

## Federal Accounting Standards Advisory Board

Tab A

	Time	Name	Letter No.	Organization
1	8:30	<b>Bob Bixby</b> Executive Director	66	Concord Coalition
2	9:00	<b>Sheila Weinberg</b> CEO and Founder	30	Institute for Truth in Accounting
3	9:30	<b>John Rother</b> , Director, Strategic Planning and Policy	37	American Association of Retired Persons
4	10:00	<b>Thomas Prince</b> , Professor of Health Industry Management Professor of Accounting Information and Management	51	Kellogg School of Management Northwestern University
5	10:30	<b>Jagadeesh Gokhale</b>	35	Cato Institute
6	11:00	<b>Martha Zeigler</b> Director of Finance	50	Metropolitan Sewage District of Buncombe County, North Carolina
7	11:30	<b>Steven L. Schaeffer</b> Assistant Inspector General for Audit Office of the Inspector General	22 24 49	Social Security Administration, Office of the Inspector General; Baltimore Chapter of Association of Government Accountants; and President's Council on Integrity and Efficiency (PCIE), Audit Committee
8	1:00	<b>Robert Childree</b> Chairman	55	Association of Government Accountants, Financial Management Standards Board
9	1:30	<b>David Walker</b> Comptroller General	61	Government Accountability Office
10	2:00	<b>Senator Charles Grassley</b> (or his representative)	52	US Senate Committee on Finance
11	2:30	<b>Stephen Goss</b> Chief Actuary and/or <b>Al Winters</b> Actuary	27	Social Security Administration
12	3:00	<b>Howell Jackson</b> John S. Reid, Jr. Professor of Law	--	Harvard Law School
13	3:30	<b>Mike Shannon</b> 2006 Republican Nominee for US Congress (Illinois, 9 <sup>th</sup> District)	62	
14	4:00	<b>Terrill ("Terry") Menzel</b> Partner, KPMG	53	KPMG LLP
15	4:30	<b>Congressman Jim Cooper</b>	65	US House of Representatives
16	5:00	<b>Alison Fraser</b> Director, Thomas A. Roe Institute for Economic Policy Studies	63	Heritage Foundation

# THE CONCORD COALITION



May 17, 2007

Ms. Wendy M. Comes, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street NW  
Washington, DC 20548

Dear Ms. Comes,

This letter is in response to your request for comments on the Federal Accounting Standards Advisory Board's (FASAB) *Preliminary Views, Accounting for Social Insurance, Revised*. Two views are set out in this document, the Primary View and the Alternative View. For reasons discussed below, we believe that the Alternative view is preferable.

Since its inception, The Concord Coalition has strongly supported efforts to better inform the public about the huge unfunded obligations that this generation is leaving to future generations — primarily as the result of projected cost growth in Medicare and Social Security. To help raise the alarm, we have testified at congressional hearings, written op-eds for major newspapers, devoted a regular publication called “Facing Facts Quarterly” to this issue and taken out full-page ads in the *New York Times*. Most recently, we have organized a nationwide series of public forums known as the “Fiscal Wake-Up Tour,” which includes United States Comptroller General David Walker and fiscal policy experts of differing perspectives from the Brookings Institution and the Heritage Foundation.

Given the intensity of our efforts in this regard, we have a deep interest in how the nation's long-term fiscal commitments are communicated to and understood by the public. For many years we expressed frustration that estimates of the unfunded obligations of Social Security and Medicare were not generally available to the public and almost never discussed. In recent years, with FASAB's help, that has changed. Pursuant to new FASAB standards, the Treasury's Consolidated Financial Report of the United States now includes estimates of unfunded benefit obligations in a Statement of Social Insurance (SOSI). Moreover, FASAB has given these estimates more prominence by classifying them as “basic financial” rather than “supplementary stewardship” information. The President's Budget and the Social Security and Medicare Trustees' Annual Report have also begun to publish estimates of the programs' unfunded obligations.

This new openness about long-term social insurance costs is welcome. The usual measures of budgetary and trust-fund accounting say little about two key issues: sustainability and generational equity. We are thus encouraged that FASAB is considering further methods of improving the quantity and transparency of information about these issues. The differences between the Primary and the Alternative views do not appear to be about this goal but about the most appropriate method for achieving it.

In that regard, both views would retain the SOSI in the Consolidated Financial Report of the United States Government showing the present values of projected benefits and dedicated revenues of social insurance programs. Both views would also add an explanation for changes in these present values during the reporting period.

The fundamental distinction between the two views is that the Primary View would recognize as current liabilities and expenses future social insurance benefits for those who have achieved 40 quarters of covered employment. These sums would be added to the balance sheet and to the statement of net costs in the Consolidated Financial Report. The Alternative View would maintain the current practice of recognizing social insurance liabilities for benefits that are due and payable.

Another distinction is that the Alternative View would enhance reporting of the government's long-term fiscal condition by including a Statement of Fiscal Sustainability as required supplementary information in the Consolidated Financial Report. This statement would go beyond social insurance reporting to include projections for all government operations and revenues under various scenarios.

#### **A. Social insurance as a liability**

The Concord Coalition agrees with the Alternative View that social insurance benefits, beyond those due and payable, are not liabilities and should not be treated as such in the government's financial statements.

The requirement that social insurance payments must be due and payable for a liability to arise is neither an arbitrary standard nor a disingenuous attempt to conceal the "truth" about the government's finances. It simply reflects the essential nature of social insurance programs.

For example, in its landmark decision *Flemming v. Nestor*, 363 U.S. 603 (1960), the U.S. Supreme Court established that workers accrue no property rights by participating in Social Security. The program rests solely on the sovereign and distinct powers of government to tax and to spend. Social Security is a legislated entitlement, not a contract. Congress can, and on many occasions has, altered the rules by changing taxes and benefits. It can, and undoubtedly will, do so again in the future.

Congress has reserved this right because the nation's priorities and circumstances can change. During World War II, for instance, Congress allowed Social Security benefits to lag behind inflation. During the boom of the 1950s and 1960s, it legislated large real-dollar increases in benefits. In 1983 major cost cutting reforms were once again enacted in the face of impending trust fund insolvency.

A liability can only arise when there is an enforceable claim. If one party, in this case the government, can unilaterally alter or cancel its obligation no enforceable claim arises and there is no liability. This basic fact separates social insurance benefits from private sector benefits, which justifies a difference in how to account for them.

Rather than expose the truth about long-term fiscal challenges, the Primary View would inadvertently perpetuate a popular misconception that Social Security and Medicare represent “earned” or “guaranteed” benefits. This misconception is a big obstacle to needed reform.<sup>1</sup>

To be sure, adopting the Primary View would not change the legal basis of social insurance benefits since FASAB is totaling lacking in any such authority. Yet by declaring a “liability” where none exists, the Primary View might encourage the public to believe that today’s projected benefits are somehow immutable commitments. By that logic, any Congressional action to reduce future benefit promises — as almost everyone believes must be done to some extent — would be seen as repudiating a liability “owed” to seniors rather than ensuring a sustainable fiscal path for future generations. And to the extent that repudiating a liability is thought to be something the government must not do, the only “reform” option would be for Congress to raise taxes by whatever it takes to satisfy these future Social Security and Medicare payments.

Another problem with recognizing a liability for future social insurance benefits is that they cannot be measured with the level of certainty that should be expected for the Consolidated Financial Report. As noted above, social insurance benefits have been changed in the past and will be again in the future. Moreover, even under current law, future Social Security and Medicare Part A benefits cannot be measured with certainty because there is no authority to pay them once the respective trust funds are exhausted. The 2007 Trustees Report estimates that this will occur in 2018 for Medicare Part A and 2040 for the combined OASDI Social Security trust funds. The Primary View would thus result in the untenable conclusion that the government has a “liability” for payments it has no authority, let alone obligation, to pay.

## **B. Statement of Fiscal Sustainability**

All of the above *does not* mean that social insurance benefits beyond those due and payable should be ignored. It is possible, and indeed necessary, to estimate long-term social insurance costs under current law for purposes of long-term fiscal planning.

Policymakers and the public must understand the huge projected cost of these programs and their potential to overwhelm all other national priorities. As a matter of sound policy planning and generational equity, we must know if we are on a sustainable fiscal path.

The Concord Coalition thus supports the Alternative View proposal to add a governmentwide Statement of Fiscal Sustainability (SOFS) as required supplementary information to the government’s financial statements. This new statement, in conjunction with the current SOSI, would highlight the nature and magnitude of the federal government’s long-term fiscal condition in a more comprehensive and contextual manner than would be accomplished by the Primary View.

The most valuable contribution of a SOFS would be to show long-term year-by-year cash flow projections under various assumptions regarding spending and taxes. A close look at the unfunded obligations in the SOSI leaves no doubt that the nation faces a huge cost challenge. No single present value number, however, can give a complete and accurate picture of the magnitude of the long-term fiscal challenge or the required response. Present value numbers say nothing about annual spending levels, and hence when the cost burden will become acute. Nor do they tell

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<sup>1</sup> In their 2007 Report, the Social Security and Medicare trustees stated, “we believe their currently projected long run growth rates are not sustainable under current financing arrangements.”

us the government's annual borrowing needs, and hence its impact on U.S. savings, investment, and living standard growth.

A major drawback of long-term summarized figures is that they can conceal a roller coaster fiscal path and thus obscure the pros and cons of different reform approaches.

Consider two reform plans: one that first allows Social Security and Medicare spending to rise above today's level, then cuts it beneath today's level, and a second that keeps spending from rising in the first place. The impact on the programs' unfunded liabilities might be similar, but not the impact on the budget or the economy. It's a bit like wading out to a sand bar. The present value calculation says that you'll be safe and dry once you get there. You need annual budget projections to tell you whether you're going to drown on the way.

There is no doubt, however, that a well-designed fiscal sustainability statement — one that includes annual cash flow projections — would help wake America up to the long-term fiscal challenge. It would provide useful indicators of fiscal sustainability and generational inequity under various scenarios and act as a helpful guide to reform efforts — not by prescribing options but by showing the magnitude and timing of the challenge.

### **Conclusion**

Although The Concord Coalition believes that current social insurance benefit programs are unsustainable and need to be reformed, we do not agree with the position taken in the Primary View that these programs' unfunded obligations should be treated as current liabilities in the Consolidated Financial Report of the United States Government. While the apparent motive is sound, the method is not. Instead of improving transparency, it would misrepresent the essential nature of these promises and needlessly complicate necessary reform efforts.

By contrast, the Alternative view would continue efforts to improve transparency of long-term obligations while allowing for the possibility of reform and better reflecting the government's overall fiscal position.

Sincerely,



Robert L. Bixby  
Executive Director  
The Concord Coalition



Searching for the Truth  
in broad daylight

# Institute for Truth in Accounting

## Summary of Testimony Response to Preliminary Views issued October 23, 2006 Accounting for Social Insurance, Revised

A fisherman can distinctly see any fish that are near the surface. The deeper in the water the fish, the less clearly one can see them. If the fish are deep enough, even if one knows they are there, the fish can become invisible.

Today there is a great emphasis on transparency in financial reporting. IFTA finds the Primary View presentation of Social Insurance costs and liabilities to be the more transparent of the two views presented in the October 23, 2006 Preliminary Views document. While additional Social Insurance information would be provided in the Alternative View, its proposed government-wide financial statement presentation resides deeper in the federal government's financial report and is, at best, translucent.

IFTA agrees with the Primary View's recognition of benefit costs being accrued over the period of covered employment starting from the point of full insurance benefit qualification. This is the proper recognition, because it is the covered work period that determines the qualification for and amount of benefits. Fundamentally, the Social Security and Medicare programs remain premised on the promise that an individual's "contribution" to the program is held by the Government in trust and then paid out in retirement. These programs to date are not billed to be forms of taxation separated from and independent of the benefits to which one is entitled upon retirement or disability. Starting the recognition of benefit costs from the point of full insurance benefit qualification also recognizes that those who have not achieved full qualification do not receive tax refunds if they ultimately fail to qualify. Also benefits bases do not increase after the covered work period has ended. We reject, therefore, the Alternative View that benefits paid are non-exchange transactions.

IFTA would, however, use the Primary View's pro forma financial statements as the basis for a statement of sustainability rather than as a financial statement. We are particularly impressed with the transparency of the interperiod inequities (for example comparing line "c" to line "k" on page 102 of the PV) as it relates to sustaining social insurance.

The financial reporting liability should be the accrued liability for current participants (for example, for Social Security line "g" on page 102 of the PV). The cost reported on the face of the financial statements for any fiscal year should include actuarial current costs. To facilitate the public's ability to evaluate elected officials' decisions, any actuarial cost of benefit level adjustments enacted during that fiscal year should also be included. Since any social insurance "trust fund" investments are in U.S. obligations and such investments are eliminated in the government-wide consolidation, market value fluctuations are not a cost factor.

IFTA does not agree that the "present value of future payroll taxes and income taxes to be paid" should be included in the calculations of the accrued liability and related current year cost. These "earmarked" taxes are commonly used to pay for non-social insurance benefits and services. The "present value of future benefits attributable to current and future participants' future work in covered employment..." should also

not be included. While inclusion of these two items is useful as part of a statement of sustainability, a balance sheet liability is a condition at one point in time.

IFTA agrees with the Alternative View that recognition of future social insurance benefits, which have vested due to a covered work period, on the financial statements would diminish significantly the relative size and importance of other expenses and liabilities shown on the financial statements. This should not be considered negatively. This is a reality citizens need to know. Omitting what currently are monstrous costs and liabilities from the face of the government-wide financial statements grossly distorts the presentation of the Government's true financial position from the perspective of the constituency from who these reports are most directly useful—the American citizens. This inappropriately shifts the focus away from the most financially significant programs managed by Federal agencies.

IFTA would consider, but likely still disagree, with the Alternative View about the timing of the recognition of the liability and cost if the following steps were taken by the Government:

- 1) The 7.65% in specific social insurance payroll taxes and related employer payroll taxes were canceled;
- 2) The discontinuation of the use of the term “trust fund” by Government employees and officials, including members of Congress and the Administration, to describe funds that the Government has custody and control of and does not take on a fiduciary responsibility to hold in trust for beneficiaries;
- 3) A massive, straight-forward education program to help the American public and their elected officials to understand that:
  - a) social insurance benefits are not guaranteed and can be canceled or reduced at any time and,
  - b) payroll taxes taken out of private companies' employees' paychecks are forms of taxation, not “contributions” maintained in separate “trust fund” accounts;
- 4) The cessation of issuing personalized annual Social Security Statements of estimated benefits and;
- 5) The enactment of a law that would consider it felony fraud for any Government employee or officials, including members of Congress and the Administration, to imply the continuation of social insurance programs and the solvency of “trust funds.”

It is well established that the promise of social insurance benefits is a legitimate "social contract." Translucency at best was not the goal the Board set for itself in 2003, when it first committed to improving how these social insurance liabilities are reported. Social insurance benefits are set automatically through continuing appropriations. Congressional action is required to increase or decrease these benefits. Reporting the social insurance liability on the face of the balance sheet and related cost on the statement of net cost would allow the public and their elected officials to straightforwardly identify increases or decreases in promised benefits. Then the public could easily evaluate their elected officials' decisions to adjust benefits.

For more than 20 years the Financial Accounting Standards Board (FASB), recognizing the onset of challenges in private sector pension and other post employment benefits plans, has been working to improve financial reporting of benefits earned during a covered work period but paid after the close of that covered work period. More and more of these costs and liabilities swim closer to the surface of private company financial reports. This transparency has led to more informed decision-making in the private sector. Such transparency should be the goal of the Government and would strengthen our democracy by providing citizens essential financial information. This knowledge would facilitate greater citizen participation in the decision-making processes that are critical to the posterity of our country. Citizens need to be able to clearly see all of the relevant facts about our country's financial position on a timely basis and in an understandable format. Just like a fisherman who can't see a shark deep in the water, what we can't see can hurt us.



Searching for the Truth  
in broad daylight

Sheila Weinberg

Non-Federal - Other

# Institute for Truth in Accounting

April 13, 2007

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

Dear Ms. Comes:

Subject: Response to Preliminary Views issued October 23, 2006  
Accounting for Social Insurance, Revised

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

## **Overall Response**

A fisherman can distinctly see any fish that are near the surface. The deeper in the water the fish, the less clearly one can see them. If the fish are deep enough, even if one knows they are there, the fish can become invisible.

Today there is a great emphasis on transparency in financial reporting. IFTA finds the Primary View presentation of Social Insurance costs and liabilities to be the more transparent of the two views presented in the October 23, 2006 Preliminary Views document. While additional Social Insurance information would be provided in the Alternative View, its proposed government-wide financial statement presentation resides deeper in the federal government's financial report and is, at best, translucent.

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Response to FASAB's Preliminary Views Accounting for Social Insurance

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IFTA does not agree that the "present value of future payroll taxes and income taxes to be paid" should be included in the calculations of the accrued liability and related current year cost. These "earmarked" taxes are commonly used to pay for non-social insurance benefits and services. The "present value of future benefits attributable to current and future participants' future work in covered employment..." should also not be included. While inclusion of these two items is useful as part of a statement of sustainability, a balance sheet liability is a condition at one point in time.

IFTA finds more transparency in the Primary View in that government-wide entity liability and expense recognition are the same as for the component entity and therefore are closer to the surface in the financial report. The line items displayed on the consolidated government-wide entity's financial statements are also the same as for the component entities, including SOSI. The government wide statement of net cost would not have the detailed allocation of cost components which may be included in each component entity's statement of net cost.

**Institute for Truth in Accounting**

Response to FASAB's Preliminary Views Accounting for Social Insurance

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IFTA would consider, but likely still disagree, with the Alternative View about the timing of the recognition of the liability and cost if the following steps were taken by the Government:

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It is well established that the promise of social insurance benefits is a legitimate "social contract." Translucency at best was not the goal the Board set for itself in 2003, when it first committed to improving how these social insurance liabilities are reported. Social insurance benefits are set automatically through continuing appropriations. Congressional action is required to increase or decrease these benefits. Reporting the social insurance liability on the face of the balance sheet and related cost on the statement of net cost would allow the public and their elected officials to straightforwardly identify increases or decreases in promised benefits. Then the public could easily evaluate their elected officials' decisions to adjust benefits.

Institute for Truth in Accounting

Response to FASAB's Preliminary Views Accounting for Social Insurance

April 13, 2007

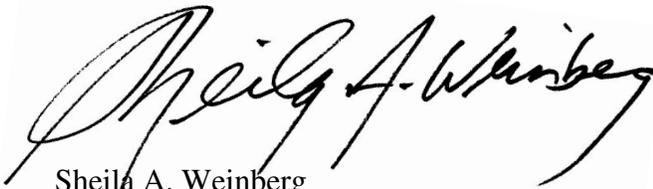
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For more than 20 years the Financial Accounting Standards Board (FASB), recognizing the onset of challenges in private sector pension and other post employment benefits plans, has been working to improve financial reporting of benefits earned during a covered work period but paid after the close of that covered work period. More and more of these costs and liabilities swim closer to the surface of private company financial reports. This transparency has led to more informed decision-making in the private sector. Such transparency should be the goal of the Government and would strengthen our democracy by providing citizens essential financial information. This knowledge would facilitate greater citizen participation in the decision-making processes that are critical to the posterity of our country. Citizens need to be able to clearly see all of the relevant facts about our country's financial position on a timely basis and in an understandable format. Just like a fisherman who can't see a shark deep in the water, what we can't see can hurt us.

IFTA's responses to FASAB's specific questions are attached.

Members of the Institute for Truth in Accounting look forward to testifying at FASAB's hearing on May 23, 2007. Thank you again for the opportunity to comment on this Preliminary Views document. Please do not hesitate to contact us, if you have any comments or questions.

Sincerely,

A handwritten signature in black ink that reads "Sheila A. Weinberg". The signature is written in a cursive, flowing style.

Sheila A. Weinberg  
Institute for Truth in Accounting  
Founder & CEO

**Specific Responses to FASAB Questions**

*Q1. Which obligating event do you believe creates a liability and expense that should be recognized?*

Answer to Q1: IFTA agrees with the Primary View, which would recognize cost and liability when participants become fully insured under the terms of the programs. For Social Security and Medicare, fully insured status essentially occurs at 40 quarters or equivalent of work in covered employment and this would be considered the first obligating event. Additional obligating events would occur as fully insured participants continue work in covered employment. IFTA also agrees with the Primary View that conditions for receiving a future benefit are substantially met when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities. Waiting to recognize the cost and liability associated with Social Insurance benefits until the benefits are “due and payable,” grossly understates those costs and liabilities. This recognition does not give the financial report readers the relevant information needed to make timely decisions.

*Q2. Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary View?*

Answer to Q2: Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment. Actuaries deal with these issues all the time. Population demographics are estimable from employer tax filings. Current benefits statutes are known. Actuarial longevity tables are readily available. This information is currently available and used as a source in the preparation of personalized annual Social Security Statements. Potential future increases or decreases to benefits, while relevant to a statement of sustainability, are irrelevant to measuring Social Security and Medicare obligations once a particular fiscal year has closed.

*Q3. Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?*

As outlined in our overall response, IFTA agrees with the Primary View proposal.

*Q4. The Alternative View proposes that a statement of fiscal sustainability be presented in the consolidated Financial Report of the United States Government. The statement would be included as required supplementary information. (See Appendix C for an illustration.) The new statement would provide sustainability information on the entire Government, including*

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*information to assess the sustainability of social insurance programs and information on intergenerational equity. Do you believe the proposal should be adopted?*

Answer to Q4: A statement of fiscal sustainability presented in a management discussion and analysis would be useful especially if interperiod inequities were transparent. Because such a statement of fiscal sustainability would require estimations of population, demographics, etc., IFTA questions whether this statement would be auditable.

*Q5. Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?*

Answer to Q5: The recognition of deferred revenue for earmarked revenues in excess of related program costs should not be considered. Recognizing deferred revenues would imply a liability to those taxpayers who paid the "earmarked" taxes, when in fact these taxes have already been distributed to those taxpayers and their beneficiaries in the form of government services and benefits.

*Q6. The Primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information. Please offer any comments that you wish to make on the Primary and Alternative Views provisions.*

Answer to Q6: There are substantial basic accrual accounting and financial reporting issues that need to be addressed before details are worked on.



April 16, 2007

Wendy M. Comes  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

Re: Request for Comments on Accounting for Social Insurance, Revised.

Dear Ms. Comes:

AARP is writing to comment on the Federal Accounting Standards Advisory Board's (FASAB) document, *Preliminary Views – Accounting for Social Insurance, Revised*. This document presents two views, the Primary and Alternative View, on how the federal government ought to account for social insurance programs. In general, AARP supports the Alternative View.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. We produce AARP The Magazine, AARP Bulletin, AARP Segunda Juventud, NRTA Live & Learn, and provide information via our website, [www.aarp.org](http://www.aarp.org). AARP publications reach more households than any other publication in the United States.

AARP advocates for policies that enhance and protect the economic security of individuals as they move from work to retirement. Through its research, publications, advocacy, and training programs, AARP seeks to eliminate ageist stereotypes; encourage employers to hire and to retain older workers; and help older workers overcome obstacles in the workplace. This is important to AARP because approximately 45 percent of our more than 35 million members are working.

From time to time the FASAB reexamines how the federal government accounts for social insurance programs. Currently, social insurance programs, including Social Security and Medicare, are accounted for using a "due and payable" or cash balance standard. How social insurance programs are accounted for in the federal ledger and in the consolidated Financial Report of the U.S. Government has a significant effect on the way these programs are viewed and could

influence the timing and specifics of changes to these important programs. Contemplated changes to social insurance accounting standards should take into account how accurate, useful, and consistent with the spirit of the law the revised standards are.

AARP believes that the Alternative View, which maintains the “due and payable” standard with added reporting on the sustainability of social insurance programs, depicts the status of these programs in a way that is accurate as well as useful to lawmakers and the general public. The Primary View, in proposing to recognize a financial liability at an early point in an individual’s work life, does not create a standard that accurately represents the nature of our pay-as-you-go social insurance programs.

### **At what point should a liability and expense be recognized?**

The key difference between the Primary View and Alternative View is the point at which sufficient eligibility conditions are met to create a liability and a “present obligation.” The Primary View holds that a liability and related expenses should be recognized when participants become “fully insured,” i.e., they have 40 quarters of covered earnings. The proponents of the Alternative View continue to support the recognition of obligations for social insurance programs when participants have met all eligibility requirements and benefits are “due and payable” (this is essentially a cash, or pay as you go, concept).

AARP supports the Alternative View’s recognition of a benefit obligation because it acknowledges that benefits are uncertain until they are actually paid. Even the age of eligibility for Social Security benefits (62) or Medicare (65) cannot be regarded as the sole condition creating a present obligation, since individual choices and program changes can still alter the benefit.

The Primary View uses the term “liability” to refer to accrued benefits, suggesting a contractually binding commitment that cannot be altered by the government. Private sector accounting rules recognize these types of commitments because private sector entities can be legally bound by government. For example, federal law governing defined benefit pension plans (ERISA) requires that pension benefits that are accrued cannot be reduced by the employer. The concept of accrued benefits in ERISA does not translate meaningfully to the world of social insurance programs, such as Social Security and Medicare. Government social insurance obligations do not have the same legal status that accrued pension benefits do under ERISA or that individual or corporate tax liabilities have.

Social insurance programs, while not subject to annual scrutiny like appropriated programs, are subject to changes in authorizing legislation by the committees of jurisdiction. Changes in law could affect benefits for future and current retirees. It has long been held that one Congress cannot bind the hands of another: so there are no promised benefits from Social Security or Medicare that cannot be

altered at any time by Congress to the benefit or the detriment of beneficiaries -- current or future. Members of Congress and the Administration recommend changes to benefits that may or may not be law. For example, the 1983 Social Security Amendments, which were adopted to strengthen the program, included a 6-month delay of the July 1983 Social Security Cost of Living Adjustment (COLA) and a change to annual rather than semi-annual updates thereafter, which affected current and future beneficiaries. The Kolbe-Stenholm Bill, which was reintroduced over several Congresses, included several benefit changes, such as accelerating the increase in retirement age. Flexibility is helpful in shaping social insurance programs that respond to a changing social, demographic and fiscal environment.

There may also be practical reasons for not treating fully insured status as an obligating event. Some analysts have argued that treating expected benefits as liabilities may make it more difficult politically to gain consensus on the reforms needed to achieve long term solvency for the programs.

**Are Social Security and Medicare obligations measurable for purposes of recording a liability after 40 quarters or equivalent of covered?**

The issue of whether social insurance obligations are measurable after 40 quarters is related, but secondary to, the issue of when conditions are met to create an obligation, or legally binding commitment. It is difficult to determine the precise obligations for Social Security or Medicare until they are due and payable. Obligations can be changed by acts of Congress before full eligibility is established, and they can even be changed once a worker becomes a beneficiary.

The issue of when Social Security and Medicare obligations are measurable may depend on what is meant by "measurable" -- a word which is used only twice in the document but not defined. Measurement implies a precision that does not occur in social insurance programs until benefits are actually paid. Currently both the Social Security Trustees' Report and the Congressional Budget Office provide estimates, however even 75-year projections are subject to estimating errors, and projections that go beyond that are little more than rough extrapolations. To consider obligations that are far in the future as "measurable" for the purpose of recording a liability is totally unrealistic.

**Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?**

The Statement of Social Insurance (SOSI) is one of the principal financial statements of the U.S. Government and shows the financial standing of social insurance programs. It appropriately presents information on social insurance programs in a context that is well-suited to the very specific and specialized

nature of these programs. As we have noted above, future benefits are different from the definite and measurable liabilities that are created by various other government activities, such as liabilities to contractors, interest payments to holders of Treasury securities, or social insurance benefits that have become “due and payable.”

Linking SOSI line items to the balance sheet and the statement of net cost could, in fact, be detrimental to the over-arching goal of providing helpful and transparent information for several reasons.

First, placing only present value obligations for social insurance programs onto the balance sheet would overwhelm and diminish the information presented on the balance sheet concerning other present obligations and activities of the federal government. In addition, there is a serious risk that changes in the balance sheet position from year to year could be largely driven by changes in the assumptions used to calculate the large present value amounts for social insurance programs. For example, the calculation of the present value of obligations can be greatly affected by even small changes to the discount rate used, and this creates volatility that is magnified with each additional year that the forecast period is extended. Typical forecasts for social insurance programs extend 75 years, or even over infinity; corporations often use shorter horizons.

Moreover, presenting social insurance obligations on the balance sheet does not present these obligations in a framework that addresses the programs’ abilities to meet their obligations. In particular, the financial condition of these programs is also affected by Congress’ ability to raise revenues, which would not be reflected on the balance sheet. The SOSI, on the other hand, provides this context and, as a result, presents a more complete picture of the financing of these programs.

As other commentators have pointed out, the government is engaged across a wide range of activities to promote the general welfare, including education, defense, transportation et cetera. There is no expectation that the government would cease to provide these services, yet most people would agree that future spending on these activities should not be included as liabilities. AARP objects to overwhelming the balance sheet with potential future benefits to be paid by social insurance programs as it differentiates these costs from other important financial responsibilities of the U.S. Government. Therefore, we view the proposal as unnecessarily focusing on the long-term social insurance obligations.

**Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported and, if so, do you favor such reporting as proposed by the Primary View, as proposed by the Alternate View, or some other approach?**

The SOSI should be modified to include the reasons for changes in a way that is understandable and increases transparency. The changes proposed by the

Alternative View are preferable because they recognize an obligation at the point when benefits become “due and payable.” Two improvements that ought to be made to the Alternative View’s proposal include using language that is more understandable for the general public and incorporating the reasons for changes into the body of the SOSI rather than having them in a separate document.

The Primary View’s proposal is unacceptable due to its recognition of liabilities and expenses prior to their becoming “due and payable.”

**Do you believe that a statement of fiscal sustainability should be presented in the consolidated Financial Report of the United States Government?**

AARP does not object to a statement of fiscal sustainability, but has strong concerns about the proposed use of infinite horizon forecasting (see the section regarding infinite horizon forecasting below). We also have some concerns over how this proposal could be implemented, given the scope of the required forecasting effort and the very difficult forecasting issues that would arise from the wide range of government activities.

The goal of the Statement of Fiscal Sustainability would be to project all future revenues, and costs for all Federal programs, over the same long-range period that is used for Medicare and Social Security. This effort would require forecasters to make assumptions about the scope and nature of future economic activity for the next 75 years and into perpetuity. For example, future tax revenues will depend on the characteristics of future tax bases in a future economy that may well be very different from the present economy. Similarly, projecting future government expenditures would require assumptions about future requirements in the areas of defense, education, transportation, et cetera. For a 75-year forecasting horizon, this effort would require the sustained effort of a team of expert researchers. We do not believe that it would be possible to make meaningful projections for the entire budget over the infinite horizon.

Predicting sustainability for the Medicare program over the long term is particularly difficult because it depends on estimates of health care spending growth. Factors influencing medical care expenditure growth include: expansions of health insurance coverage; relative medical price inflation; supplier-induced demand and defensive medicine; and technological change. All of these factors are challenging, if not impossible, to predict.

**Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?**

As the Alternative View states, “any earmarked social insurance program revenues in excess of program costs incurred by the earmarked funds during the period are invested in Government securities.” These investments in Treasury securities are assets held by the trust funds but are a liability to the U. S Treasury, which must redeem the securities with interest at a future date. These

securities are treated as offsetting amounts in government financial statements. The result of this treatment is that the financing provided by earmarked funds for other government activities, which would otherwise be financed through issuing debt to the public, increasing taxes, or reducing spending, is not shown on the U.S. balance sheet.

The Alternative View states that consideration should be given to reporting and recording such excess earmarked revenues as “deferred earmarked revenues,” and not counting them as revenue in the current period. The rationale for this treatment is that, social insurance benefits should be recorded in the period in which they are paid and earmarked revenues should be recognized in the period in which they are used. The revenues would be reported as deferred earmarked revenues, but would be classified as a liability on the balance sheet (Paragraph A148, page 91).

In the discussion of the Alternative View in the FASAB document, paragraph 48 on page 38 says that the supporters of the Alternative View “believe that the balance sheet, which shows what the Government owns and owes as a result of past operations, should include as liabilities only those items that are present obligations of the Government.” But the general thrust of the Alternative View seems to be that social insurance benefits do not become obligations until they are due and payable, and these “deferred earmarked” revenues represent future spending and not present obligations. This would seem to argue from a logical standpoint that these revenues not show up as liabilities on the balance sheet.

On the other hand, showing a liability would indicate that the Treasury does have an obligation to pay Social Security for those outstanding securities. This might have a beneficial effect in demonstrating that these are real obligations and not, as has sometimes been argued, “worthless IOUs.” On balance, it seems that the presentation of these revenues as liabilities may appear contradictory to the Alternative View that there are no present obligations until benefits are “due and payable.”

### **The reform limiting consequences of the Primary View provisions.**

The Primary View’s proposal to change the method of accounting for social insurance from cash balance accounting to accrual accounting could diminish the likelihood of adopting meaningful reforms.

Recent reform proposals have promised not to alter benefits for retirees or near-retirees; however, such a stipulation still allows those reforms to affect people who, under the Primary View’s proposal, are “fully insured,” i.e. all workers who have completed 40 quarters of covered work. This reference to “fully insured” individuals and to a liability would create a false sense among future beneficiaries that their benefits are guaranteed. If such a guarantee were to exist when a participant reached 40 quarters of covered work, it would mean reform

could not affect these “entitled” individuals. Thus, any benefit changes could take effect only when participants who are not currently insured begin to retire. This postponement would undermine the programs’ financing.

AARP understands that the proposed standard does not create a legally binding obligation. Nonetheless, the “appearance” of such an obligation could create additional political pressure to retain current benefits and could make substantive reform harder. It is important that any changes intended to make the financial position of social insurance clearer ought not make reform more difficult.

### **The weakness of infinite horizon forecasting in the Alternative View.**

AARP believes that the infinite horizon forecasting concept is not helpful and may, in fact, mislead the public. There are several flaws in this concept.

First, infinite horizon forecasts for Social Security and Medicare have, to date, been presented as single-point estimates, and have not been accompanied even by routine measures of statistical reliability. For example, forecast results are sensitive to very small changes in assumptions, particularly when very long-term forecasts are at issue.

In addition, for an infinite horizon forecast to be helpful, it needs to be put into the context of how large the rest of the economy will be over the same infinite horizon. Such comparisons appropriately shift the emphasis from a figure that appears to be very large in the context of today’s economy to a figure that could potentially be managed in a future, larger economy.

The result is that infinite horizon forecasts create a false sense of certainty around the number being presented. In a letter to the Social Security trustees dated December 19, 2003, the American Academy of Actuaries argued that infinite horizon forecasts are “on balance, a detriment” to the Trustees’ annual presentation because the measures provide “little if any useful information about the program’s long-range finances and indeed are likely to mislead anyone lacking technical expertise in the demographic, economic and actuarial aspects of the program’s finances into believing that the program is in far worse financial condition than is actually indicated.”<sup>1</sup>

Moreover, the 2004 Technical Review Panel on the Medicare Trustees Report noted that long-range forecasts of the use and costs of medical services could be more problematic than forecasting economic and demographic variables. As a consequence, they concluded that any long-range forecasts beyond 75 years were extremely uncertain.

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<sup>1</sup> American Academy of Actuaries, letter to the Trustees of the Social Security System dated December 19, 2003. Available at: [http://www.actuary.org/pdf/socialsecurity/tech\\_dec03.pdf](http://www.actuary.org/pdf/socialsecurity/tech_dec03.pdf).

Given the evident uncertainty of extremely long-term forecasts, and the speed of economic change, it would be unwise to emphasize forecasts over the infinite horizon. Forecasts over infinity confuse, rather than illuminate, the discussion about Social Security and Medicare.

### **Conclusion**

Accounting standards for social insurance should promote an understanding of the fiscal situation of social insurance programs. Any such standard must take into account the structure of social insurance programs and recognize Congress' ability to modify these programs as required.

AARP generally supports the Alternative View, finding it to be a much more accurate representation of the financial situation of social insurance programs. We urge the board to take into account the effects of each proposal and create a standard which informs both lawmakers and the public clearly without limiting the flexibility of lawmakers or misrepresenting how social insurance operates. We feel that the Primary View does not accomplish these goals.

AARP appreciates the opportunity to comment on the preliminary views document, *Accounting for Social Insurance, Revised*. If you have any questions or need further assistance, please do not hesitate to contact Evelyn Morton of the Federal Affairs staff at (202) 434-3760.

Sincerely,

A handwritten signature in black ink, appearing to read "David Certner", with a long horizontal flourish extending to the right.

David Certner  
Legislative Counsel and Director of Legislative Policy  
Government Relations and Advocacy

>>> "Tom Prince" <[t-prince@kellogg.northwestern.edu](mailto:t-prince@kellogg.northwestern.edu)> 4/23/2007 10:10 AM >>>  
Monday, April 23, 2007

Wendy M. Comes, Executive Director  
Federal Accounting Standards Advisory Board  
Washington, DC 20548

To Whom It May Concern:

My recent email was rejected because of a typographic error.

I am delighted that FASAB is considering changing the financial reporting of the federal health care expenditures and future obligations. As the Board begins to review the federal reports, inadequate empirical studies of covered lives and healthcare expenditures will become apparent to members of the Board.

I wish you the utmost success in your deliberations.

Very truly yours,

Tom Prince

Tom R. Prince  
Professor of Health Industry Management  
Professor of Accounting Information and Management  
Kellogg School of Management  
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## Federal Accounting Standards Advisory Board

Wendy M. Comes, Executive Director  
Federal Accounting Standards Advisory Board  
Washington, DC 20548

[comes@fasb.gov](mailto:comes@fasb.gov)

To Whom It May Concern:

I realize the responses were due by April 16, 2007; however, my disabled son had a series of seizures this week which prevented me from responding by that date. A few years ago, my son while riding a bicycle was run over by a motorcyclist who was traveling at 65 miles per hour. The motorcyclist was killed and had no insurance. Since the accident, I have ceased teaching in the day-time at Northwestern University's Kellogg School and schedule my classes in the evening. My wife returned to teaching after 30+ years because the pressure of coping with a disabled son was very difficult for her.

As a CPA, I believe that members of the Financial Accounting Standards Advisory Board must argue for "reasonable" data from the federal agencies on **healthcare status**. Simple assumptions based on limited surveys are not professionally acceptable. We need to know the facts on our legal and social obligations as a society for the elderly. Will the Social Security deficit hit in 2016, 2015 or 2014?

In 1968 to December 1973 I supervised the creation of the American Hospital Association's national database. I was Dr. Paul Sanazaro's assistant at the National Center for Health Services, Research and Development in the 1960's and early 1970's. Three federal agencies replaced the National Center in the 1970's.

I have been a consultant in 47 of the 50 states to major healthcare entities and have won 19 of 20 federal law cases in court. The federal judge died within days of completing the 20<sup>th</sup> law case; he was in very poor health.

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In April 1987 I was asked to review the proposed creation of a new financial database for health care entities by a national investment company. **Investor's Tools** has been owned by eight different entities and was acquired in 2004 by Standard & Poor's. The first seven owners gave me the "right" to refuse consulting oriented faculty from getting free access to the healthcare database.

Recent federal reports suggest we do not have an uninsured problem for people 65 years of age and over. Table 136 reports that 13.7% of the **65 years and over** population in 2003 had Medicare risk Health Maintenance Organization; 10.4% had Medicaid

coverage; 35.9% had Employer-sponsored plans; 26.2% had Medigap coverage; 13.9% had Medicare fee-for-service only or Other [pages 402-403].

***Health, United States, 2006 with Chartbook on Trends in the Health of Americans***, 2006 (The U. S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Health Statistics) 543 pp.

Having reviewed the results of processing over one-million discharge records over the past 30 years, the government's statistics on the over 65 years of age population do not seem reasonable. A recent empirical study on residents of New York City published in ***Inquiry*** reports that 19 percent of the U. S. born patients over the age of 65 have zero Social Security income and are not covered by Medicare.

Bradford H. Gray, Roberta Scheinmann, Peri Rosenfeld, and Ruth Finkelstein, "Aging Without Medicare? Evidence from New York City," ***Inquiry*** 43: 211-221 (Fall 2006).

Question 1. I concur with the Primary View. However, I would provide limited disclosure of the financial facts. If a new disease were to increase the early death rate for a large segment of the population, then some members of Congress may want to provide extra large payments out of the Social Security Trust Funds to the uninsured. [I realize that the Social Security Trust Funds is merely a concept; but many citizens believe it is a real checking account.]

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Question 2. There is a difference between "Are Social Security and Medicare Obligations measurable" versus is this a desired reporting? In the 1950s I was asked to graduate early from Undergraduate School so I could teach the introductory course in Statistics. After receiving my Ph.D. at the University of Illinois in Champaign, a Ford Foundation grant to Northwestern University required me to teach three related courses – Statistics, Finance, and Accounting. The students had the same teacher for purposes of integrated instruction in these three courses.

The Honorable David M. Walker has given two addresses in Chicago over the past nine months. At both events, he was asked about the **Social Security Trust Fund**. If corporate officials do not understand the Social Security Trust Fund, then how do you expect ordinary citizens to understand the reporting of the Social Security Trust Fund?

In the early 1970s I received an unsolicited grant from the United States Department of Naval Research to use cluster analysis in determining where the submarines were. While I had applied cluster analysis to information technology problems, one of the nation's leaders in operations research wanted me to apply that experience to submarines. I went to Washington and got the grant modified so it was not applications oriented. Some Ph.D.

students at Kellogg did a lot of analytical work on attributes and this was helpful in their professional careers.

I strongly believe there should be a reporting on the obligations of individuals participating in the Social Security Trust Fund and its status. Informed citizens can reduce calls for inappropriate payments for non-covered lives. Political suggestions for Federal Government payments to uninsured individuals can excel the demise of the Social Security Program.

Please disclose the facts regarding obligations of individuals with 40 quarters or equivalent of work experience but also report the payments out of the Social Security Programs. I would not report the current obligations (paragraph 16g) on the Balance Sheet. This makes it too easy for quick political decisions to be made in Washington that may be detrimental to the survival of the Social Security Programs.

Page 3

In Appendix C, I would suggest more entries in the tables that provide descriptive information on covered lives. How many citizens have 35 quarters of equivalent work, how many with 40, etc. What are the current payouts for these citizens when they reach 67 years of age?

Question 3. I do not concur with either position on the Statement of Social Insurance (SOSI). I would add statistical and demographic data on the population for both workers and individuals receiving benefits. The new tables should clearly explain the various profiles of the populations and their future expected benefits.

Question 4. The statement of fiscal sustainability should contain more profile information on both workers and covered lives. Under a cash basis of accounting, the profile should clearly indicate the future financial obligations for each segment of the population—both current workers and those retired.

Question 5. The cost of advancements in medical technology and new medical conditions can dramatically alter the projected healthcare expenditures over the next ten years. In place of implementing either of the options for Question 5, I would suggest a healthcare assessment of what the future may hold for medical technology over the next ten years and the cost of those initiatives.

Question 6. Are healthcare expenditures increasing by 14% per year? If so, what will this look like in 2012? Will all Medicare beneficiaries demand the latest medical technology that is available in 2012 to treat their conditions? The tables in Appendix B omit the dynamic increases occurring in healthcare expenditures. These increases will add to the in balance between receipts and expenditures.

I am delighted that these major questions are being considered by the Federal Accounting Standards Advisory Board. I wish you the utmost success in reaching agreement on these new reporting arrangements.

Sincerely,

Thomas R. Prince

Page 4

**JAGADEESH GOKHALE**

CATO INSTITUTE  
1000 MASSACHUSETTS AVENUE  
WASHINGTON D.C. 20001

*Senior Fellow*

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Wendy Comes,  
Executive Director,  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW, Suite 6814  
Washington, DC 20548

Dear Ms. Comes,

Thank you for the opportunity to provide comments on FASAB's "Preliminary Views, Accounting for Social Insurance" document. I attach below my integrated response and comments on the Primary and Alternative Views included therein.

Sincerely Yours,

Jagadeesh Gokhale  
Senior Fellow  
Cato Institute  
Washington D.C

A Note on FASAB's "Preliminary Views, Accounting for Social Insurance" document  
By Jagadeesh Gokhale, Senior Fellow, Cato Institute

Date: April 16, 2007

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Recent studies on federal budget reporting have emphasized the need for forward-looking fiscal measures. Traditional fiscal measures such as outstanding debt held by the public and annual deficits are backward looking because they result from past government transactions with the public in the form of government taxes and expenditures.

The government is in principle an everlasting entity.<sup>1</sup> Ensuring proper fiscal management to maintain continuity of government operations requires forward-looking fiscal measures. Such measures should indicate whether existing government policies are sustainable and how the fiscal burdens of paying for government spending on public goods under those policies would be distributed within and across generations and over time. The measures should be easy to communicate and should facilitate analysis of the tradeoffs involved under alternative policy changes.

Adopting the Primary View proposal would not introduce any new fiscal measures, but it would alter the content and sizes of traditional measures – national debt, annual budget deficits, and net operating costs. Hence judgment ought to be based upon whether adopting the Primary View proposal would enhance the quality and

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<sup>1</sup> History suggests that no government is everlasting and one may conjecture that the current U.S. government would eventually be replaced by an extra-constitutional regime. However, that possibility cannot be admitted when defining and measuring government commitments to provide public services with the objective of managing the government's finances to ensure its continuity.

informational content of traditional measures. My answer to this question is in the negative.

### **A Critique of the Primary View Proposal**

The quality of traditional measures would not be enhanced by the change proposed under the Primary View. According to economic theory, any fiscal policy (or policy change) must be defined in terms of its impact on the resources of private economic agents – individuals and firms. Changes to private agents’ budgets caused by taxes and transfers are likely to alter their economic choices. Under this perspective, if changes in government taxes and expenditures do not alter private budget options and choices, those changes do not constitute a real change in fiscal policy.

Recent studies have shown that traditional cash flow measures of fiscal policy – government debt, deficits, and net operating costs – are *neither necessary nor sufficient* as descriptions of real underlying fiscal policies. Hence, by implication, those measures are not capable of consistently reflecting the government’s financial condition, its sustainability, and its performance as an economic steward. Consider that any given debt and deficit series may be consistent with many alternative real fiscal policies. For example, balanced budget increases in taxes on workers and transfers to the retirees would deliver a different real underlying fiscal policy but would not, by construction, alter reported deficit or debt levels in any future period. Furthermore, a given real fiscal policy may be consistent with alternative debt and deficit series. For example, investment of government funds in private securities (or, alternatively, sale of government assets) coupled with a cut (alternatively, an increase) in capital income taxes

could be designed to leave the government's "stake" in the economy's profits unchanged and, therefore, may not alter private agents' budgets. However, such a change in the government's asset portfolio and future taxes would produce a different time series of deficits and net current operating cost. Adopting the Primary View proposal would not fundamentally change these rather severe shortcomings of traditional fiscal measures. Hence, it would deliver no improvement in the quality of recognized government liabilities.

The Primary View proposal also does not significantly advance the informational content of traditional fiscal measures. Eligibility for Social Security and Medicare benefits depends on several factors. The Primary View holds that the acquisition of 40 quarters of covered earnings is a watershed eligibility requirement for Social Security and Medicare. Achieving "qualified" status under this rule, according to the Primary View, leads to a claim on future benefits that should be recognized to be just as inviolable as the contractual agreement to service and repay outstanding government bonds. However, because eligibility for social insurance benefits is contingent on several additional conditions, defining this particular eligibility condition as being more critical than others seems arbitrary. That's especially true because like other conditions, this particular eligibility condition could, by law, be altered by Congress at any time and retroactively.

The inclusion of future benefits accrued through past and current transactions but not those that would accrue through future transactions appears similar to setting an arbitrary time horizon (say, of 75 years) over which to evaluate Social Security's and Medicare's financial condition under current policies. Because the government would always remain in operation, and because social insurance policies are inertial – that is, the likelihood that

future benefit accruals would occur under rules roughly similar to current ones is quite high – it appears unreasonable to make the implicit assumption that all accruals from future employment under current policies would be zero.<sup>2</sup> Recognizing liabilities based on the achievement of “qualified” status does not introduce a sufficiently forward-looking element to outstanding debt and deficits (or net cost) as fiscal measures. That means two critical shortcomings of traditional measures are preserved: First, implicitly ignoring future accruals of government commitments makes those measures incapable of communicating information on the sustainability of current policies. Second, traditional measures do not identify the distributional implications of current policies – an important item for providing a complete and consistent description of real underlying fiscal policies. Without these informational attributes, the objective of communicating relevant information about the government’s financial status would remain unfulfilled.<sup>3</sup>

### **General Comments**

- Drawing a strict distinction between “recognized liabilities” and “other commitments” appears quite beside the point when in fact the degree of commitment attaching to various federal government expenditures is a continuum. The government’s spending commitments include very firm ones – inflation-protected Treasury bonds, inflation-indexed social insurance benefits to current retirees, the commitment to defend the country against foreign aggression, etc.; less firm commitments include nominally denominated Treasury bonds, future social insurance

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<sup>2</sup> Note that, by assumption, fiscal policies would be changed appropriately in the future to ensure continuity of government. This is the condition of *ex post* government sustainability.

<sup>3</sup> See “Fiscal and Generational Imbalances: New Budget Measures for New Government Priorities” by Jagadeesh Gokhale and Kent Smetters, AEI Press: Washington, 2003.

commitments to middle-aged workers, welfare assistance to immigrants, etc.; and very weak commitments include funding science research, build a war memorial, and so on. And this continuum in the degree of commitments does not correspond monotonically to the distinction between contractual to non-contractual obligations: Some contractual payment commitments – nominally denominated Treasury bonds, for example – may be weaker in terms of real purchasing power delivered than some non-contractual ones – inflation indexed social insurance benefit payments to current retirees.

- Although *measurement* of current accrued Social Security and Medicare benefits is not sufficiently forward looking (future accruals under current policies are ignored), it is more consistent with a forward-looking approach than the current “due and payable” standard for liability recognition. But the *recognition* of current accrued benefits as “government liabilities” may place political and legal limitations on the choices available to future policymakers. Such potential constraints are unlikely to be consistent with FASAB’s objective of proper management of federal resources for ensuring continuity of the federal government. The measurement and prominent display of *all* government commitments under current policies, including those to accrue in the future under existing policies, would not create such limitations but would more fully characterize the government’s fiscal stance and financial condition.
  
- The measurement of accrued benefits based on the earnings records of “qualified” workers would also depend on other liability-triggering conditions that may or may

not be currently satisfied: For example, the “qualified” worker may be already married for 10 years or more and the spouse could claim dependent and survivor benefits in the future based on the “qualified” worker’s earnings record. Those future dependent and survivor benefits should be counted as accrued liabilities today under the Primary View proposal. However, those benefits may not actually be claimed by the spouse in the future if the spouse also earns qualified status and accrues larger benefits based on his or her own earnings record. Thus, calculations of accrued benefits in future periods must be adjusted to extinguish the earlier qualification for dependent and survivor benefits based on the worker’s record.<sup>4</sup> Indeed other events such as a future completion of 10 years of marriage to a qualified worker, future marriages, divorces, births, deaths, disability, etc. would also trigger additional future benefit accruals, earlier benefit claims, or extinguish past accrued benefits under the Primary View proposal. Such complications in the evolution of “recognized liabilities” under the Primary View proposal could cause considerable errors in measuring accrued liabilities and make the statements of liabilities and net costs unreliable as indicators of the federal government’s financial condition.

- Irrespective of its merits or demerits, however, implementing the Primary View proposal – of boosting the amount recognized as liabilities on the government’s books – could constitute a useful experiment for economists. It would allow us to gauge whether financial market participants consider a quantum increase in the nation’s recognized liabilities – one not accompanied by any real policy change – as new

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<sup>4</sup> Alternatively, future liability recognition on the basis of the spouse acquiring “qualified” status should take account of only the excess of her own benefits over the dependent and survivor benefits to which she is already eligible.

information and whether it would cause an immediate and appreciable adjustment in Treasury interest rates.

### **Conclusion**

The primary focus in accounting and reporting on the federal government's financial condition should not be placed on simply distinguishing between "true-blue" liabilities and other commitments. Such distinctions are inherently arbitrary and fiscal measures based on them do not consistently reflect the real nature or changes in underlying fiscal policies. Various types of government obligations fall along a wide continuum in terms of how firm they are perceived to be. Because the government itself is infinitely lived in principle, it would be better to focus on prominently reporting sustainability and stewardship implications of *current policies*. That requires placing much greater emphasis on forward-looking fiscal measures – that include the government's current *and future* payment commitments under existing policies. Such actuarial measures would consistently reflect the future implications of existing policies and policy changes over time and for different population groups. However, they do not currently receive the prominence they deserve and, therefore, are not adequately considered in public reform debates and in the fiscal policymaking process.

For the reasons given above, I do not support the Primary View proposal. I support the Alternative View proposal to add reports on sustainability and stewardship information. I would recommend that such reporting be integrated into the current statement of net cost and balance sheet information under the heading "Future Implications of Current Policies," and that this information be prominently displayed in

the Executive Summary of the United States' Financial Report. Moreover, the narrative in the Management's Discussion and Analysis should provide a consistent framework for explaining relevance and importance of such information. That explanation should articulate the unique features of government entities that compel a forward-looking perspective, specify a consistent framework for assessing policy sustainability and economic stewardship, and explain how the report's estimates should be interpreted. Supplementary notes should provide details on the assumptions and construction of sustainability and stewardship indicators.

>>> "Martha Zeigler" <[mzeigler@msd.buncombe.nc.us](mailto:mzeigler@msd.buncombe.nc.us)> 4/23/2007 9:48 AM >>>

I apologize for the late transmittal. Between taxes and deadlines in our agency's budgetary process, last week was a difficult time (well, actually it's been rather hectic for some time, but I'm preaching to the choir as I'm certain your job takes up much more than 8 hours of your day, as well). However, if it's possible, I'd like to offer a few comments concerning selected questions.

Q: Which obligating event do you believe creates a liability and expense that should be recognized?

A: I believe the obligating event which creates the liability and expense which should be recognized is when the participant becomes fully insured under the terms of the program. The economic reality is that the only reason a fully insured participant would NOT receive some benefit would be death prior to qualifying age leaving no spouse nor dependent children. This uncertainty can be actuarially determined with great accuracy. Since there is no way a participant can voluntarily or involuntarily separate from the Social Security system after becoming fully insured (such as with a private pension plan), that establishes the timing of the rights and obligations for these benefits.

Q: Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent work?

A: Thousands of state and local government and private defined benefit plans are able to actuarially determine liabilities to be reported under FASB and GASB standards with even shorter vesting provisions. GASB 45 is a prime example.

Q: Do you believe that a statement of fiscal sustainability should be presented in the consolidated Financial Report of the United States Government?

A: YES! The primary purpose of financial statements is to provide timely, accurate, and useful information for management and policy short AND LONG-TERM decisions. Sustainability projections are vital for federal administrators, elected officials, citizens, and holders of US Treasury debt, especially evaluating long-term fiscal impacts of the Social Security system and holding appropriate officials accountable for their decisions. As a citizen and parent, I believe intergenerational equity is of the highest importance. Whether in terms of environment, finance, or other key issues, I believe it is the duty, responsibility, and gift of each generation to try to leave the country a little better for our children and grandchildren. The financial future of our nation is too valuable to compromise for short-term political gain.

A statement of fiscal sustainability should provide valid information for all stakeholders to develop a rational and acceptable strategy for managing fiscal responsibilities equitably and with the least detriment to all concerned.

Thank you for this opportunity to participate.

Martha Zeigler, CPA  
Director of Finance  
Metropolitan Sewerage District  
2028 Riverside Drive  
Asheville, NC 28804  
828-225-8214  
828-232-5530 (fax)

>>> "Schaeffer, Steve" <[Steve.Schaeffer@ssa.gov](mailto:Steve.Schaeffer@ssa.gov)> 4/11/2007 3:06 PM >>>

- > Ms. Comes,
- > Executive Director
- > Federal Accounting Standards Advisory Board
- >
- > On October 23, 2006 the Federal Accounting Standards Advisory Board
- > issued Statement of Federal Financial Accounting Standards,
- > Preliminary Views, Accounting for Social Insurance, Revised.
- > Specifically, the Board asked responses to six questions.
- >
- > Attached you will find the comments from the SSA-OIG. Our comments
- > concur with the comments provided by the PCIE. In brief, the SSA-OIG
- > supports the Alternative View.
- >
- > Thank you for the opportunity to review this document. We look
- > forward to the future progress of this project. If you have any
- > questions please contact me on 410-965-9701.
- >
- > Thank you
- >
- >
- > Steven L Schaeffer,
- > Assistant Inspector General for Audit
- > Office of Inspector General
- > Social Security Administration
- >
- >
- > <<PCIE SOSI Workgroup-Consolidated Preliminary View Responses.doc>>

**Question One:**

**Which obligating event do you believe creates a liability and expense that should be recognized? Please provide the rationale for your answer.**

**Response:** We believe that the Alternative View would be the best obligating event to report for social insurance. This decision was based on the fact that the Primary View only illustrates one liability number on the balance sheet, which distorts the future income amount because it has offsetting future income that is not being considered. In addition, changes in assumptions, estimates, and laws could potentially cause great fluctuations which would distort the liability proposed by the Primary View.

- While on the other hand, the Alternative View will maintain the recognition and measurement of expense and liability that is currently reported under SFFAS 17, and this view is consistent with the proposed definition for liability and expenses that is currently in the Elements exposure draft.

**Question Two:**

**Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary View? Please provide the rationale for your answer.**

**Response:** No, we do not believe that the Social Security and Medicare obligations are measurable as proposed in the Primary View. This was based on the fact that Section 214(a) of the Social Security Act states that a person is fully insured for retirement benefits if they have one quarter of coverage (whenever acquired) for each calendar year elapsing after 1950 or, if later, after the year in which they became age 21, and before the year they became age 62. Any years wholly or partially within a period of disability are not counted. For example, if a person became age 21 after 1950 and were never entitled to a period of disability before age 62, they need 40 quarters of coverage. However, based on the information stated in the Social Security Act a person obtaining 40 quarters of covered employment could still be years away from being eligible to receive benefits.

In addition, the Primary View only applies to retirement and does not take into consideration disability. For example, to be eligible for Disability benefits a claimant must have at least 20 quarters of coverage during the 40 quarter period ending the last day of the quarter in which the disability began. However, if the current disability onset begins under age 31, an alternative 20/40 requirement may be used. The worker must have earned quarter coverage in at least  $\frac{1}{2}$  of the quarters beginning with the quarter after the quarter he/she attained age 21, through the quarter of onset.

Thus, the Primary View needs to ensure it includes information pertaining to the disability standards, since the 40 quarters does not apply.

Also, estimates of this nature are inherently uncertain. For example, some obligations would be recognized over an unreasonably lengthy elapsed time before such amounts stand the chance of becoming due and payable.

**Question 3.1:**

**Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?**

**Response:** No we do not agree that additional line items should be added to the SOSI. Because the “due and payable” liability, which was established in SFFAS 17, clearly depicts the expense recognized for the reporting period and the benefits paid during the period. The liability for retirement benefits is incurred when the age and quarter coverage has been obtained.

In addition, given the unsustainable nature for the social insurance programs and the reasonable expectation for future reform, the impact of including the liability in the SOSI statement as proposed by the Primary View would lead to “misinterpretations” on the part of the users.

**Question 3.2:**

**Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported and, if so, do you favor such reporting (1) as proposed by the Primary View, (2) as proposed by the Alternative View, or (3) some other approach?**

**Response:** We agree with the reporting as proposed in the Alternative View because this view will present more descriptive and informative information that will allow the opportunity for more well informed decisions to be rendered. However, we believe that the “Statement of Changes in Social Insurance” should only be disclosed as Required Supplementary Information, and should not be subjected to being audited.

**Question Four:**

**Do you believe the Statement of Fiscal Sustainability should be adopted? Please provide the rationale for your answer**

**Response:** No. As reflected in the Appendix A: Paragraph A156, the Alternative View proposes additional information on sustainability in two parts. 1) a Statement of Changes in Social Insurance, and 2) Required Supplementary Information related to the overall fiscal sustainability of all federal programs. A156 further states that a period of 75 years would be used for the statement of fiscal sustainability. The development of costs to run all federal programs over the next 75 years would be cost prohibitive, extremely labor intensive and very judgmental. The factors used to develop 75 years

costs of all federal programs would be too uncertain to measure with confidence. There are many things that are very difficult to project/measure, such as natural disaster, disease, military necessity, etc.

However, if the Statement of Fiscal sustainability is adopted it should only be exclusive for government-wide and not to the individual agencies. In addition, this statement should be disclosed as Required Supplementary Information. (RSI)

**Question Five:**

**Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs? Please provide the rationale for your answer.**

**Response:** No we do not believe that the Board should consider recognizing deferred revenue for earmarked revenues. Because from a legal standpoint every working person is required to pay Social Security taxes and thus deferring revenue should not even be considered. In addition, this area needs to be researched further as this would require revising portions of SFFAS 27 *Identifying and Reporting Earmarked Funds*. For example, currently the standard depicts that a component entity should disclose all earmarked funds for which it has program management responsibility. In addition, the standard states all amounts reported and disclosed in the reporting entity's basic financial statements or the notes thereto, should be recognized and measured using the standards provided in generally accepted accounting principles (GAAP) applicable to the Federal Government. For example, under GAAP the accounting principle states that revenue is recognized only when a specific critical event has occurred and the amount of revenue is measurable, which is inconsistent with the deferring revenue requirements in the Preliminary View Document.

**Question 6.1:**

**Please offer any comments that you wish to make on the Primary View provisions.**

**Response:** We disagree with the Primary View provision because in this proposal estimates would be placed on the face of the financial statements for the liability and expense amounts. Accounting estimates are made when the measurement of some amounts or the valuation of some accounts is uncertain, pending the outcome of future events, and when relevant data concerning events that have already occurred cannot be accumulated on a timely, cost-effective basis. Since, estimates are based on subjective as well as objective factors; it may be difficult for management to establish controls over them, thus creating more skepticism from the auditors. In addition, the Primary View will not fully explain the change in the net present value of the program related cash flows. However, in the Alternative View provision it will present a statement of fiscal

sustainability that will highlight the trends, and will discuss the reasons for changes in the sustainability measures.

**Question 6.2:**

**Please offer any comments that you wish to make on the Alternative View provisions.**

**Response:** In general, we are in agreement with the Alternative View. However, we believe that the Statement of Changes in Social Insurance should be RSI and the Statement of Fiscal Sustainability should be applicable to only the government-wide financial statement and be presented as RSI. In addition, we do not agree with the consideration of recognizing deferred revenue for earmarked revenue.

Attached is an excerpt from Testimony provided to Subcommittee on Government Management, Organization, and Procurement, House Committee on Oversight and Government Reform by Linda Combs, Controller, Office of Management and Budget, in March 2007. "To this end, the CFO Council (CFOC) and the President's Council on Integrity and Efficiency (PCIE) are currently joining forces to improve the cost-effectiveness of how we go about producing audited financial statements. The presentation of our financial data should be understandable and useful without becoming an excessive cost and drain on agency resources. The CFOC and PCIE will work together with the larger financial community and the Congress to determine if we are sharing the right information with the Government's stakeholders, if the data are timely and in the right format for decision making, and if there is an appropriate amount of audit scrutiny and precision of the data in the Government's reporting. By improving the cost-effectiveness of our current activities, we will empower our financial leaders to expand their focus beyond clean audits and material weakness resolution into other critical areas of fiscal responsibility, such as the reporting of the full costs of Federal programs and activities so that Federal managers have better information to make key business decisions."

The Board should ensure that any changes to the current Statement of Social Insurance are cost beneficial to all users.

April 25, 2007

Wendy Comes, Executive Director  
Federal Accounting Standards Advisory Board  
Mail Stop 6K17V  
441 G Street, NW – Suite 6814  
Washington, DC 20548

*Advancing  
Government  
Accountability*

2208 Mount Vernon Ave  
Alexandria, VA 22301

(703) 684-6931  
(703) 548-9367 (fax)

Dear Ms. Comes:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the October 23, 2006 exposure draft (ED) by the Federal Accounting Standards Advisory Board (FASAB or the Board) of a Preliminary Views document (PV) on Accounting for Social Insurance, Revised. The FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members have also been encouraged to comment separately.

We congratulate the FASAB for taking a giant step towards more transparent reporting relating to the accounting and reporting for these programs, although we think that more needs to be done before actual guidance is issued.

The FASAB has created a Fiscal Sustainability Task Force that is expected to have developed recommendations on sustainability reporting by the end of 2007. The nature of those recommendations is unknown at this point, but the recommendations have the potential to directly impact the responses to this PV. Obviously, there is a missing piece in the federal government reporting picture. Governments in general often make promises to their constituents about services to be provided without determining or without communicating to the public how long those services can be sustained using existing tax structures.

Democratically elected governments have a tendency to commit to social programs without fully calculating, considering and therefore disclosing the costs of those programs. Governmental accrual accounting should provide the processes, procedures and reporting formats to calculate and disclose the estimated costs of policy obligations in an objective manner. This will allow elected officials, and the general public, to duly consider policy costs, and vote accordingly. It is important that neither current costs (deficit spending), policy obligations, nor capital costs are passed on to future generations without understanding their impact.

It appears the Fiscal Sustainability Task Force is a much needed step forward in addressing the federal government's unique obligations which may not currently qualify as traditional liabilities for financial reporting purposes. Although not currently included, these obligations need to be considered for policy decisions and to assess the overall financial position of the government.

One member elaborated on the point thus, “Facts regarding the nation’s current financial condition and long-term fiscal outlook are being disseminated to more and more individuals through the Fiscal Wake-Up Tour and other methods. This increased public awareness is causing citizens to be unsettled and fearful of the future, and they recognize that the financial statements must not be providing the information needed for decision-making at the federal level. As such, there may be a tendency for many of us to reply in a manner that supports whichever option puts the most liability down on the books in order to help our citizens and our lawmakers wake up to the problems in the future.” In this case, that would be the primary view. This emotional decision may be made regardless of the merits of the well developed arguments of the alternative view.

So we would suggest that the Board table this PV and the responses received until the Fiscal Sustainability Task Force can show us what the future of sustainability reporting will be, how much significance and relevance a sustainability report would have in relation to the other financial statements, and what other federal promises and obligations would be included in such a report. In the meantime, the Board will probably get very divergent views on how social insurance should be handled.

Once the Fiscal Sustainability Task Force recommendations are available, we think it will be much easier for responders to make an objective decision regarding the issues currently addressed in the PV. The FMSB wishes to wait until then to comment on any proposed guidance which is issued as a result of the task force’s recommendations.

Finally, we note that, of the five programs subject to the proposed standard, FASAB has “pension-type” programs (Social Security and Railroad Retirement) and “insurance-type” programs (Medicare, Unemployment Insurance and Black Lung). We believe the pension-type funds should follow accounting similar to pensions outside of the federal government and the insurance-type funds should follow accounting similar to insurance organizations outside of the federal government.

The FMSB appreciates the opportunity to comment on the exposure draft. The majority of members approved the issuance of this letter. We would be pleased to discuss the issues in this letter with you at your convenience. Please contact Anna D. Gowans Miller, CPA, AGA’s Director of Research and facilitator for this project, at [amiller@agacgfm.org](mailto:amiller@agacgfm.org) or (703) 684-6931, ext. 313.

Sincerely,



Robert L. Childree, Acting Chair,  
AGA Financial Management Standards Board

cc: Jeffrey S. Hart, CGFM, CFE  
AGA National President

**Association of Government Accountants  
Financial Management Standards Board**

**July 2006 – June 2007**

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Anna D. Gowans Miller, Technical Manager, AGA, Staff Liaison

**GAO**

Accountability \* Integrity \* Reliability

**Comptroller General  
of the United States****United States Government Accountability Office  
Washington, DC 20548**

May 7, 2007

Ms. Wendy M. Comes, Executive Director  
Federal Accounting Standards Advisory Board  
Mailstop 6K17V  
441 G Street, NW  
Washington, DC 20548

*Wendy*  
Dear Ms. Comes:

The U.S. Government Accountability Office (GAO) is pleased to provide its comments on the Federal Accounting Standards Advisory Board (FASAB) Preliminary Views document entitled Accounting for Social Insurance, Revised.

We have strongly supported efforts to improve the transparency of social insurance programs, including the FASAB's addition of the Statement of Social Insurance as an audited basic financial statement. We believe the FASAB's current deliberations on the presentation of social insurance programs represent an important step in recognizing the need for greater transparency in connection with the federal government's current financial condition and future fiscal path.

We strongly support the need to refine the federal government's current reporting model to fully achieve the stewardship financial reporting objective and to provide greater transparency and more useful information to the readers of the financial statements. At the same time, we strongly believe that the alternative view is, by far, the best means of fully and effectively communicating important information to readers about the long-term financial condition of social insurance and other federal government programs. More specifically, we support the presentation of a Statement of Fiscal Sustainability and annual changes therein and recognition of deferred revenue (an additional liability) for the amount of the trust fund balances. The Alternative View provides full accountability and disclosure to the American public of the fiscal condition of the social insurance programs and of the complex interrelationship of these programs with the overall fiscal condition of the federal government. We do not believe that the Primary View achieves similar results. In fact, we believe it is inappropriate and would result in certain inconsistencies and expectation gaps in connection with public reporting of our nation's social insurance programs.

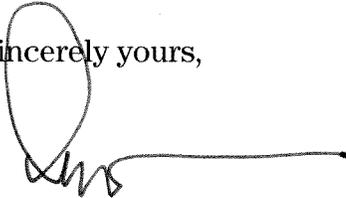
To build public awareness of our Social Security, Medicare, and other long-term fiscal challenges and the hard decisions that must be made, I have engaged in a number of

actions, including participating in public presentations and town hall forums in over 20 states to discuss the federal government's current financial condition and deteriorating long-term fiscal outlook, including the challenges posed by our nation's current social insurance commitments. These forums, popularly referred to as the "Fiscal Wake-up Tour," are led by the Concord Coalition and also include the Heritage Foundation, the Brookings Institution, and a range of other "good government" groups.

The Fiscal Wake-up Tour is designed to state the facts and speak the truth in order to increase public awareness and accelerate actions by appropriate federal, state, and local officials. Based on my first hand experiences, including extensive interaction with town hall participants and conversations with a number of my colleagues worldwide, the best and most effective way to communicate our current obligations and future commitments in the financial statements would be the one outlined in the Alternative View. Furthermore, the position outlined in the Alternative View is more consistent with the current international practice than the primary view.

Our comments, which are detailed in the enclosure to this letter, provide our responses to the questions put forth in the Preliminary Views document. If you have any questions on our comments, we are available for further discussions. Please call me at (202) 512-5500 or Robert Dacey, Chief Accountant at (202) 512-7439.

Sincerely yours,

A handwritten signature in black ink, consisting of a large, stylized 'D' followed by a horizontal line that ends in a small flourish.

David M. Walker  
Comptroller General  
of the United States

Enclosure

**GAO Responses to Questions Set Forth in the Accounting for Social Insurance, Revised Preliminary Views Document**

Introduction

We agree with the Board on the financial reporting objectives that are intended to be achieved by the revisions to social insurance reporting. Specifically, as stated in Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, “federal financial reporting should provide information that helps the reader to determine whether:

- The government’s financial position improved or deteriorated over the period, [and]
- Future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due...”

Therefore, any revisions to social insurance reporting should be designed to achieve these objectives.

**Question 1:**

**Which obligating event do you believe creates a liability and expense that should be recognized? Please provide the rationale for your answer.**

**Response:**

We strongly agree with the Alternative View. The obligating event for liability recognition for social insurance benefits should continue to be considered the point when an individual meets all eligibility requirements for benefits and the benefit payments become “due and payable.” There should be no change to the current liability and expense recognition standards for social insurance benefits, as discussed in Statement of Federal Financial Accounting Standard (SFFAS) No. 17, Accounting for Social Insurance.

In summary, as stated in the Alternative View,

- Social insurance benefits beyond the due and payable amount are not present obligations of the federal government;
- Recognition of such future social insurance benefits as current expenses and liabilities would result in a substantial mismatch of net costs for nonexchange programs in the current year and the services provided in that year – disrupting an alignment that allows programs to match costs with results;
- Recognition of future social insurance benefits on the financial statements would diminish significantly the relative size and importance of other expenses and liabilities shown on the financial statements. As a result the financial statements would contain misleading information about the Government’s true financial position and would inappropriately shift the focus away from other expenses and liabilities that are managed by federal agencies; and

- Given the ability of the federal government to change the laws relating to social insurance programs and the certainty of its doing so given the unsustainability of current benefit payments with current financing, about which beneficiaries are on notice, amounts of benefit payments that will be made are uncertain and not reliably estimable.

First, social insurance and other nonexchange transactions are unique to the government. They are fundamentally different from exchange transactions and should continue to be accounted for differently. The compulsory payment of social insurance taxes by an individual and the subsequent receipt of social insurance benefits by that same individual constitute separate nonexchange transactions. For example, the compulsory payment of social insurance taxes does not entitle an individual to a benefit in a legal, contractual sense and benefits paid to an individual are not directly based upon taxes paid or employment services rendered. For nonexchange transactions like social insurance benefits, in general, the federal government has a legal liability only for benefits that are “due and payable”. Other non-exchange benefits, such as Medicaid and food stamps, are currently recognized only on a “due and payable” basis. Social benefits (non-exchange transactions) differ from employer provided benefit plans (exchange transactions) in that they do not represent an exchange of current service for deferred compensation and the benefits do not vest. Specifically, under social insurance programs, the individual does not exchange his or her labor for a benefit from their employer, the recipient of his or her labor; rather, collectively the citizenry pays benefits to those who have worked before.

Second, SFFAC No. 1 established the principle that, since the federal government had little earned revenue and no profit motive, but had instead the goal of providing services that are collectively chosen to improve the well-being of citizens, government costs should be matched year-by-year with the delivery of such services. Thus, cost could be matched with program delivery, and analyzed in relation to outputs, outcomes, and other relevant performance measures. These measures would improve resource allocation and program management, improving the effectiveness and efficiency with which services are delivered and permitting accountability to citizens for service delivery. This principle has been successfully applied in the development of FASAB standards over the past fifteen years. The Alternative View would continue to record costs only for services provided during that year for social insurance and other federal programs. In contrast, the Primary View would record a cost in the current year for services (e.g., benefits) that are not provided for many years.

Third, under the Primary View, the projected social insurance liability and expense amounts would be very large and overwhelming in relation to other recognized liabilities. In addition, the balance sheet and the statement of net cost could fluctuate year to year by large amounts, potentially in the trillions of dollars, due to the uncertain nature of projected social insurance estimates. As such, adoption of the Primary View of adding significant liabilities to the balance sheet and significant expenses to the statement of net cost will diminish the usefulness of financial statements in improving financial management and will undermine the credibility and value of the balance sheet and the statement of net cost.

Finally, there is general agreement that the Social Security and Medicare programs, as currently structured, are unsustainable and that social insurance reforms are a certainty. However, it is not possible to predict what specific actions the Congress will undertake to modify or change future benefits. The inherent uncertainty surrounding agreement and settlement for amounts projected for social insurance benefits, outside of what is currently “due and payable,” does not lend itself to recognizing a liability and expense as proposed by the Primary View. There is a history of Congressional benefit adjustments that affect not only future beneficiaries, but current beneficiaries as well. The “Your Social Security Statement” periodically sent to individuals states that “Your estimated benefits are based on current law. Congress has made changes to the law in the past and can do so at anytime. The law covering benefit amounts may change because, by 2040, the payroll taxes collected will be enough to pay only about 74 percent of scheduled benefits.” These statements highlight the fact that Social Security (as currently structured) cannot be sustained and that the Congress can and has changed the rules regarding eligibility for social insurance benefits, at any time, and will undoubtedly do so in the future.

In summary, the Alternative View best defines the obligating event in that a liability and expense is created when an individual meets all eligibility requirements and benefits become “due and payable.”

**Question 2:**

**Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary View? Please provide the rationale for your answer.**

**Response:**

No. As noted above, we do not believe that an additional liability beyond “due and payable” for social insurance benefits exists (see response to question 5 re: liability for deferred revenue). As stated in response to question 1, there is general agreement that Social Security and Medicare, as currently structured, are unsustainable and that social insurance reforms can be expected. The unsustainable nature of these programs and the certainty of modification to these programs, as evidenced by past Congressional reforms, highlight the fact that estimates of this nature are inherently uncertain to measure with confidence, may not be reliable, and therefore could affect the integrity of the financial statements.

**Question 3.1:**

**Do you believe that the Primary View proposal to add lines to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?**

**Response:**

No. Consistent with our position that the liability for social insurance benefits should be those that are “due and payable,” we do not believe that any change is necessary to the current format of the Statement of Social Insurance.

The SOSI, as currently illustrated in SFFAS No. 17, Accounting for Social Insurance, is approximately two pages. The format of presentation as proposed by the Primary View results in a longer and more complex SOSI and will not easily be understood by readers of the financial statements.

The SOSI, which became an audited, basic financial statement in fiscal year 2006, and related disclosures provide important information about earmarked revenues and scheduled benefits related to the social insurance programs. The sustainability information in the SOSI is based on long-term cash flow projections that assume that the program will continue as currently structured. As the programs will undoubtedly be changed due to their unsustainability, the SOSI does not purport to present what is actually expected to occur. In that respect, it clearly serves a different role than the balance sheet. Therefore, tying the SOSI to the balance sheet is unnecessary and not relevant.

**Question 3.2:**

**Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported, and, if so, do you favor such reporting (1) as proposed by the Primary View, (2) as proposed by the Alternative View, or (3) some other approach? Please provide the rationale for your answers.**

**Response:**

We believe that the reasons for changes in SOSI amounts during the reporting period should be reported and support the Alternative View of presenting changes in social insurance that will (1) reconcile beginning and ending net present values reported in the SOSI for social insurance programs, and (2) provide the significant reasons for changes in the net present value during the reporting period. This information can be presented in either a new, complementary Statement of Changes in Social Insurance or incorporated into the existing Statement of Social Insurance.

The presentation of changes in social insurance, as proposed by the Alternative View, will present the full extent of changes in the net present value of projected revenues and scheduled benefits and identify and analyze those changes. This information will highlight the reasons for any improvement or deterioration in the financial condition

of these programs and will provide useful information to the reader. We believe it is important for the reader to take note of the relative changes in the SOSI in order to draw comparisons with prior year results and obtain a better understanding of the factors affecting social insurance projections.

**Question 4:**

**Do you believe the proposal to create a governmentwide Statement of Fiscal Sustainability should be adopted? Please provide the rationale for your answer.**

**Response:**

Yes. We are in strong agreement with the Alternative View that a Statement of Fiscal Sustainability should be presented that would include future revenue and expense for all federal government programs. Such a statement will clearly communicate important information to readers about the long-term financial condition of the federal government, including the long-term sustainability of federal programs, inter-generational equity issues, projected annual cash flows, sensitivity of assumptions, and changes in fiscal sustainability during the year. This statement will also provide greater transparency of federal programs and a more comprehensive view of the nation's overall fiscal outlook to the readers. Further, we are in agreement with the Alternative View that an appropriate understanding of the sustainability of social insurance requires a consideration of not only the social insurance programs, but also of the government as a whole. For example, the Statement of Fiscal Sustainability will highlight the extent to which Medicare Supplementary Medical Insurance (about 75% of which is funded through general revenues) competes with other federal programs for scarce general revenue dollars.

The term "financial condition," as used in the financial reporting objectives, is broader than the "financial position" included in the balance sheet. The Statement of Fiscal Sustainability, most appropriately addresses financial condition, recognizes a broad range of future outcomes, and discloses the impact of multiple scenarios, most of which lack the degree of certainty consistent with other amounts used to describe financial position. The Statement of Fiscal Sustainability provides a clear and comprehensive analysis of the extent to which future budgetary resources would be sufficient to sustain public services and meet obligations as they become due. Also, presentation of changes in fiscal sustainability during the year provides a clear and comprehensive measure of the extent to which the federal government's financial condition improved or deteriorated during the year.

We support the Board's new project to develop fiscal sustainability reporting and strongly believe that it should be prioritized over any further work on social insurance reporting.

**Question 5:**

**Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs? Please provide the rationale for your answer.**

**Response:**

Yes. Earmarked revenues received in excess of benefits incurred (which are invested in special U.S. Treasury securities) should be recorded as deferred revenue. In our view, excess earmarked revenues should not be recorded as revenue in the current period because they are held for designated purposes and should not offset non-earmarked costs in determining net operating cost. The social insurance benefit expense should be recorded in the period in which services are provided and such earmarked revenues should be recognized in the period in which they are used. We believe the approach presented by the Alternative View for earmarked revenues will best capture the true financial picture associated with these revenues.

In addition, the creation and the structure of “trust funds” in the United States is unique, which highlights the need for different approaches to properly reflect their economic substance. In our view, the best way to do this is to record a liability for deferred revenues.

**Question 6.1:**

**Please offer any comments that you wish to make on the Primary View provisions.**

The goal of the deliberations surrounding social insurance programs is to provide greater transparency of the financial condition of the federal government to the readers of the financial statements. In this regard, we do not believe the Primary View would provide the level of transparency or completeness that will be of the most benefit to the readers of the financial statements.

Further, the Primary View does not fully address the financial reporting objectives discussed in SFFAC No. 1. The Primary View does not communicate the full extent to which the government’s financial position improved or deteriorated over the period, and it does not provide sufficient information to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. Also, we do not believe that the creation and recognition of a long-term liability, as defined in the Primary View, reflects the true nature of social insurance programs, the extent of the federal government’s responsibilities for these and other programs, and the federal government’s ability to revise these responsibilities.

We also note the following specific concerns about the proposals in the Primary View:

- The creation and recognition of a long-term liability, without recognizing the earmarked and other tax revenue to be collected over the projection period to fund the liability will create confusion on the part of the readers of the financial statements as to whether future resources are likely to be sufficient to sustain federal programs and if the federal government's financial condition has improved or deteriorated over the past year. Also, it could lead to misinterpretation of the financial condition of those programs by the reader as well as impair the credibility of the financial statements.
- The Primary View does not provide an understanding of the interaction of all future revenues and expenditures for social insurance and other federal programs to the readers of the financial statements. Therefore, the readers are unable to obtain a true understanding of the financial condition and long-term sustainability of social insurance and other federal programs.
- Recognition of inherently uncertain liabilities could affect the integrity of the financial statements, thereby, leading to further confusion on the part of the readers as to the sustainability of federal programs and the actual condition of the federal government.
- Recording a liability after 40 quarters or equivalent of work in covered employment does not take into consideration the differing requirements of eligibility for social insurance benefits. For example, minimum work experience is not required to receive Medicare benefits. All U.S. citizens, at birth, and qualified resident aliens are entitled to participate in the Medicare program at age 65, whether or not they have worked 40 quarters.
- Payment of Social Security and Medicare—Part A benefits are limited to the earmarked revenues held in the respective trust funds (unlike Medicare—SMI trust funds that receive automatic general fund transfers). Therefore, recognizing a liability in excess of trust fund balances for Social Security and Medicare—Part A benefits does not reflect the legal or economic reality of the programs. Recording deferred revenue would recognize this reality.
- Participation in the Medicare—SMI (Parts B and D) is voluntary and dependent on the payment of monthly premiums by participants

**Question 6.2:**

**Please offer any comments that you wish to make on the Alternative View provisions.**

The Alternative View, by far, provides the level of transparency that will be of the most benefit to the readers of the financial statements. The Alternative View best achieves the financial reporting objectives as presented in SFFAC No. 1 and meets the unique reporting requirements of the federal government. The Alternative View measures the government's long-term financial condition and improvement or deterioration in such financial condition during the year. Further, the Alternative View measures the ability of the federal government to meet long-term obligations as they become due.

The Alternative View will clearly communicate important information to readers about the long-term financial condition of the federal government, including the long-term sustainability of federal government programs, inter-generational equity issues, and the annual changes therein. The Alternative View will also provide greater transparency of federal government programs, including social insurance programs, and a more comprehensive view of the nation's overall fiscal outlook to the readers.

Further, the Alternative View would provide several key measures of the federal government's financial condition and changes therein:

- End of year measures (balance sheet, statement of social insurance, statement of fiscal sustainability)
- Annual measures (budget (cash) results, accrual results, changes in social insurance, changes in fiscal sustainability)

In addition, the Alternative View is more consistent with current state and direction of international practice. Based on research and conversations with colleagues worldwide, we are not aware of any country that records a long-term liability for social insurance programs such as that proposed by the Primary View. Also, at its last meeting, the International Public Sector Accounting Standards Board (IPSASB) reaffirmed that its exposure draft on social benefits will deal only with disclosure requirements for cash transfer programs and will not address recognition of a liability for social benefits. Further, as noted in the Alternative View, the Governmental Accounting Standards Board Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions, par. 2, states that* "providers [of nonexchange benefits] should recognize liabilities (or a decrease in assets) and expenses from government-mandated or voluntary nonexchange transactions, and recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all eligibility requirements, including time requirements, are met.

Rather, there is increasing interest in the international community on fiscal sustainability reporting as a vehicle for reporting on a government's financial condition. For example, the United Kingdom and the EU annually report on fiscal sustainability and other countries have or are planning to report on fiscal sustainability. Also, at its last meeting, the IPSASB placed a high priority on and plans to initiate a project on long-term fiscal sustainability reporting in 2007. As noted above, we are in strong agreement with the Alternative View that a Statement of Fiscal Sustainability should be presented and support the Board's new project to develop fiscal sustainability reporting.

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# United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

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April 20, 2007

Wendy M. Comes, Executive Director  
 Federal Accounting Standards Advisory Board  
 Mailstop 6K17V  
 441 G Street, NW, Suite 6814  
 Washington, DC 20548

Dear Ms. Comes:

This letter responds to the request for public comments on the proposed Statement of Federal Financial Accounting Standards, "Accounting for Social Insurance, Revised."

The unique characteristics of the two largest social insurance programs, Social Security and Medicare, preclude the recognition of a liability beyond the amount due and payable.

These unique characteristics include the fact that current law expressly reserves the right to alter, amend, or repeal any provision of these programs.<sup>1</sup> While such action may be politically untenable, the U.S. Supreme Court has upheld the right to reduce or eliminate benefits, even for those already receiving them.<sup>2</sup> Moreover, the legal authority to pay benefits is limited by the balance of government securities held by the respective trust funds.<sup>3</sup> Should these balances become exhausted, benefits could no longer be paid in full or on time.<sup>4</sup>

The current due and payable standard is consistent with the definition and characteristics of a liability contained in the Financial Accounting Standards Board's Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, December 1985—

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

<sup>1</sup> 42 U.S.C. § 1304

<sup>2</sup> *Flemming v. Nestor*, 363 U.S. 603 (1960) and *Richardson v. Belcher*, 404 U.S. 78 (1971)

<sup>3</sup> 42 U.S.C. § 401(h) and § 1395(h)

<sup>4</sup> 31 U.S.C. § 1341

Application of the current standard under current law supports the following conclusion. The government has an obligation (“present duty”) to pay benefits to qualified individuals (“other entities”) following a determination of eligibility (“specified event [that] has already happened”). Once all of the eligibility conditions have been met, individuals are entitled to receive benefits (“no discretion to avoid”) as long as they remain qualified.<sup>5</sup>

Benefits beyond the current period of entitlement depend on continuing eligibility and are subject to statutory change. Thus, only those benefits that are due and payable – essentially one month of Social Security benefits and any outstanding payments to Medicare providers for services previously rendered – are fully consistent with all of the characteristics of a liability as enumerated above.

Rather than accept the fact that social insurance programs do not fit the current definition of a liability, those who hold the Primary View appear to believe the preferred course of action is to change the definition. Indeed, FASAB is currently engaged in a related project that could result in an entirely new and expanded definition of a liability sufficient to encompass social insurance programs.<sup>6</sup> While the authority to take such action is clearly within the discretion of the Board, such action would lack credibility. It is disingenuous to claim that a liability exists on the basis of a definition that was changed solely for the purpose of making such claim.<sup>7</sup>

Moreover, those who hold the Primary View insist “the existence of an obligation is determined by the provisions of current law...future events – including potential changes in law – do not trigger or prevent expense and liability recognition.”<sup>8</sup> But, they conveniently ignore the provision of current law that precludes the payment of benefits beyond the balance of government securities held by the respective trust funds.<sup>9</sup> Thus, even if one accepts the proposed definition of a liability, the proposed measurement of the liability is flawed because it does not reflect current law.

Under current law, future Social Security and Medicare Part A benefit payments cannot exceed the sum of payroll taxes, income taxes on Social Security benefits, voluntary Part A premiums, and interest credited to the respective trust funds.

Providing the public with useful information about our nation’s financial condition is an important goal. However, government activities do not readily conform to private sector accounting concepts. Instead of redefining these concepts in order to force social

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<sup>5</sup> *Goldberg v. Kelly*, 397 U.S. 254 (1970) “Welfare benefits are a matter of statutory entitlement for persons qualified to receive them and procedural due process is applicable to their termination.”

<sup>6</sup> Federal Accounting Standards Advisory Board, Exposure Draft: Definition and Recognition of Elements of Accrual-Basis Financial Statements, June 7, 2006

<sup>7</sup> Federal Accounting Standards Advisory Board, Accounting for Social Insurance, Revised, Preliminary Views, October 26, 2003, Appendix A, pp. 56-57.

<sup>8</sup> *Ibid.*

<sup>9</sup> See Footnotes 3 and 4 above.

insurance programs into existing balance sheet categories and misleading the public; FASAB should focus its efforts on revising and expanding the statement of social insurance.

The current statement of social insurance shows the present value of Social Security and Medicare cash-flows that are projected to occur over the next 75-years under the Trustees' intermediate assumptions.<sup>10</sup> These numbers are deficient in several respects.

Summarized numbers, in discounted dollars over a 75-year period, do not accurately convey the cost of future benefits in a readily understandable manner. Historically, social insurance programs have been financed through payroll taxes on a pay-as-you-go basis. Thus, the projected cost of future benefits should be shown as a percentage of taxable earnings.<sup>11</sup> These figures would clearly illustrate the rising cost of benefits relative to the resources available to pay for them.

Second, social insurance programs have never been fully funded, but some of them could be. Thus, the projected cost of future benefits should also be shown on a "forward funded" basis. This measure would reflect a blend between the infinite horizon and sustainable solvency.

As presented in the 2006 annual trustees report, the present value of Social Security benefits minus Social Security taxes over the infinite horizon is 4.1 percent of taxable payroll.<sup>12</sup> In other words, to forward fund the projected cost of future benefits, current and future workers would need to pay an additional 4.1 percent of taxable wages each and every year, forever. Admittedly, some people find the concept of eternity unsettling.

The concept of sustainable solvency, developed by the Social Security actuaries in the mid-1990s to evaluate reform proposals, seeks to address the problem that 75-year solvency is unsustainable because the 75-year projection period moves forward each year dropping a surplus year and adding a deficit year. Thus, the goal of sustainable solvency is to achieve a trust fund ratio that is level or rising in the 75<sup>th</sup> year.<sup>13</sup>

The concept of forward funding proposed here differs from the infinite horizon because it does not include changes in economic and demographic assumptions beyond the 75<sup>th</sup> year. It differs from sustainable solvency because it does not include the beginning trust

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<sup>10</sup> These projections are based on scheduled benefits and do not reflect the impact of trust fund exhaustion on the legal authority to pay future benefits.

<sup>11</sup> Taxable earnings are the best metric for comparison to current law. A broader measure, such as GDP, should be used when analyzing proposals that change the taxable wage base. However, GDP is not the ideal metric because it includes many items that are non-taxable, such as non-profit institutions and the imputed rent on owner-occupied housing. Other metrics should be considered, such as total labor compensation.

<sup>12</sup> The 2006 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, May 1, 2006, page 60, Table IV.B7. The 4.1 percent figure excludes the beginning trust fund balance.

<sup>13</sup> The trust fund ratio is defined as the trust fund assets at the beginning of a year divided by the cost of benefits in that year.

fund balance, but it does specify an ending investment fund balance. These differences are designed to address the concern that the far distance future is unknowable and that the trust fund is not a real asset from a unified budget perspective.<sup>14</sup>

The concept of forward funding would reflect the sum of the current 75-year present value projection plus the present value of the 75<sup>th</sup> year divided by the assumed ultimate interest rate. The results of this calculation, as shown in the table below, would indicate that current and future workers would need to contribute an additional 2.95 percent of taxable wages each year in order to build and maintain an investment fund that would generate sufficient earnings to cover the remaining cash-flow shortfall in the 75<sup>th</sup> year.<sup>15</sup>

#### Illustrative Calculation for Forward Funding Social Security

	PV in Trillions of Dollars	Income	Cost	Taxable Payroll
1	2006-2080	\$31.9	\$38.3	\$243.2
2	2080	\$0.2	\$0.3	\$1.8
3	Ultimate Interest Rate	5.8%	5.8%	5.8%
4	Line 2 divided by Line 3	\$4.1	\$5.8	\$30.9
5	Forward Funding (1+4)	\$36.0	\$44.1	\$274.1

Unlike Social Security, which is relatively "well behaved" from an actuarial perspective, Medicare is exceedingly problematic. Historically, per capita Medicare costs have risen significantly faster than per capita Gross Domestic Product (GDP). If this trend were to continue, Medicare would eventually exceed GDP. To avoid showing this result, the Medicare trustees arbitrarily assume Medicare growth will subside. There is no basis for this assumption other than Herb Stein's axiom, "If something can't go on forever, it will probably stop." The future cost of Medicare is unknown and therefore not measurable, which is yet another reason to reject the Primary View.<sup>16</sup>

However, for the purpose of a revised and expanded social insurance statement, it would be highly instructive to present two estimates. The first estimate would assume historical trends. The second would assume per capita Medicare growth equal to per capita GDP growth. These estimates would isolate the effects of excess medical cost growth from other economic and demographic assumptions. These estimates should be presented in the same manner as the Social Security estimates described above.

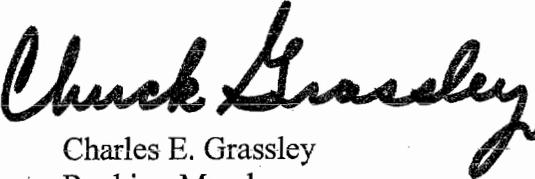
<sup>14</sup> The beginning trust fund balance could be viewed as an asset of the Social Security program in the narrow legal sense that it provides the authority to pay benefits. But, it could also be viewed as a liability of the government in the broader economic sense that it is a claim on future resource. These two views cancel each other out in a unified federal budget.

<sup>15</sup> These calculations are based on Tables VI.F6 and VI.F9 of the 2006 Social Security trustees report.  $(\$44.1 - \$36.0) / \$274.1 = 2.95\%$

<sup>16</sup> Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, December 1985, paragraph 47 "Particular items that qualify as assets or liabilities under the definitions may need to be excluded from formal incorporation in financial statements for reasons relating to measurement, uncertainty, or unreliability,..." [emphasis added]

The primary goal of a revised and expanded social insurance statement should be to identify the potential cost of future benefits, as well as the potential resources available to fund these costs. These costs and resources can only be accurately assessed within the context of the entire federal budget. FASAB has sensibly chosen to appoint a Fiscal Sustainability Task Force to consider these issues. Any changes to the social insurance statement should await the results of this task force. In the meantime, the Board should reject any effort to redefine social insurance programs as a liability beyond the amount due and payable.

Sincerely,

A handwritten signature in black ink that reads "Chuck Grassley". The signature is written in a cursive, slightly slanted style.

Charles E. Grassley  
Ranking Member

## Steve Goss - Summary

Comments on “Accounting for Social Insurance, Revised Statement of  
Federal Financial Accounting Standards Preliminary Views”  
Presented by Steve Goss, Chief Actuary, Social Security Administration  
May 23, 2007

The Office of the Chief Actuary at the Social Security Administration has worked with the FASAB closely for many years through the development of the Required Supplementary Stewardship Information and its evolution into the Statement of Social Insurance. I'd like to thank the Board for the opportunity to comment on the preliminary views document.

**LIABILITY**---The Alternative View supports the long standing view of FASAB that a Social Insurance liability can only be recognized when a benefit becomes due and payable.. The Primary View makes no compelling case for changing that approach.

The Primary View would recognize a liability when a worker first attains “fully insured status” under the program. While insured status is one necessary condition for benefit receipt, it is in no way sufficient to qualify as an obligating event for liability recognition.

An overriding uncertainty exists under the Social Security (and all Federal Social Insurance) programs. This is the Government’s right and ability to alter potential future benefits. Until benefits become due and payable, there is no binding commitment over which a worker has control and so no liability can be recognized.

In the recent concepts paper on elements of accrual accounting, the FASAB well established that an asset cannot exist without the holder of the asset having exclusive control. Similarly, for there to be a liability the entity with the liability cannot have the ability to single handedly alter the liability. Because the Federal Government retains the right to alter benefits up to the time they are due, there can be no liability until benefits become both due and payable.

Deeming potential future benefits as liabilities would fail to be consistent with the actual funding mechanism of the Social Insurance programs. Future benefits can be paid on a current cost (pay as you go) basis only if future tax collections are made at the same time. Thus, such future taxes would have to be deemed as current assets if future benefits were to be deemed as current liabilities. Both possibilities make no real practical sense and neither qualifies for the designation. Thus, this information should not be added to SOSI or the balance sheet.

Other concepts required for liability recognition, such as the need for an exchange transaction to create an obligating event, simply do not exist based on the crediting of earnings or payment of taxes while working. Benefits are not directly related to or committed upon the receipt of earnings or the payment of taxes. Again, as FASAB ruled appropriately in SFFAS 17 and has upheld since, a liability can only be recognized when a benefit is due and payable.

**STATEMENT OF CHANGES**---We agree with the Alternative View that inclusion of a Statement of Changes in Social Insurance as supplementary information would be desirable, but only in the case of Social Security if it is consistent with the statement in the Trustees Report. But we also recommend including the amount of trust fund reserves available at the valuation date in the Statement of Social Insurance for agency and government-wide statements. While Trust Fund assets do net out on the unified budget, they are very important in the narrower context of Social Security solvency. Here the fund assets have real value and will allow benefits to be paid well after exhaustion of the TF. Reflecting the starting Trust Fund assets for OASDI would help clarify the true actuarial status of the program.

**SUSTAINABILITY**---We agree with the alternative view that a **Statement of Fiscal Sustainability** would be a useful and informative addition to the consolidated Financial Report for the entire Federal Government. But such a statement should be developed only if it can fairly and appropriately represent the prospects for all Federal programs.

Some attempts to develop this kind of analysis are based on the assumption that discretionary (non-entitlement) Federal spending will automatically and certainly be balanced against revenue, and thus will not provide any potential for long term shortfalls or surpluses. This is inappropriate. If this statement is to be created and is not to be misleading, it must reflect a reasonable extrapolation of actual current action. For the discretionary portion of the budget, current tax rates and policy should be the basis for reasonable extrapolations of current policy, spending levels, and trends.

For sustainability, the elements of *timing and trend* are critical. The clearly appropriate measure that would allow comparison across all Federal programs is the ratio of projected annual program cost to annual gross domestic product (GDP). Expressed in these terms, the various program costs could be compared or combined in a form that readily relates to the fundamental potential tax base for all Federal programs, the GDP. The level and trend of such annual ratios would provide a clear picture of the expected draw on the economy to fulfill the intended spending. Expressing the future revenue levels and trends in a similar manner would complete the sustainability picture.

Aggregated present-value numbers for long periods of time, like 75 years, or even longer, are not appropriate for assessing sustainability. In any context, such summarized numbers should not be expressed as ratios to the numbers of just current workers or current households. The financial shortfall over the next 75 years cannot possibly be borne by only today's workers or households. Eliminating these shortfalls will require changes in scheduled benefits and taxes that will affect most if not all current and future workers and beneficiaries throughout the next 75 years. Thus, such ratios should be presented for long periods only relative to the total number of workers, households, earnings, or GDP that are expected during the period as a whole. Aggregated shortfalls over many years can only be meaningfully compared to aggregated resources over the same period.

Written Comments on  
“Accounting for Social Insurance, Revised  
Statement of Federal Financial Accounting Standards  
Preliminary Views”  
From Steve Goss, Chief Actuary, Social Security Administration  
April 13, 2007

I, along with Alice Wade, Al Winters, and others in the Office of the Chief Actuary at the Social Security Administration, have worked with the FASAB closely for many years through the development of the Required Supplementary Stewardship Information and its evolution into the Statement of Social Insurance. Our role of working daily in analyzing program policies and legislation that would change these policies, along with developing assumptions, methods, and projections for the future experience of the programs has given us certain insight into the nature and workings of these programs. It is therefore our pleasure to share with the Board our comments on the preliminary views document that was released for comment on October 23, 2006.

In general, we believe the Alternative View represents a more appropriate position for accounting for Social Insurance than does the Primary View. The position of the Alternative View regarding the recognition of a liability is consistent with long standing views of FASAB and we believe that the Primary View makes no compelling case for changing that long held position.

The questions posed in the Preliminary Views document provide an excellent format in which to elaborate on our general comment, and to remark on certain very preliminary material set forth on the question of sustainability in the Alternative View. Our comments on these issues and answers to the specific questions are below.

1. *Which obligating event do you believe creates a liability and expense that should be recognized?*

We support the Alternative View which states that only liabilities and expenses under the Social Security program that are both due and payable should be recorded as a liability. We do not support the Primary View.

The Primary View suggests that a liability and expense should be recognized for a worker under the Social Security program when the worker first attains “fully insured status” under the program. While insured status is one necessary condition for benefit receipt, it is in no way sufficient to qualify as an obligating event for liability recognition.

Fully insured status as indicated in the Primary View can be achieved for those who are relatively young by having worked enough to earn only 6 quarters of coverage. Only when “permanently fully insured status” has been achieved, by having earned 40 quarters of coverage, is there any notion of an obligation for

retired worker benefits. Fully insured status may be met with less than permanently insured status at any time up to age 62. Thus, achieving fully insured status at any age below age 62 does not indicate that insured status will be met when other benefit eligibility criteria may be met in the future.

But even attaining the current requirement for permanently fully insured status (40 quarters of coverage) fails to provide an obligating event for a liability. In addition to the usual uncertainties related to survival to retirement age and subsequent work activities, an overriding uncertainty exists under the Social Security (and any Federal Social Insurance) program. That uncertainty is related to the fact that the Federal Government has the right and ability to alter or even eliminate the potential benefit that appears to have been earned. As one example, the requirement for permanently fully insured status could well be changed to something more than 40 quarters of coverage by the time the worker approached age 62. This might readily be the case if the earliest eligibility age for retirement benefits, age 62, were changed in the future. Thus, it is simply not possible under these programs to declare that there has been an obligating event for recognizing a liability for benefits for any month of eligibility until the worker is due benefits for that month. Prior to that time there is no binding commitment over which the worker has control and so no liability can be recognized. The Alternative View should be followed and the current recognition point for liability retained.

A technical, but critical issue is associated with the suggestion by the Primary View to establish a premature point of liability recognition. Insured status itself is considerably more complicated and potentially elusive than recognized in the Primary View. For example, insured status for disabled worker benefits under the Disability Insurance Program requires less than 40 quarters of coverage on a lifetime basis, generally, but also generally requires earning 20 quarters of coverage within the last 40 quarters of time. This means that even if 40 quarters of coverage are earned at some point, there is no assurance on this basis that the worker will then or in the future be insured for disability benefits.

The elusive and potential changeable status of insurability (both fully insured and disability insured statuses) leads to the prospect that the Primary View would recognize a liability at one point in time based on then current insured status, only to rescind the liability at a subsequent time when the individual has lost insured status. This situation would occur even under current law with no change, and simply adds to the case stated above for not recognizing liability based on insured status alone.

Much discussion has occurred within the public sessions of the FASAB on the topic of liability recognition in recent years. Many possibilities have been put forth including careful consideration of the definition of liability and asset, and consideration of even a constructive obligation. It has been clear that even the criteria for a constructive obligation are not met with social insurance benefits. In the recent concepts paper on elements of accrual accounting, it was well

established that an asset cannot exist without the holder of the asset having exclusive control. Similarly, for there to be a liability the entity with the liability cannot have the ability to single handedly alter the liability. Because the Federal Government retains the right to alter up to the time when a benefit is due, such benefit cannot be a liability until it is both due and payable.

Other concepts related to liability, such as the need for an exchange transaction to create an obligating event, simply do not exist based on the crediting of earnings or payment of taxes while working. Benefits are not directly related to or committed upon the receipt of earnings or the payment of taxes. Again, as FASAB has ruled in SFFAS 17 and has upheld since, a liability can only be recognized when a benefit is due and payable.

2. *Do you believe that Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary Views (see paragraphs 16-18 and especially subparagraph 16g in the standard; also see A54-S55 in basis for conclusions.*

Social Security and Medicare future obligations reflecting the intended (scheduled) benefits in current law are in principle measurable, and are in fact currently measured in a number of different forms. But these future obligations are not “*measurable for the purposes of recording a liability*” until they become due and payable on a month-by-month basis.

Attaining insured status at a point in time before actual benefit eligibility does not mean that the individual will still be insured subsequently when other criteria may be met. It is not possible to compute or assign any value to potential future benefits without great speculation on events that are not under the control of the worker, some of which are in fact under the control of the Federal Government. If it is not possible to say that an obligating event has occurred for purposes of recording a liability, then it is certainly not possible to measure any amount as a liability.

Paragraphs 16g and 16f in the Primary View state that for workers not yet disabled or at retirement eligibility age, a liability should be included for “... the future benefits attributed to past work in covered employment...” Because even insured status at a later time is not guaranteed based on insured status at the current time, no future benefits can yet be “attributed” to those or other earnings for purposes of recording a liability.

Thus, the very uncertainty that any insured status will persist into the future, along with multiple other uncertainties, make it inappropriate to measure potential future benefits for the purpose of recording a liability. Any attempt to measure a

potential benefit at the time of attaining any form of insured status would be so highly speculative and uncertain that it could not be considered to be a liability.

3. *The primary view proposes to change the SOSI by (1) adding line items tying to (or articulating with) the revised expense and liability amounts reported on the SNC and BS; and (2) adding a new section to the SOSI that would explain the changes in the SOSI amounts from the beginning to the end of the reporting period. (Paragraph 16 and Appendix B for illustration).*

*The Alternative View proposes to leave the SOSI unchanged but to add a new principle financial statement entitled "statement of changes in social insurance" which could be combined with the SOSI. The new statement would provide an explanation for changes to the present value amount included in the statement of social insurance.*

*3.1 Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?*

No, the Primary View proposal to add line items to the SOSI that tie revised expenses and liabilities amounts to the Balance Sheet and Statement of Net Cost should not be adopted. Recording Social Insurance obligations as liabilities on the balance sheet for future months of potential eligibility would not be an accurate depiction of the Federal Government's financial position. Since Social Insurance obligations do not meet the definition of a liability (until they are due and payable), showing these amounts on the balance sheet as liabilities would be misleading and inappropriate.

In particular, deeming very large amounts of potential future benefits as liabilities would fail to be consistent with the actual funding mechanism of the Social Insurance programs. Future benefits can be paid on a current cost (pay as you go) basis only if future tax collections are made at the same time. Thus, such future taxes would have to be deemed as current assets if future benefits were to be deemed as current liabilities. Both possibilities make no real practical sense and neither qualifies for the designation. Thus this information should not be added to SOSI or the balance sheet.

*3.2 Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported and, if so, do you favor such reporting (1) as proposed by the Primary View (2) as proposed by the alternative view or (3) some other approach?*

The Alternative View approach to illustrating changes in SOSI is vastly superior. One of the largest drawbacks of the present value dollar amounts shown in SOSI,

and elsewhere, is the fact that the amounts increase substantially from one report to the next solely because of the change in the valuation period. The Alternative View table of change would highlight on the first line the extent to which the SOSI balance changes just because of the change in valuation date. The other categories of change are logical, informative, and readily available as they coincide with values already computed and provided in the annual Trustees Reports for Social Security and Medicare. The presentations of change in these reports have been developed and refined for decades. The Alternative View wisely adopts this carefully thought out approach. This table would be a useful addition to the required supplementary information in the financial statements.

4. *The Alternative View proposes that a statement of fiscal sustainability be presented in the consolidated Financial Report of the United States Government. The statement would provide sustainability information on the entire Government, including information on intergenerational equity (See paragraphs 43 in the standard and A163 in the basis for conclusions for a discussion of the proposal and Appendix C for an illustration). Do you believe the proposal should be adopted?*

Yes, we agree that a Statement of Fiscal Sustainability would be a useful and informative addition to the consolidated Financial Report for the entire Federal Government. But such a statement should be developed only if it can fairly and appropriately represent the prospects for all Federal programs.

Some attempts to develop this kind of analysis are based on the assumption that discretionary (non-entitlement) Federal spending will automatically and certainly be balanced against revenue, and thus will not provide any potential for long term shortfalls or surpluses. This is inappropriate. If this statement is to be created and is not to be misleading, it must reflect a reasonable extrapolation of actual current action. For the discretionary portion of the budget, current tax rates and policy should be the basis for reasonable extrapolations of current policy, spending levels, and trends. Recent policy and spending reflect current intent at a political level, and this should be reflected for the future.

If projected future values for Social Security (for example) are to reflect scheduled benefit costs as opposed to reduced benefits that would be payable after the trust funds exhaust, then values reflecting “intent” will be shown. It should be made clear that these values are not expected to be payable under current law, while they do reflect the apparent *intent* of the Congress to pay benefits in the future. For Social Security, the expected funding gap reflects an extrapolation of current policy and if this is done for the entitlement programs, then it should be done similarly for all Federal programs.

The form of any statement of sustainability must be developed so that useful information can be presented in a way that will be clear and in no way misleading.

Here we differ with the table included in the Alternative View. Their proposed table would provide summarized present value amounts over long periods including the next 75 years and also the infinite future. In fact, such summarized numbers are inappropriate and inefficient for portraying sustainability. To portray sustainability, the elements of timing and trend are critical. To “sustain” something means that it must first be established, and then maintained. This cannot be demonstrated or ascertained in a summarized value for a lengthy period. In fact, a summarized value for a period can only indicate the cumulative financial status at the end point of the period, providing no information about the levels or trends within or beyond the period.

For this purpose, the concept of “sustainable solvency” was developed for analysis of Social Security financial status under reform proposals. To be deemed sustainably solvent, the program financing must be projected to be adequate to permit payment of all scheduled benefits throughout the next 75 years, with a ratio of trust fund reserves (or assets) to program annual cost that is stable or rising at the end of the 75-year period. The latter requirement is the essential element of sustainability and thus includes attention to both level and trend in the financial measure.

For “sustainability” as opposed to the narrower concept of “sustainable solvency”, a measure of the level of annual program cost and, just as important, the trend in that level is needed. A ready and compelling candidate that would allow comparison across all Federal programs is the ratio of projected annual program cost to annual gross domestic product (GDP). Expressed in these terms, the various program costs could be compared or combined in a form that readily relates to the fundamental potential tax (revenue) base for all Federal programs, the GDP itself. The level and trend of such annual ratios would provide a clear picture of the expected draw on the economy to fulfill the intended spending. Expressing the future revenue levels and trends in a similar manner would complete the sustainability picture.

What is not appropriate or even useful for an analysis of sustainability is an aggregate number over a long period of time, as in either the 75-year period or the infinite future. Such numbers, while useful for some purposes have no ready relevance to sustainability, and should not be used in this context.

Because such summarized values are easily misunderstood, great care must be used in their presentation in instances where they are relevant. The presentation in the Alternative View of present value summarized shortfalls over these periods expressed as ratios to the numbers of current workers or current households is inappropriate and misleading. The financial shortfalls over the next 75 years, and over the infinite future cannot possibly be borne by only today’s workers or households. Eliminating these shortfalls will occur through changes in scheduled benefits and taxes that will affect most if not all current and future workers and beneficiaries throughout the next 75 years and throughout the infinite future.

Thus, such ratios should be presented for long periods only relative to the number of workers or households expected to exist during the period as a whole. Aggregated shortfalls over many years can only be meaningfully compared to aggregated resources over the same period.

A final note relates to the glossary entry for “Fiscal Sustainability” in the Preliminary Views document. Here a definition of “sustainable solvency” (described above, as developed by the Office of the Chief Actuary and used for over a decade in reform proposals and in the Trustees Report) is mischaracterized and is attributed to the Government Accountability Office. The glossary says “being able to pay full benefits as they come due permanently.” This is really incorrect in two ways. First, care should be taken in characterizing solvency for the future as the projected or expected ability to pay full benefits, under a specific set of assumptions, on a timely basis. If the projection indicates that the best estimate for the future would be a solvent program with only a small reserve margin, then there would actually be almost a 50 percent chance that the program would not be solvent at any given future point in time. The second point is that under a projection that indicates sustainable solvency, there is no assurance of “permanent” solvency. The specification for sustainable solvency requires that the trend be stable or improving at the end of 75 years under best estimate assumptions. There is of course the possibility that experience may be worse than expected during the 75 years, and that the trend may not turn out to be as favorable at the end of 75 years.

5. *Do you believe the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?*

We believe that further research into the merits of recognizing deferred revenue for earmarked revenues in excess of benefit payments may be beneficial. However, we do believe that this should be done as a separate project.

6. *The Primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information (paragraphs 15-37 Primary view; 64-84 Alternative view). Please make any comments that you wish on both views.*

#### *6.1 Comments on the Primary View*

As stated above, reporting future Social Insurance benefits as liabilities on the balance sheet would be inappropriate and misleading. The nature of the programs’ benefit structures and financing mechanisms make a liability designation for future benefits inappropriate just as it would be inappropriate to characterize future potential tax collections as current assets. The membership and preferences of the Congress change over time, and so do the desires and

values of the American people. We cannot foresee what changes may be pursued over the next 75 years.

We strongly disagree with the Primary View position of adding line items to the Balance Sheet and Statement of Net Cost that would create a new and different liability calculation in financial statements. The balance sheet shows financial status at a certain point in time and shows what a government owes as a result of past operations. It should include only liabilities that are present obligations of the Government. The Statement of Net Cost should reflect the principle of matching costs of government operations during a particular year with services provided by the government during that year. Showing expenses for future scheduled benefits would not match this principle. In addition we disagree with the Primary View regarding the Statement of Change, and reject the statement put forth in the Primary View.

Finally, and most importantly, we highly recommend against the Primary View on inclusion of future benefits as liabilities. Such benefits are reflected when indicated as becoming due and payable. There is no basis for extending the concept of liability beyond the long-held view of due and payable benefits. The government retains the unique ability to alter these benefits and revenues on a single-handed basis. The benefits are non-transaction events, and there is no logical basis for establishing a liability recognition point before the benefits become due and payable.

#### *6.2 Comments on the Alternative View*

We agree with the approach for liability recognition in the Alternative View, which is to continue the long held practice of recognizing Social Insurance benefits for any month of eligibility as liabilities only once such benefits are due and payable.

Social Insurance information displayed in government financial statements for Social Security and Medicare should be consistent with the information presented in the annual Trustees Reports for these programs. To this end, we encourage the inclusion as supplementary information a Statement of Changes in Social Insurance as presented in the Alternative View, entirely consistent with the Trustees Reports. But we also recommend inclusion both in the agency financial statements and in the government wide statement, specifically under the Statement of Social Insurance, the amount of trust fund reserves available at the valuation date. While Trust Fund assets do net out on the unified budget, they are very important in the narrower context of Social Security solvency. Here the fund assets have real value and will allow benefits to be paid well after exhaustion of the TF. Reflecting the starting Trust Fund assets for OASDI would help clarify the true actuarial status of the program.

Finally, we agree that a statement of sustainability for all Federal programs would be a useful and informative addition to the Consolidated Financial Statement for the entire Federal Government. However, we believe that to address sustainability the fundamental characteristics of timing and trend are essential. We believe that the only representation that satisfies these criteria and could be readily and simply applied for all Federal programs is projected annual cost of these programs, and projected revenue, on an annual basis, expressed as percentages of the projected gross domestic product (GDP) on an annual basis. Thus we reject the summarized values over long periods of time as useful indicators of sustainability, and particularly object to expressing these values on a per capita basis including only current workers or households.

Good afternoon. I would like to thank you all in advance for your time and for the opportunity to address your Advisory Board this afternoon.

Of all the speakers at this public hearing, I am admittedly and far and away the least qualified. However, I may be the only speaker that represents the first of many generations that will feel the true impact of your Board's actions (or lack of action).

I flew here today to appeal to your board, because I believe that our representative democracy is not equipped to avert a long-term fiscal meltdown. As the bulk of our population barrels toward retirement, as voter turnout and voter density are higher among the elderly, resources continue to be disproportionately allocated to the aged and aging. That works as long as the worker-to-retiree ratio remains constant. We all know that it will not.

Retirement security for needy Americans in their golden years is a responsible and compassionate goal of our society. However, we simply cannot afford the levels of benefit payments that have been promised. Using simple percentage-of-GDP math, the annual increase in cost for Social Security, Medicare, and Medicaid in 25 years will be equivalent to an additional 40 concurrent Iraq wars. Just like the leaders of Ford, Chrysler, and General Motors, our nation's leaders have promised too much pension to keep things running during the good years, and our competitiveness will suffer just the same as tougher times approach.

Locked in a partisan stalemate as a result of legislative districts gerrymandered to rig the outcome of over 90% of House elections, Representatives in both parties are unwilling to make the compromises we need to stay afloat. I respectfully submit to you that Congress may be rendering itself *obsolete*.

In other words...The way to become an officer on this ship is to NOT talk about the iceberg that we all plainly see in front of us and have seen for quite some time. In the 1970s former U.S. Secretary of Commerce, Peter Peterson, was saying, "You know, in the year 2008 our social insurance programs are going to be facing a demographic imbalance."

And people said, "2008, that's so far away..."Not so far away.

The nation's top Accounting Officer, Comptroller General David Walker, who spoke to this board earlier today, has traipsed all over the country holding press conferences trying to sound the alarm bells. He was even featured on 60 Minutes.

Former Fed Chairman Alan Greenspan, who is known for his flighty, hard-to-interpret, nebulous characterizations of economic conditions, testified before Congress and called this situation a quote "Looming Fiscal Crisis." ...that's sort of uncharacteristic... clarity.

Ben Bernanke, Greenspan's successor, has testified before Congress twice in the past year and explained that failure to address this imbalance between benefits promised to

Baby Boomers and projected revenue collection could undermine the entire U.S. economy.

Yet.....Nothing!

We are witnessing a fundamental flaw in democracy that allows current generations to inflate our own standard-of-living beyond simple security for the needy at the expense of the standard-of-living of future generations.

Your program lists me here as the 2006 Republican Nominee of U.S. Congress in the 9<sup>th</sup> District of Illinois. Let me be real clear, the reason I ran as a Republican is simple: because I live in a district that is drawn with a predetermined outcome for the Democratic incumbent. She has won election in each of the past five election cycles (that's 10 years) with 76%, 78%, 75%, 76% and 74%. You can understand why it was pretty easy for me to win the Republican Primary. Like 16 other districts in Illinois, my district is "fixed" for the incumbent to win every time. If I lived in a district that was instead crafted for a Republican incumbent to win every time, then I would have run as a Democrat...that simple. This topic of accounting for social insurance programs is beginning to, and will continue to, divide Americans less along party lines and more along generational lines.

My incumbent Congressman is a self-described advocate for the elderly. Alternatively, I characterized myself as an advocate for younger and future Americans. Now I don't have to tell you that that is not very smart if you're trying to get elected. As I mentioned, old people vote in droves, and young people don't vote much or are not yet old enough to vote. But I wasn't trying to get elected. I was trying to make a point.

Do any of you remember the sixties? Does anyone here know what a sit-in is? Rather than sitting in a campus classroom refusing to leave or in a business or in the middle of the street, I was conducting a sit-in in a campaign for U.S. Congress. In protest, I refused to accept campaign contributions. And I am committed to help other candidates from within either party conduct similar protest campaigns in any legislative district that is not competitive...and there are plenty of them. In 2008, I am projecting there will be three "sit-in" candidates in Illinois, one in Iowa, one in Minnesota, and one in Missouri. We will be there on the ballot, refusing to accept any money. It's an uphill battle, but it pales in comparison to the uphill battle that younger and future Americans are up against.

In lieu of a capable Congress, the balance of power and responsibility to govern has shifted to the Judicial Branch and Executive Branch...but perhaps to Advisory Boards like this one.

Now how does all this relate to Accounting standards? You see, when we rig the outcome of elections ... there are consequences. If you're a Congressman in Republican America (that's codeword for Rural America), you can get re-elected over and over and over until you're 110 years old by promising, voting for, and delivering tax cuts. And when you're a Congressman in Democratic (Urban) America, you can get re-elected over and over and over by promising, voting for, and protecting ever-increasing retirement benefits.

When there is zero risk to incumbents getting re-elected, there is no incentive to work with the other party to actually accomplish anything. There is no appetite for compromise. And we propel toward the iceberg. When there is zero risk to incumbents, they show up here in Washington with a list of demands, not a willingness to work with others. And we propel toward the iceberg. When there is zero risk to incumbents, they tend to strike a lethal deal, where both sides get what they want! Republicans get tax cuts and Democrats get ever-increasing retirement benefits. The combination of the two is a recipe for fiscal ruin. We are on course to hit that iceberg and drown our children in our own debt.

I speak on occasion at local High Schools in Chicago to educate students about the situation.

Teachers will sometimes say that the kids aren't smart enough to understand this stuff. I disagree. I think that kids are inherently curious and attracted to the truth if you lay out the facts. I draw it right on their blackboard and explain that there are 78 million people in the pipeline who, today, are paying taxes and not collecting benefits that, tomorrow, will not be paying taxes and will start collecting benefits. I ask them how long their family would survive if one spouse made purchases their family couldn't afford, and then the other spouse refused to go to work to bring in any income into the family, and then the first spouse said, "Fine, well I'm just going to continue buying things and put it all on a credit card." Kids understand a dysfunctional marriage. And that is exactly what we have between our two dominant political parties. What most families would never do to their own children (rack up a giant credit card bill and hand it over to the kids), we are all collectively doing to younger and future generations. When I speak at these high schools, I tell kids to tell their parents that there's a guy running for Congress who said to go home and ask for a check for \$175,000 (that's each kid). That is the present value, the amount per man, woman, and child that our government needs cash-in-hand today, earning interest, to pay for the retirement benefits promised to future retirees... ironically promised to the same demographic that is unwilling to pay the taxes needed to fund the programs. It's almost \$60 Trillion.

In my role as strategic sourcing professional for a major retailer, I assist various areas of the enterprise negotiate contracts and resolve disputes with suppliers. I have a real passion for the principles of successful negotiation. I have studied and taught these principles originally pioneered by Roger Fisher and William Ury of the Harvard Project on Negotiation. The principles of successful negotiation amount to building trust with your counterpart, while simultaneously pursuing leverage and credibility.

Credibility  
Leverage  
Relationship

Credibility! Credibility is achieved by being perceived as fair and objective. Objectively speaking, an American born in the first wave of the Baby Boom (1946) will get different Return (on investment) from the taxes paid into... and subsequent benefits consumed from... Social Insurance programs than someone like me (born in 1972) and wildly different than my two daughters (born in 2003 and 2006). Your group coins it “Intergenerational Equity.”

Credibility  
Leverage  
Relationship

Let’s talk about Leverage! Young people in America have very little leverage. They are outnumbered and are overwhelmingly outvoted. But young people do have one tiny piece of leverage. It is they, dare I say it is we, who will write the history books of your time. And right now, we are sharpening our pencils to write something like the following: “Every previous American generation left the nation in better fiscal shape than they had found it, until...a generation came along post World War II in a Baby Boom.” Let history record that an obscure panel called the Financial Accounting Standards Advisory Board (FASAB) had an opportunity to disclose to the American people the effect of this flaw in our democracy by the treatment of obscure future liabilities as...well...future liabilities. Let history record the names of these board members:

Tom L. Allen  
Claire Gorham Cohen  
Robert Dacey  
John A. Farrell  
Norwood J. Jackson, Jr.  
Donald B. Marron  
James M. Patton  
Robert N. Reid  
Alan H. Schumacher  
Danny Werfel

Credibility  
Leverage  
Relationship

Let’s talk about Relationship! Roger Fisher and William Ury emphasize over and over in their two books “Getting to Yes” and “Getting Past No” how important relationship is when navigating a sticky negotiation. As part of building trust and fostering relationship, they offer a crucial tip that is worth more than all the gold in the Federal Reserve.

“Don’t declare your position,” they write. “Instead, express and work toward your *interests*.”

The difference between a position and an interest is subtle. There is only one way to satisfy a position, which is to capitulate. If Company A declares to Company B, “in order to do business with us, you must occupy the vacant building next door to our facility,” there is only one way to satisfy that demand. However, if Company A expresses to Company B, “our interest is on-time delivery of inventory,” there are many ways to work together to satisfy that interest...and it gives an opening of Company B to take an active role in drafting a solution.

Let me close by saying that I mean no disrespect to any of you individually or collectively as members of the generation[s] that precede mine. This is a sensitive topic and will only become more sensitive over time.

I am not here to demand that your board comply with my position. I certainly don't have all the answers. My *interest* is to educate the American public to, in turn, motivate a “do-nothing” Congress to solve this unyielding, long-term, strategic challenge. My other interest that I'm confident you share is to help preserve the Baby Boom Generation's legacy. And oh is it a legacy worth preserving! Unlike my generation (X), which is arguably asleep at the switch, Baby Boomers yielded tremendous influence and were a voice for change in their teenage and young adult years for such admirable goals as Civil Rights, Voting Rights, and Equal Rights for Women. Unlike today's youth, Baby Boomers were a voice of restraint in a misguided, un-winnable military adventure. And music from the Baby Boom generation is easily the best rock-n-roll music ever recorded.

It's ALL at risk. If nothing changes, those contributions to America and to American culture will be overshadowed by a legacy of fiscal irresponsibility, a lack of stewardship, and the aggregate effect of individual selfishness that could impoverish our country.

Let's bridge a growing gap between generations...not blow up the bridge. A great start would be to keep one set of books with the true cost of future liabilities on those books rather than allowing politicians to ignore the fact that we are closer-and-closer to that iceberg every day.

It is truly an honor to appear before you today on behalf of younger and future Americans. Again, I thank you for the enviable opportunity.

>>> Mike Shannon <[michael\\_p\\_shannon@yahoo.com](mailto:michael_p_shannon@yahoo.com)> 5/8/2007 12:29 PM >>>  
Dear Board Members:

When considering whether to disclose the present value of future liabilities (as accounting rules require corporations to do), ask yourselves this: would you rack up an insurmountable debt with a deferred payment schedule and leave it to your children without their knowledge/consent? What no family would do to our own children, we are all collectively doing to our childrens' generations.

My interest is to help preserve the Baby Boom Generation's legacy, which is at risk. Such contributions as Civil Rights, Equal Rights for Women, Voting Rights, and the Cultural Revolution are all at risk of being overshadowed by a legacy of fiscal irresponsibility. The Baby Boom Generation (1946-1964) is on course to leave an unprecedented debt burden to those of us in its wake. What's more, that debt burden is not on the books! The current federal budget pretends that future social liabilities such as Social Security and Medicare do not exist, based on a technicality that they are, technically, not legal obligations. They are obligations. We have (over) promised these benefits to the aged and aging, and these promises must be renegotiated in an objective, transparent fashion in order to maintain the financial viability of the United States. We must not just pretend that the problem does not exist and hope that it goes away. It will not.

By not disclosing the enormity of this eventual cash flow crunch, your Board will force future leaders of this country to point people in their golden years to the "small print" as we suddenly reduce their benefits. It is devious. It is scandalous. It is immoral.

Sincerely,

Michael P. Shannon  
2006 Republican Nominee for U.S. Congress (Illinois - 9th District)



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April 23, 2007

Ms. Wendy M. Comes  
Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street, NW, Suite 6814  
Mailstop 6K17V  
Washington, DC 20548

Dear Ms. Comes:

We appreciate the opportunity to respond to the document summarizing the Preliminary Views of the Federal Accounting Standards Advisory Board on issues related to *Accounting for Social Insurance* ("PV Document").

We fully support the Board's direction of providing additional information associated with social insurance. In reviewing the PV document, we found that our views are generally consistent with those of the Primary View presented in the PV document. We acknowledge that the Board has been discussing two separate projects, one on the financial reporting model and another on sustainability reporting, that may significantly impact the overall presentation of the existing financial statements and introduce sustainability reporting. However, we have structured our responses to concentrate on the reporting objectives within the current financial reporting model, including the proposed concept statement, *Definition and Recognition of Elements of Financial Statements* as it relates to federal entities' accounting for social insurance.

In the remainder of this letter we provide our responses to the questions posed in the PV document.

#### **PV Document Request for Comments and Our Response**

1. Which obligating event do you believe creates a liability and expense that should be recognized? Please provide the rationale for your answer.

KPMG Response: We believe the obligating event for recognizing a liability and expense occurs when participants commence work in covered employment. We understand that our view point goes a step further than the Primary View of recognizing a liability and expense when participants become fully insured under the terms of the programs and as defined in the glossary to the PV document. However, we agree with the Primary View documented in the basis of conclusions that the "social insurance programs are exchange programs that, with each period of covered employment, workers and their employers exchange a commitment to pay earmarked taxes for a promise from the Government to provide social insurance benefits in the future." We agree also with the Primary View documented in the basis of conclusions in the PV document that the social security liability meets the essential characteristics of a liability of the Federal Government – "1) it constitutes a present

Wendy M. Comes, FASAB Executive Director

April 23, 2007

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obligation to provide assets or services to another entity; and 2) the Federal government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur.” Consistent with Statement of Federal Financial Accounting Standard (SFFAS) No. 5, we are associating the term “obligation” with its generic or general meaning of a responsibility to act in a certain way and not federal budgetary accounting.

2. Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary View (see pars. 16 – 18 and especially subpar. 16g in the standard; also see A54 –A55 in the basis for conclusions)? Please provide the rationale for your answer.

KPMG Response: We believe the Social Security and Medicare obligations are measurable for purposes of recording a liability from the point participants commence work in covered employment as well as in subsequent quarters. Thus, we agree with the Primary View but have taken the matter a step further as discussed in our response to the first question. According to the *Financial Report of the U.S. Government*, the Board of Trustees, which includes the Commissioner of the Social Security Administration, provide annual reports to Congress that present 75-year actuarial estimates of the Old-Age, Survivors, and Disability Insurance (“Social Security”) and Medicare Trust Funds. The availability of these projections seems to be a point of agreement between both views as it is utilized within both discussions. However, the Alternative View is premised on the notion that, in spite of such projections, Social Security and Medicare obligations can not be measured reliably because Congress has the ability to legislate changes to future benefits to be paid out.

We agree with the Primary View that the existence of an obligation should be determined based on the current law. While laws can be altered, financial reports should address conditions as they exist at the end of the reporting period. This view is consistent with existing accounting literature addressing the accounting for environmental cleanup liabilities and employee pensions which require that obligations are determined based on current law. The possibility that circumstances will change is not considered. Accordingly, we believe that future events, including potential changes in law, should not prevent expense and liability recognition for social insurance programs. Further, while we recognize the inherent uncertainties associated with estimating the present value of future benefits to be provided under social insurance programs in future periods, we believe that such obligations are measurable for financial reporting purposes.

3. a. Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?
- b. Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported and, if so, do you favor such reporting (1) as proposed by the Primary View, (2) as proposed by the Alternative View, or (3) some other approach?

Please provide the rationale for your answers.

Wendy M. Comes, FASAB Executive Director  
April 23, 2007  
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KPMG Response: We believe correlating the expenses recognized with the change in the liability between the statement of net cost, balance sheet, and statement of social insurance provides a more meaningful presentation for readers of the financial statements. Thus, we agree with the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively.

We believe that the reasons for the changes in SOSI amounts during the reporting period should be reported as proposed by the Primary View. This approach is consistent with the traditional presentation of assumptions in the notes to the financial statements. For example, SFFAS No. 18 states the following for loan programs: "Reporting entities should disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions that have had a significant and measurable effect on subsidy rates, subsidy expenses, and subsidy reestimates."

4. Do you believe the proposal [of presenting a statement of fiscal sustainability] should be adopted? Please provide the rationale for your answer.

KPMG Response: We believe the proposed statement of fiscal sustainability should be removed from the discussions relating to accounting for social insurance. We believe recognizing a liability for social insurance is moving in the right direction for determining sustainable solvency of the U.S. Government. However, we believe the statement of fiscal sustainability should be fully vetted within the broader project on that topic.

5. Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs? Please provide the rationale for your answer.

KPMG Response: We believe that the obligating event for expense and liability recognition occurs as participants work in covered employment. Accordingly, recognizing deferred revenue for earmarked revenues in excess of related program costs is not an essential element for the financial statements to "provide accurate and transparent information to Americans so that they can make well-informed decisions for themselves and their Government" [paragraph 42 of the PV document]. Our rationale is based on the following factors:

- The *Financial Report of the U.S. Government* presents earmarked funds by major fund in accordance with SFFAS No. 27, *Identifying and Reporting Earmarked Funds*. Thus, the notes to the government-wide financial statements present the assets, liabilities, and change in net position by major fund for earmarked funds. The change in net position section includes disclosures of revenue from the public and program expenses. The information in the notes to the government-wide financial statements is supported by additional information in the component units' financial statements.
- As noted in our responses to the other questions, we support the view to correlate the expenses recognized with the change in the liability between the statement of net cost, balance sheet, and statement of social insurance along with our view to recognize a liability and expense when participants commence work in covered employment.



Wendy M. Comes, FASAB Executive Director  
April 23, 2007  
Page 4 of 4

6. a. – Please offer any comments that you wish to make on the Primary View provisions.
- b. – Please offer any comments that you wish to make on the Alternative View provisions.

KPMG Response: We have no additional comments regarding the provisions in the PV document.

If you have questions about our response, please contact Mr. Terrill E. Menzel at 518-427-4607 or [tmenzel@kpmg.com](mailto:tmenzel@kpmg.com).

Very truly yours,

*KPMG LLP*

#65

Jim Cooper

Federal - Other

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May 15, 2007

Wendy M. Comes, Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street NW, suite 6184 (mailstop 6K17V)  
Washington, D.C., 20548

Dear Ms. Comes:

I write today to provide my comment to the Federal Accounting Standards Advisory Board (FASAB) on its Preliminary Views (PV) on *Accounting for Social Insurance, Revised*.

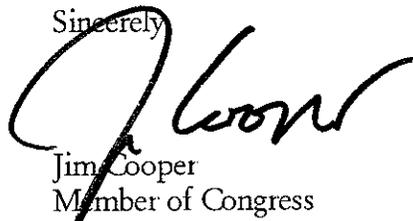
I would first like to express my admiration to FASAB for their leadership on this issue. While many in Washington privately fret over a looming wave of social insurance liabilities, public acknowledgement of this threat lags dangerously behind. Whatever the final decision of the Board, their effort to highlight the future imbalances in social insurance programs must be commended.

The purpose of the Financial Report is to give the American public a clear and comprehensive picture of the federal fiscal position. When considering any changes to its content, FASAB should avoid choices that unnecessarily complicate or limit. The distinction between the Primary and Alternative Views in the PV resides in their respective criteria for when a liability is recognized. The most instructive question is: *Which criteria best comport with the public understanding of social insurance?*

In answer to this question, and in accordance with the most open and honest disclosure of the federal fiscal position, I wish to express my support for the Primary View expressed in the PV.

Attached is my expanded response to the request for comments contained in the PV.

Sincerely



Jim Cooper  
Member of Congress

**Q1. Which obligating event do you believe creates a liability and expense that should be recognized? Please provide the rationale for your answer.**

A1. The Primary View's *fully insured* criteria adequately characterize the obligating event creating a liability and expense. Completion of 40 quarters of covered work, the event at which individuals become fully insured, is consistent with the generally accepted public understanding of the point at which a worker has entered into exchange (quasi- or otherwise) with the federal government for future social insurance benefits.

Potentially, an actuarial model could predict the expectation that individuals completing discretely graduated increases in quarters worked would become fully insured. In such a case, the benefits of those individuals who have completed some positive number less than 40 quarters would have a weighted liability recognized. This weighted participation should be rolled into Current Participants not of retirement age or disabled, described in par. 16b, as each additional quarter worked moves them closer to that cohort and their recognized liability. The Primary View, on the other hand, would include these workers under Future Participants, described in par. 16c.

**Q2. Do you believe that the Social Security and Medicare obligations are measurable for purposes of recording a liability after 40 quarters or equivalent of work in covered employment as proposed in the Primary View (see pars. 16 – 18 and especially subpar. 16g in the standard; also see A54 – A55 in the basis for conclusions)? Please provide the rationale for your answer.**

A2. I believe these obligations are measurable for these purposes as proposed in the Primary View. This is especially true where it regards the inclusion of the present value of past work, but not future work, for those fully insured regardless of age or disability status (as described in pars. 16e-g). Future work for all groups (as described in pars. 16h-l) should be considered, but only as supplemental to the liability described in par. 16g, whether presented on their own line (par. 16h) or a subtotal line (pars. 16i,l).

Uncertainty in measurement is unavoidable. That same uncertainty, though admittedly applied to a smaller base, is already included in the statement of net cost through the measure of public employee retirement liabilities.

**Q3. 3.1 – Do you believe that the Primary View proposal to add line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively, should be adopted?**

**3.2 – Do you believe that the reasons for changes in SOSI amounts during the reporting period should be reported and, if so, do you favor such reporting (1) as proposed by the Primary View, (2) as proposed by the Alternative View, or (3) some other approach?**

**Please provide the rationale for your answers.**

A3. The articulating proposed by the Primary View should be adopted. As the purpose of the balance sheet and statement of net cost are to provide clear and comprehensive

information, the integration of these with the SOSI is warranted. A new principal financial statement, as proposed by the Alternative View, could complicate the presentation of these changes and is therefore unnecessary. The SOSI, balance sheet, and statement of net cost – the existing principal financial statements – should stand alone.

**Q4. Do you believe the proposal should be adopted? Please provide the rationale for your answer.**

A4. While the goal of a statement of fiscal sustainability is laudable, it exists outside of the essential function of the Financial Report. Infinite horizon projections, generational equity, and simple sustainability are all very relevant to conversations concerning social insurance. However, they can cloud the snap-shot approach to the federal fiscal position intended in this context. For these reasons, it should not be adopted.

**Q5. Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs? Please provide the rationale for your answer.**

A5. Deferred earmark revenues should be considered as a separate project, if at all. While I would not explicitly say they should not be considered outside of the expansive examination they receive in Note 20 of the Financial Report, any change to how they are treated deserves its own proposal.

**Q6. 6.1 Please offer any comments that you wish to make on the Primary View provisions.**

**6.2 Please offer any comments that you wish to make on the Alternative View provisions.**

A6. Outside of suggested adjustments described in A1 and the statement provided at the beginning of my letter, I do not have any additional comments to make at this time.



May 2, 2007

Wendy M. Comes  
Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street NW, Suite 6814 (Mailstop 6K17V)  
Washington, DC 20548

Dear Ms. Comes:

Thank you for the opportunity to comment on the Federal Accounting Standards Advisory Board's (FASAB) Preliminary Views, Accounting for Social Insurance, Revised. The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(c)(3). It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work. The views I express in these comments are my own and should not be construed as representing any official position of The Heritage Foundation.

FASAB has taken an important step to examine financial reporting for social insurance to ensure that lawmakers, citizens, and markets have adequate, clear, and transparent information about the nation's financial position. Though there is disagreement on how best to make improvements among board members, it is important that those supporting both views agree that better information is necessary to improve understanding about the nation's finances.

Medicare and Social Security are the largest of the social insurance programs and are widely recognized as being both unsustainable and a threat to the nation's prosperity. Spending on these two programs alone is projected to mushroom from 7.7 percent of GDP in 2007 to 12.7 percent in 2030 and 15.2 percent in 2050. This does not compare well with the historical tax level of 18.3 percent of GDP. It is imperative that the nation better understand the full extent of the costs of these programs over the long term. Clear, transparent, and consistent disclosure of the nation's current financial position and long-term condition are essential to achieving that understanding. Experiences of states and other nations show that better disclosure has pushed lawmakers to come to terms with policies and practices that are politically attractive in the short term but unaffordable over the long-term. This should be one key goal when accounting for social insurance.

The biggest difference between the two preliminary views is when, exactly, a liability should be recognized for social insurance. Both views propose further disclosure about the sustainability of these programs, though they do so in different ways. The Primary View would make fundamental changes to reporting on social insurance programs, most notably by accruing future benefits as liabilities once workers complete 40 quarters of qualified work. The Alternative View would continue the current practice of recording benefits when they are due and payable, maintain the “Statement of Social Insurance” (SOSI), and expand disclosure by adding a “Statement of Change in Social Insurance.” Overall, the Alternative View would present a more representative position of the nation’s social insurance programs.

### **Recording a Liability for Benefits**

As the Primary View notes, there are some similarities between private-sector retirement benefits and social insurance programs which, in their view, the quasi-exchange features of work, payroll taxes, and benefits in these programs constitute a semi-exchange that results in a liability that will be paid in the future. The Primary View cites the Financial Accounting Standards Board’s (FASB) Statements of Financial Accounting Standards (SFAS) as a basis for its consideration of liabilities for Medicare and Unemployment Insurance and the proposed accounting treatment. However, despite some similarities, there are strong and important differences.

Social insurance programs are fundamentally different from the post-retirement employee benefits for which FASB and the Governmental Accounting Standards Board (GASB) set accounting standards. As noted in the Alternative View, Social Security and Medicare are not employee benefits, nor are they the result of a voluntary transaction in the same way post-retirement employee benefits are—a fact that should give serious pause when considering whether future costs constitute a traditional liability for financial statement purposes.

Nor are social insurance benefits immutable. Congress can change benefits at any time, and, as affirmed by the 1960 Supreme Court decision in *Flemming v. Nestor*, these benefits are not contractual or “locked-in.” This is very different from pension benefits, whether private- or public-sector, which can only be changed prospectively unless done through bankruptcy. As noted by the Alternative View, according to GASB’s exposure draft “Elements of Financial Statements,” a liability is “a duty or responsibility to sacrifice resources or future resources that the entity has little or no discretion to avoid.” Under this definition, classifying future social insurance benefits as liabilities would be misleading.

Better disclosure and transparency of social insurance in financial statements is necessary to prompt serious debate and discussion about reforming these programs. In that debate, language is important, and it is critical not to miscast the nature of these benefits as something that cannot be changed in the future. In the minds of many, simply calling future benefits “liabilities” conveys that there is nothing that can be done to restructure them to make them more affordable. Since perception is reality, this central feature of the Primary View would be a harmful step backwards in disclosure.

## **Recording an Asset for Payroll Taxes**

The Primary View bases its proposal on the view of a quasi-exchange feature of social insurance between a worker and the government, with the worker completing a required 40 quarters of service to qualify and note the relationship to wages, social insurance benefits, and payroll taxes paid. In that regard, there are some similarities between private- and public-sector post-retirement employee benefits, as noted above, and the Primary View's treatment of social insurance future cash outflows drawn from FASB and GASB. Those models also draw upon a benefit plan's net funding position, which takes the cost of paying current and future benefits into account, as well as assets such as employee and employer contributions and investment earnings.

However, the Primary View's proposal would not book an asset for future payroll taxes. This would present a misleading picture of the current position and long-term sustainability of social insurance programs. This is especially true since payroll taxes are dedicated to financing Social Security and Medicare. Recording just benefit liabilities without reference to dedicated revenue sources presents an incomplete and inaccurate view of those programs. Further, this would be unlike any other discussion of the long-term condition of these programs and would cause substantial confusion.

## **Social Insurance Statements**

The Alternative View's treatment would keep the SOSI, which presents the 75-year present value of future benefits and revenues, as an audited financial statement. It would add a "Statement of Change in Social Insurance." This new statement would be an important addition to the financial statements and would facilitate debate about the long-term viability of these programs. It could also provide a model for analyzing the effects of reform proposals. FASAB should also consider presenting these changes over the infinite time horizon, in addition to the 75-year time horizon, to ensure that the full effects of revenue and benefit changes are disclosed.

The Alternative View would also add a "Statement of Fiscal Sustainability" that would analyze current and projected levels of federal spending, revenues, and debt as a share of GDP over the 75-year and infinite time horizon. Social insurance programs would be a key feature of this statement. This would also entail projecting spending and taxes for the rest of the federal budget. The Alternative View rightly notes that there is a limit on what the nation can tax in order to provide government services and service debt and that too much of both will harm economic growth. Social Security and Medicare are governed by perpetual laws that do not sunset or expire, and they do not require annual appropriations decisions by Congress. Thus, the existing extensive analyses of long-term revenues and costs for these programs have the necessary rigor and integrity for financial statements.

Other federal programs, from defense and education to highways and welfare, require authorization on a regular basis. Many programs are further reliant on annual appropriations decisions made by Congress. Since the fiscal future of other federal programs is highly speculative, such projections would lack the rigor and integrity of Social Security and Medicare and may not be ideally suited for the financial statement. These measures could also serve to lock in expectations over future levels of revenues. FASAB should consider using a historical benchmark for taxes when measuring fiscal sustainability.

## **Liabilities and Social Insurance Responsibilities**

Whatever standard FASAB adopts, it should provide a clear basis for evaluating the position of these programs in the long term and short term together. The Executive Summary of the 2006 Financial Report presents a clear, transparent picture of combined Net Position (assets net of liabilities) along with social insurance responsibilities in one table. FASAB should ensure that this presentation is consistently featured in the financial report. FASAB may want to consider a different term to describe long-term costs over revenues.

## **Liability for Deferred Revenues**

FASAB should also give careful consideration to recording a liability for excess earmarked revenue, as discussed in the Alternative View. These excess revenues are a liability in the form of special U.S. Treasury bonds that will likely have to be paid in the future, in which case recognizing a liability would be appropriate. But this could seem to be at odds with the view that future benefits are not due and payable. Further discussion of this in another forum, as recommended, would be appropriate.

## **Conclusion**

The Primary View has thoughtfully laid out a case for making fundamental changes to accounting for social insurance, but this approach would recognize only the liability from future benefit payments and not the asset from future revenues, which would result in unnecessary confusion and misrepresent the current position and long-term sustainability of the programs. In the eyes of many, labeling future benefits as intractable liabilities would make necessary reforms all the more difficult, and this must be avoided. Overall, the Alternative View would present a more accurate and complete picture of social insurance benefits and could be used to create a mechanism in the budget process to require analysis and recommendations for change.

Thank you for the opportunity to comment on the thoughtful work done by FASAB.

Sincerely,



Alison Acosta Fraser  
Director, Thomas A. Roe Institute for  
Economic Policy Studies

AAF/ppo