirmations, and to clarify on that the automatic stay bars threats to file abuse motions and solicitations of reaffirmations.

Credit Card Minimum Payment Disclosure

We also believe that some signal should be sent to creditors about lending practices that entice debtors to get further and further into debt.

Current Law: Most debtors believe that by making the minimum payment on their credit card they are slowing working off their debt. However, depending upon the interest rate, they may be falling further and further behind. Creditors are increasingly offering minimum payment plans that amortize debt over decades, if at all.

House and Senate bills: No related provisions.

Administration Proposal: We propose a process for subordinating debt if the creditor did not disclose clearly to the debtor the time period over which the debt would amortize at the minimum payment level. The subordinated debt would only be paid, in a Chapter 13 plan or a Chapter 7 liquidation, after all other unsecured, nonpriority debt. It most cases, this will mean it will never be repaid.

<u>Other Non-Bankruptcy Steps to Improve Consumer Credit Practices</u>

We also are exploring whether there are other non-bankruptcy steps we can take to clamp down on predatory lender practices and better help consumers to understand their own borrowing. We have consensus on a proposal that requires all lenders to disclose the time period over which debt is amortized by minimum payments. This proposal, and others under review, fall under the jurisdiction of other committees. Thus, it is not feasible to insist that Congress include these proposals in the bankruptcy bill at this time. However, we might unveil these proposals in connection with a campaign to educate consumers about the use of credit, using the bully pulpit the way we have done to encourage retirement savings.

<u>V. ADVISORS' RECOMMENDATIONS</u>

All your advisors recommend we proceed as described, including CoS, NEC, Counsel, OPL, OLA, OMB, CEA, DPC, First Lady, DoJ, Treasury, Commerce, and Education.

- The NEC believes that requiring greater responsibility of both creditors and debtors is the best way to address the "unclean hands" of some of the legislation's proponents.
- Treasury and CEA emphasize that needs-based reform will decrease the cost of, and increase access to, credit for those debtors who do pay their bills by limiting opportunistic bankruptcy among those higher income debtors who do not.
- DoJ supports the plan and stresses that other provisions of these bills, like the cap on state homestead exemptions, measures to discourage bad faith repeat filings, and provisions to improve data collection and audit procedures, are important reforms.
- OPL believes that, while consumer advocates oppose any bill, reforms limiting access to Chapter 7 and stemming coercive reaffirmations appear valid. OPL wants to see us fight for aspects of our proposal that protect against any impact on child support (before or after bankruptcy) of new nondischargeable credit card debt.
- The First Lady's Office strongly supports advancing proposals that achieve more balanced reform by calling for responsibility on the part of the creditor as well as the debtor, and recommends that we continue to focus on the child support issue to ensure that protections in this area are as strong as possible.
- OLA stresses the popularity of bankruptcy reform and advises that we advance proposals that have a realistic prospect of inclusion, or we may find ourselves faced with overwhelmingly popular legislation that fails to satisfy our announced concerns.

VI. DECISION

_____ PROCEED AS DESCRIBED

_____ **LET'S DISCUSS**

TREASURY CLEARANCE SHEET

NO. ______
Date 6/18/98

MEMORANDUM FOR: ☒ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Jonathan Gruber
THROUGH: ______
SUBJECT: Bankruptcy Reform Update

REVIEW OFFICES (Check when office clears)

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NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Jonathan Gruber	JG	6/18/98	Deputy Assistant Secretary	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer Date ______ ☐ Executive Secretary Date ______

DO F 80-02.1 (04/89)

2000-SE-005055

DEPARTMENT OF THE TREASURY
WASHINGTON

May 12, 2000

MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT

FROM: Douglas W. Elmendorf DE
Deputy Assistant Secretary for Economic Policy

SUBJECT: **Update on the Status of Bankruptcy Reform**

This memo reviews developments in the bankruptcy reform debate since the principals' meeting several weeks ago.

1. Administration Letter to Conferees

- Immediately following the principals' meeting, we worked with Sarah Rosen from the NEC to modify the draft letter to conferees. The revised letter reiterates the Administration's previous threat to veto the House bill, and says that the Senate bill better meets the President's principles for bankruptcy reform.

- We also worked with Sarah Rosen to draft a memo from Gene Sperling to the President explaining the strategy recommended by the President's advisers. The memo stated that all of the advisers believe that "if the final bill stays relatively close to the Senate bill, it would be better to sign the bill with some reservations that to risk a veto override." The memo also noted that the advisers disagree on the substantive question of whether a final bill close to the Senate bill would be a net plus or a net minus relative to current law.

- The President approved the strategy outlined in the memo. However, Gene decided, partly in response to the *Time* magazine story described below, that the letter to conferees should emphasize the human consequences of "punitive" bankruptcy legislation. The principals accepted this idea, and Sarah added a paragraph to the letter to this effect (which we edited). This change does not alter the Administration's stated position about the legislation, but it raises the emotional level a notch. The final letter is supposed to be sent to the Hill today.

2. Activity on Capitol Hill

- The bill remains mired in procedural issues, and it remains unclear when and how it will reach a formal House-Senate conference.

- In the meantime, informal negotiations are proceeding apace between staff for the likely House and Senate conferees. Senate Democrats and Republicans reached a unified Senate position, which was offered to the House a few weeks ago. The House staff has now responded. Together with the NEC, Executive Office of the U.S. Trustees, and White House and Treasury legislative shops, we met with key Senate Democratic staffers this week to advise them on technical issues related to the House response and the planned Senate response to the response.

- A number of important differences between the House and Senate bills have been resolved, and some of those in the direction that we prefer. For example, the House dropped its ban on class action lawsuits, as we expected, and accepted the Senate's proposed credit card disclosures. But the House and Senate remain far apart on other significant issues, and we cannot speculate on the ultimate outcome. The Senate Democratic staff is inclined to dig in its heels on some key issues, and they believe that the Senate Republicans will tend to stick with them.

- Senators Wellstone, Kennedy, and Feingold joined Representative Nadler in attacking the pending bill for its alleged harsh effect on consumers and for the "secret process" by which the bill is being negotiated. Their public event also included representatives from a coalition of labor, religious, and women's groups.

- Senator Hatch wants to exempt debt collectors collecting on bounced checks from the Fair Debt Collection Practices Act. This issue is a relatively new addition to the debate, and has been receiving a lot of attention lately. The Federal Trade Commission and most courts believe that bounced checks qualify as debt under the act, which protects consumers from harassment, false representations, and other unfair collection methods. Our letter to conferees says that "no compelling argument has been made" about why these rules should not apply in this case, and that "in any event, the case for the change should be subjected to sunlight and public scrutiny."

3. *Time* Magazine Story

- A story this week titled "Soaked by Congress" argues that: "Lavished with campaign cash, lawmakers are 'reforming' bankruptcy – punishing the downtrodden to catch a few cheats."

    - The article focuses on the visible cases of hardship and does not mention that reduced abuse of bankruptcy would reduce consumer interest rates – which would provide a less visible, but still important, benefit for all borrowers.

    - The unfortunate families highlighted in the bill may well be below median income, in which case they would be exempted from the new means test.

- The article also makes some specific claims about the impact of the proposed legislation that are at least exaggerated or misleading:

- "The proposed legislation would treat a bankrupt man's credit-card debt the same as his obligation to pay child support, meaning that his obligation to pay child support, MasterCard and an unmarried mother would compete for the same limited pool of cash." This would very rarely be the case. In response to widespread criticism of an early version of the House bill, including criticism from the First Lady, the bill now emphasizes the priority of repaying child support and alimony.

- "If, for example, a bankruptcy filer was left with more than $1,200 a year (beyond his basic expenses) over five years, that would be considered an abuse." This is the threshold stated in the House bill, but the Senate bill has a higher threshold.

- "If a mother tapped an ATM to buy necessities such as food or prescription drugs six weeks before filing for bankruptcy, the withdrawal could be considered a fraudulent transaction." Excessive spending just before bankruptcy is deemed abusive under current law, representing the difficult balancing between protecting legitimate uses of bankruptcy and preventing people from abusing the system. The proposed legislation reduces the dollar threshold for abuse, but not to zero.

- "If a child or some other member of the family received medical treatment within 90 days before the bankruptcy filing, the bills could never be written off, no matter how poor the family." This is only true if the treatment is paid with a cash advance (for the same reason as above). In other cases, the debt can be discharged in bankruptcy.

4. Other Press Reports

- *The Washington Post* editorialized that the Administration should veto the final bankruptcy bill if it fails to: 1) address "irresponsible behavior" on the part of creditors by including the Senate's credit card disclosure provisions; 2) retain the Senate's cap on homestead exemptions; and 3) allow sufficient flexibility for judges in the means test about whether debtors can afford to repay their debts. The *Lose Angeles Times* wrote a similar editorial.

- The *Post* reported on a study by Harvard Law professor Elizabeth Warren and co-authors of the influence of medical debt on bankruptcy filings. Warren found that over 40 percent of people who filed for bankruptcy cited medical debts as a contributing factor, which is broadly consistent with earlier research. However, her approach does not distinguish effectively between the effect of high debt loads in general and the effect of high medical debt per se. Researchers who have attempted to separate the two, by restricting the definition of a "bankruptcy causing event" to medical debt in excess of 2 percent of income, have found that such debt is not a significant cause of bankruptcies.

2000-SE-005433

INFORMATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 19, 2000

MEMORANDUM FOR SECRETARY SUMMERS
DEPUTY SECRETARY EIZENSTAT

FROM: Deputy Assistant Secretary Douglas W. Elmendorf DE

SUBJECT: **Possible Administration Decision on Bankruptcy Legislation**

Bankruptcy reform legislation is moving closer to completion, and there is some chance that the Administration will want to express its view on the final bill over the weekend. This memo summarizes the current situation.

Congressional Developments

- Democratic and Republican staff from the Senate and the House resolved many areas of disagreement earlier in the week.
- Republican Members from both houses met yesterday and agreed on their "final offer" to Democrats on the remaining differences.
- The Democrats are now considering their response to the Republicans. Senator Leahy (ranking Judiciary member) announced his opposition to the Republican offer, saying that "this is not the balanced bill that the Senate passed." But it is unclear how many other Senate Democrats will push back hard.
- We do not believe there is an agreement on the appropriate legislative vehicle, although both crop insurance and digital signatures have been mentioned.

Administration Position

- **Sarah Rosen Wartell thinks there is some chance that the Administration will want to respond publicly to developments on the Hill during the weekend, especially if the Members reach agreement. It is more likely that the Members will not reach agreement, or that – even if they do – the Administration will wait to respond. (Frankly, we don't see the rush.)**
- As you recall, the Administration's letter to conferees reiterated our veto threat against the House bill, and essentially admitted that we would probably sign the Senate bill. So deciding where on that spectrum the bill comes out is critical to the Administration's decision.

EXECUTIVE SECRETARIAT

- **In our judgment, the Republican offer is closer to the Senate bill than the House bill, but not by much.** Sarah seems to believe that the Republican offer is slightly closer to the House bill than the Senate bill. We agree with her that the issues resolved at the staff level went more in the Senate's direction, but the Republican Members' offer on the remaining issues was more disappointing.

Analysis of the Consumer Bankruptcy Provisions in the Emerging Agreement

We have not seen legislative language, so this analysis is based on second-hand descriptions of the agreement.

Means Test

- The basic impetus for bankruptcy reform is to require more debtors to enter Chapter 13, where they are forced to repay part of their debts, instead of Chapter 7, where they can walk away from most debts.

- Both parties agreed to a threshold for access to Chapter 7 that would force fewer people into Chapter 13 than even the Senate bill.

- Both parties agreed to use the IRS Collection Financial Standards for allowable expenses, as specified in both bills.

- Both parties agreed to a level of flexibility for the means test that is about midway between the Senate and House bills. The agreement allows for exceptions when "special" circumstances "justify" the debtor's proposed adjustment to the means test, and allows only the extra expenses that are "reasonable and necessary." This is a rather strict standard.

- The Republicans agreed to adopt the Senate bill's protections for below-median income debtors, which would block motions by creditors and trustees. The additional protections in the House bill were dropped.

Homestead Exemption

- The Republicans agreed to a $100,000 cap on the exemption for housing purchased within the past three years. This would address purchases for the purpose of bankruptcy planning (except that people could still pay off their mortgages in advance of bankruptcy), but would not require wealthy debtors in states with high exemptions to use their housing wealth to help repay their debts. The House bill had no effective cap, while the Senate bill had a stronger cap.

Reaffirmations

- In reaffirmations, debtors agree to repay debts that would otherwise be forgiven in the bankruptcy process. Both parties agreed to the Senate provisions on disclosure and court review, but they exempted reaffirmations of debts owed to credit unions.

- Both parties agreed to retain the right to class actions, which the House bill had deleted.

- The Republicans agreed to a $1 million cap on the amount of pension assets that a bankrupt debtor may protect from creditors. We have referred this issue (as we have throughout this process) to the pension folks in the building.

Credit Card Disclosures

- The Republicans agreed to the Senate provisions for clearer notice of teaser rates and for lenders to provide an 800-number for consumers who want information about the impact of making only minimum payments on their debts. However, the Republicans exempted banks with assets of less than $250 million from the 800-number requirement. Sarah notes that this exemption is inconsistent with the Administration's stated policy regarding CRA requirements.

Nondischargeable Debts

- In "cramdowns," the repayment of secured debt is reduced to the collateral value of the security. Both parties agreed to prevent cramdowns for debt related to autos for 5 years after purchase and for debt related to personal property for 1 year after purchase. This position is considerably closer to the Senate bill.

- Both parties agreed to the Senate provisions for nondischargeability of debt. These would increase the amount of debt that is *not* wiped away during bankruptcy relative to current law, but by less than the House bill would.

Abortion Clinic Violence

- The Republicans agreed to make debts related to intentional violence nondischargeable. The Senate bill would make debts related to violence (intentional or not) against abortion clinics nondischargeable, and the House included no such provision.

Check Collections

- The Republicans agreed to exclude attorneys' fees from the Fair Debt Collection Practices Act when applied to debt collecters collecting on bounced checks. This approach would effectively give the affected parties no recourse to the legal system, which is tantamount to the original Hatch proposal. No provision in this area was included in either the House or the Senate bills.

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