Federal Accounting Standards Advisory Board

September 20, 2005

TO: Members of FASAB

FROM: Richard Fontenrose, Assistant Director

THROUGH: Wendy Comes, Executive Director

SUBJECT: Social Insurance – Tab C

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

At the August meeting the Board agreed with staff recommendations for issues 1-6 and 10 identified in the August staff memorandum. See Appendix 1 for a table of the decisions.

The objective of the October 2005 session on social insurance is to discuss the alternatives for issues number 7 and 8, i.e., display, disclosure, and required supplemental information (RSI).

Regarding issue 9 and the additional social insurance programs, without objection the staff will develop the initial draft of the exposure document assuming the approach recommended in August is tentatively acceptable. For Railroad Retirement, an analogy will be drawn to Social Security and Medicare. For Unemployment Insurance and Black Lung Benefits, the SFFAS 17 requirements will be continued. The members will be able to review the approach when the provisions are fleshed out.

Also, the staff is presenting three other questions for discussion. The first question, which arose at August meeting, asks whether the only “obligating event” for social insurance is meeting the 40 quarters condition; or, whether increments in the liability for work after 40 quarters should be described as obligating events.

The second question is related to the first and deals with Medicare Hospital Insurance (HI) cost recognition. Since the Medicare HI participant has met the conditions to receive benefits at 40 quarters, should the present value of the full obligation be recognized at that point or attributed to years of service over his or her working life?

The third question involves the application of insurance accounting to Medicare Supplementary Medical Insurance (SMI). Specifically, should SMI be considered a short- or a long-duration insurance contract? The answer will affect the measurement of the cost and liability.

TABLE OF CONTENTS

Display Examples

For the purpose of discussing display, the staff presents five pro forma examples identified with alpha characters A through E. The text of the memorandum itself discusses particular display alternatives as individual line items. In addition, staff provides pro forma balance sheets, statements of net cost, statements of changes in net position, and other information for Examples A through E in Appendices 3-7, respectively, for reference.

The discussion in the body of the memo is limited to changes in the basic format to facilitate discussing alternative displays. In other words, alternatives are presented in the body of the memo and the member can refer to the appendix to see what selected basic statements would look like, if so desired. Also, the examples are not meant to be independent, i.e., a member might prefer a balance sheet display from one of example, e.g., a disaggregated liability, and a statement of net cost display or amortization treatment from another example.

Hypothetical numbers used for the examples were derived starting with the Social Security Administration's (SSA) FY 2004 financial statements for the Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security") program. (SSA's FY 2004 balance sheet, statement of net cost, and statement of changes in net position are in Appendix 2 for reference.) Next, the SSA actuaries' "Maximum Transition Cost"[1] (MTC) (also known as the "accrued benefit obligation") was used as a reasonable approximation of the liability amount – or "accumulated cost" – for the purposes of this memorandum. (There is a glossary of terms at Appendix 9 for reference, which the staff envisions becoming part of the eventual standard.) As noted at a prior Board meeting, the SSA actuaries estimated the MTC to be $13.5 trillion net of assets. Adding back approximately $1.5 trillion of Social Security assets – which is appropriate because the staff proposal calls for separate accounting for assets on the one hand and cost/liability on the other – yields a "gross" MTC of $15 trillion, which is our starting point for deriving the beginning balance in the hypothetical liability account and beginning net position. Also, we know that SSA

[1] See Goss, Steve, Alice Wade, and Jason Sch, "Actuarial Note: Unfunded Obligation and Transition Cost for the OASDI Program," Number 2004.1, Social Security Administration, Office of the Chief Actuary, August 2004, presented on the SSA Web site and also as Appendix D of the staff memorandum for the May FASAB meeting, dated April 20, 2005.

paid $487,643 million in OASDI benefits in 2004, which would reduce the liability under the proposal.

Staff is using (an arbitrary) $1 trillion as a "ballpark" for the annual expense. We anticipate refining this for the exposure document with the help of SSA and others. (Staff is using "cost" and "expense" synonymously.)

Since the liability would be increased by the annual accrued expense and decreased by payments to the beneficiaries, we can fill in other hypothetical amounts as follows:

Table No. 1

Beginning Liability, FY 2004 [$15,487,643 million minus $1,000,000 million.]	$14,487,643
Add: Social Security accrued expense for the year [This amount was arbitrarily assigned.]	1,000,000
Subtotal [$15,000,000 million plus $487,643 million]	15,487,643
Less: Payment to Social Security beneficiaries [SSA reported this amount as the 2004 SS expense for payments to benefits per SFFAS 17.]	(487,643)
Ending Liability, FY 2004 [This is the $13.5 trillion "Maximum Transaction Cost" calculated by SSA actuaries, with $1.5 trillion representing SS assets (in round numbers) added back.]	$15,000,000

The pro forma accounting entries to record the hypothetical FY 2004 accrued expense and the payments to benefits are as follows:

Table No. 2

Entries to record 2004 expense:		
DR -- Social Security Accrued Expense	1,000,000	
CR -- Accrued SS Liability		1,000,000
Entries to record the 2004 payments to beneficiaries:		
DR -- Accrued SS Liability	487,643	
CR -- Fund Bal w/Treasury		487,643

All examples assume that the new accounting has been in place before FY 2004, and FY 2004 therefore is neither the first nor last year of the reporting. Thus, we need to calculate a hypothetical beginning net position. For this staff used the "beginning net position" reported by SSA for OASDI for FY 2004, $1,453,080 million, and subtracted the beginning balance of the hypothetical liability shown above, $14,487,643 million, to derive a negative $13,034,563 million. Each pro forma example uses this new beginning net position.

Example A: Single Line Item Displays for Liability and Expense (Appendix 3)

Example A displays one line item for the accrued liability on the balance sheet ($15,000,000 million) and one line item for the accrued expense on the statement of net cost (SNC) ($1,000,000 million) as follows:

Selected Line Items from Pro Forma *Balance Sheet*, Example A

Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued Social Security Liability	15,000,000
Other	1,205
Total Liabilities	15,062,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,394,797)
Total Net Position	(13,393,308)

Pro Forma *Statement of Net Cost*, Example A

	2,004 (millions)
Social Security Accrued Expense	($1,000,000)
Social Security Operating Expenses	(4,758)
Expenses of Other SSA Programs	(39,380)
Total Cost of OASI Program	(1,044,138)
Less: Exchange Revenues	339
Net Cost	($1,043,799)

Although not illustrated in Example A, the benefit payments ($487,643 million) that SSA reported as an expense in FY 2004 per SFFAS 17 instead would be a decrease in the liability (and Fund Balance with Treasury) under the proposal, as shown in Table No. 2 above.

Example B: Liability Displayed by Age Cohort (Appendix 4)

Example B is the same as Example A except that it displays a liability disaggregated by age cohort as follows:

Selected Line Items from Pro Forma *Balance Sheet*, Example A

Benefits Due and Payable	51,569
Accounts Payable	489
Accrued Social Security Liability:	[15,000,000]
Participants who have attained age 62	XXX
Participants ages 15-61	XXX
Other	1,205
Total	15,062,215

This would illustrate how much is due to those already retired versus the others in the closed group, and therefore address the generational aspects to some degree. Also, the cohorts arguably would represent different degrees of uncertainty because the estimate for the 15-61 year-old cohort would go further into the future.

Example C: Liability Displayed by Payment Timing and Expense Displayed by Component (Appendix 5)

Example C adds two alternatives. The balance sheet displays the liability disaggregated by length of the projection, which illustrates on the face of the statement the uncertainty inherent therein as follows:

Selected Line Items from Pro Forma *Balance Sheet*, Example C

Benefits Due and Payable	51,569
Accounts Payable	489
Accrued Social Security Liability:	[15,000,000]
Liability for payments due 2004-2014	XXX
Liability for payments due after 2014	XXX
Other	1,205
Total Liabilities	15,062,215

The statement of net cost (SNC) below separates the cost components. Service cost and interest on the obligation are displayed as operating costs, while actuarial gains and losses is displayed as a separate SNC line item below operating cost. These two components would then be added together to derive net cost.

Pro Forma *Statement of Net Cost,* Example C

Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	944,138
Less: Exchange Revenues	339
Net Operating Cost	943,799
Actuarial Losses	100,000
Net cost	$1,043,799

The total net cost amount would be displayed on the statement of changes in net position the same way as is done currently (see Appendix 5).

Example D: Amortization of Actuarial Gains and Losses with Deferred Recognition (Appendix 6)

Example D is an amortization example. As in Example A, a single line item is displayed on the balance sheet for the liability, but the amount is smaller ($14,910,000 million) because the actuarial loss is being amortized. For this example the $100 billion of hypothetical actuarial loss is assumed to be amortized over a 10-year period at a straight-line rate of $10 billion per year, including FY 2004; thus, only $10 billion is reported on the SNC as follows:

Pro Forma *Statement of Net Cost* Example D	
Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	944,138
Less: Exchange Revenues	339
Net Operating Cost	943,799
Actuarial Losses	10,000
Net cost	$953,799

The portion of the actuarial the loss being amortized (recognized) in FY 2004 ($10,000 million) is shown as a separate SNC line item below operating cost, as in Example C; and the $10,000 million of actuarial loss is added to other expenses on the SNC to derive net cost. The other $90,000 million is not recognized. It would be disclosed in the notes, for example:

Note Disclosure:	
Note No. X: Unamortized Gain/(Loss)	
Beginning balance	$0
Addition gain/(loss)	(100,000)
Current period amortization	10,000
Ending balance	($90,000)

This approach is similar to FAS 87, *Employers Accounting for Pensions*, and 106, *Employers Accounting for Postretirement Benefits Other Than Pensions*.

Example E: Amortization of Actuarial Gains and Losses with Recognition (Appendix 7)

Example E is also a type of amortization example where the amount of the actuarial loss is amortized to net cost. The unamortized amount ($90,000 million) increases the social insurance liability and decreases (debits) "equity," i.e., net position as follows:

Selected Line Items from Pro Forma *Balance Sheet*, Example E

Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,304,797)
Unamortized Actuarial (Gains)/Losses	(90,000)
Total Net Position	(13,393,308)
Total Liabilities and Net Position	$1,668,907

Thus, the full amount ($15,000,000 million) would be shown as a liability.

The pro forma entries for the example above would be:

Pro Forma Entries for Example E		
Entries to record the 2004 expense:		
DR -- Social Security Accrued Expense	$910,000	
DR -- Unamortized Gains(CR)/Losses(DR)	$90,000	
CR -- Accrued SS Liability		$1,000,000
Entries to record the 2004 payment to beneficiaries:		
DR -- Accrued SS Liability	$487,643	
CR -- Fund Bal w/Treasury		$487,643
Entries to record amortization in subsequent years:		
DR -- Social Security Accrued Expense	$10,000	
CR – Unamortized Gains(CR)/Losses(DR)		$10,000

This is similar to the FAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, and IAS 39, *Financial Instruments: Recognition and Measurement*, approach for reporting investments in three categories. One of the categories, "available for sale," entails marking to market, with changes reported in equity as unrealized amounts. (The other two investment categories, "held to maturity" and "held for trading," are reported at historical cost or marked to market with changes reported in net income, respectively.)

The SNC would display $10,000 million of expense related to amortization of actuarial gains and losses, the same as Example D. The SNC shows the service cost and interest on the obligation disaggregated and the portion of the actuarial loss being amortized to expense in

FY 2004 ($10,000 million) as a separate line item below operating cost on the statement of net cost.

However the remaining $90,000 million would be reported on the SCNP as a separate component of net position (or "equity") after the total of the ending balance of "cumulative results," for example:

Pro Forma *Statement of Changes in Net Position*, Example E

	2,004 Cumulative Results of Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($13,034,563)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost	(953,799)	
Ending Balances	($13,304,797)	$1,489
Unamortized Gain/Loss	($90,000)	

Staff Display Recommendations

Balance Sheet

Staff recommends a single liability line item for the balance sheet that references a revised SOSI, as shown in Appendix 8. The revised SOSI would display an amount for those 62 years of age and older and for those under 62 who have 40 quarters of work in

covered employment, among other subtotals. Staff also recommends certain note disclosure (e.g., assumptions, a stochastic graph) and RSI (see below). This display would be concise while providing additional information in notes and RSI.

Statement of Net Cost

Staff recommends that service cost and interest on the obligation be displayed as separate components of "operating cost;" and actuarial gains or losses and prior service costs, if any, presented as a separate component after operating cost, but as part of the total cost on the SNC, as in Example C.

This display responds to at least one FASAB member's suggestions. It categorizes service cost and interest on the obligation as operating expense and gains or loses from actuarial changes as "non-operating expense." It would highlight the effects of actuarial changes, which are significant, and include them as a component of aggregate "net cost."

Statement of Changes in Net Position

Staff is not recommending any changes to the statement of changes in net position (SCNP) display. The staff's recommendation for the SNC display would result in the same "net cost" being carried over to the SCNP.

Does the Board agree with the staff recommendations?

Possible Note Disclosures

A. Components of cost:

For Social Security and Medicare HI:

Present value of future benefits credited in the period
Interest on the liability obligation
Actuarial gain/loss (if any)
Prior service cost (if any)
Total expense for the period

For Medicare SMI:

Claims incurred
Claims incurred but not reported
Contingent claims
Premium deficiency (if any)
Total expense for the period

B. The benefits accrued by participants with less than 40 quarters of work in covered employment

The benefits accrued by participants with less than 40 quarters of work in covered employment is displayed on the revised SOSI, line 6c (see Appendix 8). The revised SOSI could suffice, if the Board decides to require it, or the information could be disclosed in the notes.

C. The amount of the liability in excess of statutory resources

Question #2 of the August staff memorandum asked whether Social Security and Medicare liabilities should include projected amounts in excess of the current statutory resources provided. Staff recommended including the full cost and full liability to the participants. A majority agreed with the staff recommendation, and decided that the statutory limitation should be reported either on the face of the financial statements or in a footnote.

The staff notes that, as a practical matter, the statutory "cap" would not affect the social insurance liability measure. Two points: First, the statutory "cap" involves the open group projection, which, as the Board is well aware, includes all participants and all revenue and cost over 75 years, which is different than the liability measure the staff recommended. The latter measures the gross cost of benefits for a specific, limited population group. No payroll taxes to be paid in the future or benefits to be credited in the future would be included in the liability. Assets (i.e., Treasury securities), which represent accumulated excess revenue received as of the reporting date, would be accounted for separately under the proposal. Secondly, the cap appears to be a funding issue, and the Board has said that funding should not affect liability recognition.

The staff notes that the statutory limitation would affect the Medicare liability sooner than the Social Security. The statutory resources currently provided for Medicare HI will be

insufficient to pay 100 percent of claims much sooner than for Social Security. By 2020 the HI trust fund is projected to become exhausted and expenditures would exceed tax revenues.[2] On the other hand, Medicare SMI (Part B), which covers doctor bills, has access to the General Fund and therefore has no such statutory limitation.

A brief discussion in the notes of what the open group projection reveals about trust fund exhaustion may be useful information.

D. Components of the change in the liability account

Components of the change in the liability account, for example:

Liability Account	(millions)
Beginning Liability, FY 2004	$14,487,643
Add: accrued expense for the year	1,000,000
Subtotal	15,487,643
Less: Payment to beneficiaries	(487,643)
Ending Liability, FY 2004	$15,000,000

E. Statement of Social Insurance

Statement of Social Insurance (SOSI) is currently a basic statement per SFFAS 25. The staff assumes it would remain a basic statement. Appendix 8 illustrates modifications to the present value amounts currently shown on the SOSI – these modifications would permit an explanation of the relationship of balance sheet amounts and SOSI amounts. Some have suggested that the SOSI also display an explanation of changes in present value amounts between years. For example, changes could be broken down as follows:

[2] *2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, page 61. (*2005 HI and SMI Annual Report*)

Service cost	XXXX
Interest cost	XXXX
Prior service cost	XXXX
Actuarial gains/losses for the period	XXXX
Net cost for the period	XXXX
Change in future contributions and earmarked taxes	XXXX
Future service cost attributable to changes in law or policy during the period	XXXX
Actuarial gains/losses related to benefits to be accrued in the future	XXXX
Total change in net present value	XXXX

Staff suggests the Board discuss the general concept of adding information about the sources for changes in the present value amounts to the SOSI at the October meeting. Staff would then provide alternatives for consideration in January if the Board wishes to pursue this option.

F. Assumptions

SFFAS 26 requires SOSI assumptions in the notes to the financial statements. Staff assumes that the Board would not want to change that requirement. The assumptions would pertain to all basic statements, including SOSI.

G. Open and/or Closed Group Actuarial Present Value

In addition to possible SOSI changes (see Appendix 8), actuarial accrued liability and/or net present value (NPV) for the open and/or closed group populations could be displayed in the notes to contrast with the proposed liability. For example, from the Trustees' Annual Report:

Table IV.B7.—Present Values of OASDI Cost Less Tax Revenue and Unfunded Obligations for Program Participants

[Present values as of January 1, 2005; dollar amounts in trillions]

	Present value	Expressed as a percentage of future payroll and GDP: Taxable payroll	GDP
Present value of future cost less future taxes for current participants	$13.7	4.3	1.5
Less current trust fund (tax accumulations minus expenditures to date for past and current participants)	1.7	.5	.2
Equals unfunded obligation for past and current participants[1]	12.0	3.8	1.3
Plus present value of cost less taxes for future participants for the infinite future	-.9	-.3	-.1
Equals unfunded obligation for all participants through the infinite horizon	11.1	3.5	1.2

[1] This concept is also referred to as the closed group unfunded obligation.

Notes:
1. The present value of future taxable payroll for 2005 through the infinite horizon is $319.7 trillion.
2. The present value of GDP for 2005 through the infinite horizon is $921.2 trillion.
3. Totals do not necessarily equal the sums of rounded components.

Table III.B11.—Unfunded HI Obligations for Current and Future Program Participants through the Infinite Horizon

[Present values as of January 1, 2005; dollar amounts in trillions]

	Present value	As a percentage of: HI taxable payroll	GDP
Future expenditures less income for current participants	$9.6	2.3%	1.0%
Less current trust fund (income minus expenditures to date for past and current participants)	0.3	0.1%	0.0%
Equals unfunded obligations for past and current participants[1]	9.4	2.3%	1.0%
Plus expenditures less income for future participants for the infinite horizon	14.7	3.5%	1.5%
Equals unfunded obligations for all participants for the infinite future	24.1	5.8%	2.5%

[1] This concept is also referred to as the closed-group unfunded obligation.

Notes:
1. The estimated present value of future HI taxable payroll for 2005 through the infinite horizon is $415.5 trillion.
2. The estimated present value of GDP for 2005 through the infinite horizon is $956.8 trillion.
3. Totals do not necessarily equal the sums of rounded components.

Table III.C16.—Unfunded Part B Obligations for Current and Future Program Participants through the Infinite Horizon

[Present values as of January 1, 2005; dollar amounts in trillions]

	Present value	As a percentage of GDP
Future expenditures less income for current participants	$0.2	0.0%
Expenditures	$13.2	1.4%
Income	$12.9	1.3%
Beneficiary premiums	$3.3	0.3%
General revenue contributions	$9.7	1.0%
Less current trust fund (income minus expenditures to date for past and current participants)	$0.0	0.0%
Equals unfunded obligations for past and current participants[1]	$0.2	0.0%
Expenditures	$13.2	1.4%
Income	$12.9	1.3%
Beneficiary premiums	$3.3	0.3%
General revenue contributions	$9.7	1.0%
Plus expenditures less income for future participants for the infinite horizon	–$0.2	0.0%
Expenditures	$21.3	2.2%
Income	$21.5	2.3%
Beneficiary premiums	$5.4	0.6%
General revenue contributions	$16.1	1.7%
Equals unfunded obligations for all participants for the infinite future	$0.0	0.0%
Expenditures	$34.5	3.6%
Income	$34.5	3.6%
Beneficiary premiums	$8.7	0.9%
General revenue contributions	$25.8	2.7%

[1]This concept is also referred to as the closed-group unfunded obligation.

Notes: 1. The estimated present value of GDP for 2005 through the infinite horizon is $956.8 trillion.
2. Totals do not necessarily equal the sums of rounded components.

Staff Disclosure Recommendations

In addition to SOSI changes, Staff recommends the following be disclosed in the notes:

- The benefits accrued by participants with less than 40 quarters of work in covered employment (option “B” above)
- The amount of future outlays in excess of future resources over 75 year for the open group (option “C”)
- Components of the change in the liability account (option “D”), and
- Assumptions (option “F”)

The staff has recommended that the statement of net cost display components of cost on the face of the statement and therefore does not recommend it for the notes. However, the Board may prefer more aggregate reporting on the SNC, which might lead to disclosing components in a note.

Also, the staff assumes that the SOSI will continue to be a basic statement and not a note disclosure.

Finally, the open and closed group measures might be disclosure candidates, but they would be included in or derivable from the SOSI, assuming the Board intends to include it.

Does the Board agree with the staff disclosure recommendation and/or prefer other or additional disclosures?

Should information about the sources for changes in the present value amounts be added to the SOSI?

Required Supplemental Information

Alternatives A, B, and C below reflect the current SFFAS 17 requirements.

A. Cash flow projections in nominal dollars and/or as a percentage of GDP and/or as a percentage of taxable payroll.

B. Dependency ratio, i.e., the ratio of contributors to beneficiaries.

C. Sensitivity Analysis

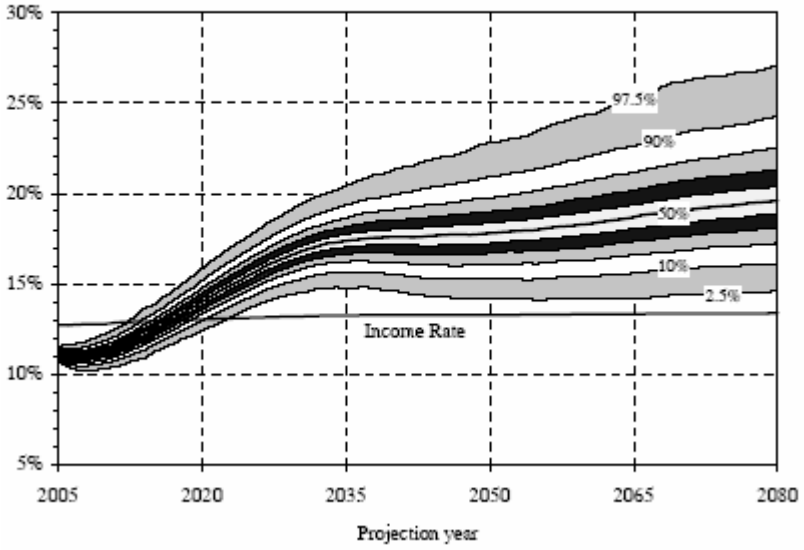
SFFAS 17 requires component entities to illustrate the sensitivity of projections and present values to changes in the most significant individual assumptions, but it does not require any particular approach. It provides examples whereby significant intermediate assumptions are varied by a percent to show the effect. Entities have adopted this approach.[3] SFFAS 17 requires the consolidated entity to provide a summary of the component entities' sensitivity analyses.[4]

One member has requested rescission of the SFFAS 17 requirement for sensitivity analysis. This member has suggested merely requiring a statement to the effect that the liability and expense amounts are estimates, that estimates vary, and that actual flows will be different, sometimes substantially different.

The Social Security Trustees have started to provide stochastic simulation to illustrate uncertainty like the following graph, which projects cost as a percentage of taxable payroll by confidence levels:

[3] SFFAS 17, par. 27(4)
[4] SFFAS 17, par. 32(4)

Figure VI.E2.—Annual Cost Rates



A standard could require the entity to explain the graph, as in the following example [adapted from the one provided by the Social Security Trustees for the above graph]:

> The probability distribution of the year-by-year OASDI cost rates (i.e., cost as a percentage of taxable payroll) is shown in [the above graph]. The range of the cost rates widens as the projections move further into the future, reflecting increasing uncertainty.
>
> The income rate under the intermediate assumptions is also included in the [graph] in order to give some indication of the patterns of cash flow for the OASDI program. Only this income rate is included because of the relatively small variation in income rates throughout the projection period.
>
> The two extreme lines in this figure illustrate the range within which future annual cost rates are estimated to occur 95 percent of the time (i.e., a 95-percent confidence interval). In other words, actual future cost rates in a given year would be expected to exceed the upper bound only 2.5 percent of the time or to fall below the lower bound 2.5 percent of the time.
>
> The lines in the figure display the median set (50th percentile) of estimated annual cost rates and the 95-percent, 80-percent, 60-percent, 40- percent, and 20-percent confidence intervals expected for future annual cost rates.
> It is important to note that these lines do not represent the results of individual stochastic simulations. Instead, for each given year, they represent the percentile distribution of cost rates based on all stochastic simulations for that year.
>
> The projected cost rates for the year 2035 for the low cost and high cost alternatives described earlier are 14.80 percent of payroll and 20.22 percent of

payroll, respectively. These are quite close to the limits of the 95-percent confidence interval, as seen in [the graph immediately above]. By 2079, the cost rates for these alternatives, 13.84 and 26.76 percent of payroll, are still fairly close to the limits of the 95-percent confidence interval (14.54 and 26.94 percent of payroll).[5]

Regarding the projection using the intermediate assumptions, the projected cost rate for the year 2035 is 17.5 percent of taxable payroll. This is quite close to the 50-percent confidence interval as seen in the graph immediately above. By 2079, the cost rate for the intermediate assumptions is 19.08 percent of payroll, fairly close to the 50-percent confidence interval of 19.94 percent of payroll shown above.[6]

Staff RSI Recommendation

The staff recommends retaining the current RSI except for the sensitivity example. Staff recommends a brief statement as suggested by the member, and a stochastic simulation presentation to be designed with the assistance of SSA and/or others as in the above graph.

Does the Board agree with the staff RSI recommendation and/or prefer other or additional RSI?

Other Issues

1. Are Increments In The Liability For Social Security After 40 Quarters Obligating Events?

The staff memorandum for the August meeting noted that a majority of the Board tentatively decided that the obligating event for Social Security and Medicare Hospital Insurance (HI) occurs when participants meet the 40-quarters of work in covered employment (or equivalent) condition for eligibility. The staff memo also said that a key component of cost is the present value of future outflows attributable to obligating events occurring in the reporting period.

[5] *2005 Social Security Trustees' Report*, p. 161.
[6] FASAB staff constructed this paragraph based on the Trustees' data and narrative.

Mr. Patton noted that these two statements might not work together. The obligating event was either 40 quarters, or 40 quarters and subsequent work in covered employment.

He asked what the present obligation occurring at 40 quarters would be for, and suggested it was for the present value of the full amount due when the participant retires rather than only the amount attributable to 40 quarters of work in covered employment. This might result if attaining 40 quarters is the sole obligating event.

Mr. Patton said he thought subsequent increments were being treated as if an earnings process was taking place. He disagreed with that treatment but said that, if this is the Board's position, then the subsequent work in covered employment was also an obligating event.

The Board discussed this issue and some members seemed to consider the increments after 40 quarters a function of measurement. In other words, the obligation occurs at 40 quarters and is measured using work completed in covered employment as of the reporting date.

Alternatives:

1. One obligating event. The present obligation occurs at 40 quarters and cost is estimated based on the measurement procedures.

2. Multiple obligating events. The present obligation occurs at 40 quarters of work in covered employment and also in each additional quarter-month-day of work in covered employment. Both are conditions that can be met.

Discussion

For Social Security, the cost for both alternatives is the present value of the benefit that the participant will receive based initially on 40 quarters of work in covered employment and incremented thereafter by each additional quarter-month-day of work in covered employment attributable to the reporting period. The issue is how to characterize

subsequent quarters (or months or days) of work in covered employment that result in a larger benefit.

The 40-quarter event has been characterized as “substantially meeting conditions” for eligibility. The Board decided that work in covered employment prior to 40 quarters was not an obligating event. Thus, if work in covered employment after 40 quarters is an obligating event, then is it qualitatively different than such work before 40 quarters?

Staff Recommendation

Staff recommends alternative #1: One obligating event: 40 quarters. Cost increments after 40 quarters would be characterized as a function of the required measurement procedures. Cost is the present value of the benefit that the participant will receive based initially on 40 quarters of work in covered employment and incremented thereafter by each additional quarter-month-day of work in covered employment attributable to the reporting period. The liability is the accumulated cost.

The goal is for the service cost component of expense to be the actuarial present value of benefits attributed by Social Security’s benefit formula to (1) 40 quarters of work in covered employment and (2) subsequent quarters (or months or days) of work, in the periods that these are attained.

A participant’s Social Security benefit is calculated using his or her average earnings from the 35 years in which he or she earned the most, indexed for increases in the average wage level since the year the earnings were received. The total indexed earnings for the 35 years are divided by 35 years and then 12 months to derive the participant’s “average indexed monthly earnings.” A formula is applied to these earnings and to derive the amount the participant will receive at full retirement age – which was 65 but is gradually increasing to 67. For example, if a participant earned the maximum taxable amount under Social Security in his or her highest 35 years his or her AIME would be $5,870. A formula is applied to the AIME that uses three “bend points” or percentages. For 2004 the percentages were 90% of the first $697 of AIME, 32% of the amount between $697 and 3567, and 15% of the remainder. Thus, the benefit in this example would be $1,851 a month. If the participant only worked 40 quarters in covered

employment he or she would have filled only 10 of the 35 years. In this case the participant's benefit would be approximately $792. If the participant had 11 years of work in covered employment the benefit would be approximately $871. The increment for year 2 is $79 and the "service cost" for year two would be the present value of $79 to be received in the future.

In other words, A Social Security participant working only a total of 40 quarters in covered employment over his or her working life receives a specific amount of benefit. If 41 quarters were worked, then a larger specific amount of benefit is due. The accumulated benefit is incremented after 40 quarters by each additional quarter (or month or day) of work in covered employment. Staff believes that additional benefits that accumulate after the first 40 quarters are parallel to interest that accrues on a debt. The liability increases on a continuous, even daily, basis.

Again, the annual cost is measured as the present value of the future benefits attributed to work in the reporting period.

Does the Board agree with the staff recommendation?

2. How Should the Medicare HI Cost Be Attributed?

The prior question with respect to the obligating event raises another issue regarding Medicare HI cost. At 40 quarters the Medicare HI participant, like the Social Security participant, has met the conditions for eligibility for the program. Unlike Social Security, however, the participant's benefit will not increase after 40. The issue is how to attribute Medicare HI cost to years of service.

The Medicare HI participant's future benefit would be calculated using the projected future costs of the coverage. The principal steps involved in projecting the future HI costs are

(1) establishing the present cost of services provided to beneficiaries, by type of service, to serve as a projection base; and
(2) projecting increases in HI payments for

(a) inpatient hospital services, skilled nursing, home health, and hospice services covered;
(b) managed care plans; and
(c) administrative costs.[7]

The Medicare HI participant's benefit is not increased by work in covered employment after 40 quarters; nor is it related to the amount of payroll taxes paid. The participant and his or her employer are required to pay 1.45% of total earnings, each. Thus, the participant earning $2 million dollars a year and paying $29,000 a year (and whose employer pays $29,000) receives the same benefit or coverage as the participant earning $20,000 and paying $290. Although participants "pay for" HI coverage throughout their working career, the amount paid will be dramatically different.

FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, requires that an employer's obligation for postretirement benefits expected to be provided to or for an employee be fully accrued by the date that the employee attains "full eligibility" for all of the benefits expected to be received by that employee (the full eligibility date). Full eligibility is attained by meeting the age, service, or age and service conditions of the plan. The "full eligibility date" is the date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits that employee is expected to receive under the plan. For example, if a plan provides a postretirement health care or life insurance benefit to an employee who renders 10 years of service, the actuarial present value of that benefit should be fully accrued at the end of 10 years of service. Similarly, if a plan provides a postretirement benefit to an employee who attains age 55 while in service, the actuarial present value of that benefit should be fully accrued when the employee attains age 55. If a plan requires both 10 years of service and 55 years of age, then actuarial present value of that benefit would be fully accrued at the longer of the two periods. Determination of the full eligibility date is not affected by the plan terms that define when the benefit payments commence.[8]

FAS 106 requires an equal amount of the obligation attributed to each year of service generally beginning at the date of hire and ending at the full eligibility date. Thus, if FAS

[7] *2005 HI and SMI Annual Report*, p. 115.
[8] See FAS 106, pars. 221-2.

106 were applied to Medicare HI, the actuarial present value of the benefit would begin to be accrued when work began in covered employment and be fully accrued at 40 quarters.

Unlike a private employer's cost, Medicare HI is not deferred compensation to be spread over the working life of employees. It is, however, a cost of government. The question is whether to recognize the present value of the full obligation at 40 quarters or spread it over the participants work in covered employment. The participant and his or her employer pay payroll taxes over that time. They are, in a sense, paying for the benefit.

The FASB stated in FAS 106 that it was unable to find a basis for attributing postretirement benefits that would be more appropriate than measurement of the current benefit cost and accumulated obligation based on years of service. The FASB noted that FAS 87 prescribes the attribution of pension benefits on the basis of years of service; compensation is considered for measuring the amount of the benefit to be attributed to each year of service when compensation levels are a factor in determining the amount of the pension benefit. "The Board found no compelling reason to prescribe a different basis for attributing postretirement benefits than the basis used for attributing pension benefits." [FAS 106, par. 210]

Thus, with respect to Medicare HI, one alternative is to recognize the present value of the entire obligation at 40 quarters. Another alternative is to recognize a percent at 40 quarters and attribute the balance to years of work in covered employment. For many participants 40 quarters would represent about 25 percent of his or her working life.

Staff Recommendation

Staff recommends recognizing the present value of the entire obligation at 40 quarters. The goal is for the service cost component of expense to be the actuarial present value of benefits attributed by Social Security's benefit formula to (1) 40 quarters of work in covered employment and (2) subsequent quarters (or months or days) of work, in the periods that these are attained. For Medicare, no additional expense is attributed to subsequent quarters of work.

Does the Board agree with the staff recommendation?

3. Should Medicare SMI Be Accounted For As Short- or Long-Duration Insurance?

At the August FASAB meeting staff recommended that insurance accounting concepts be applied to Medicare Supplementary Medical Insurance (SMI). SFFAS 5 requirement for insurance contracts are as follows:

> All federal insurance and guarantee programs (except social insurance and loan guarantee programs) should recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. The standard requires recognition of the liability that is known with certainty plus an accrual for a contingent liability …. Insurance and guarantee programs should recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported and contingencies that meet the criteria for recognition. Life insurance programs should recognize a liability for future policy benefits (a liability to current policyholders that relates to insured events, such as death or disability) in addition to the liability for unpaid claims incurred. [SFFAS 5, par. 104]

Also, "risk assumed" information is required supplementary information. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. [SFFAS 5, par. 105]

In SFFAS 25 the Board had the following to say as to why it continues to classify risk assumed information as RSI rather than basic information:

> The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables. The Board believes that additional guidance from FASAB on definition and measurement of "Risk Assumed" would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements. Developing and promulgating such guidance would require a separate project. Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies' data systems and modeling capabilities to support reporting Risk Assumed. The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner. The Board notes that the "state of the art" for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop more specific criteria for

reporting Risk Assumed, the Board will be able to learn from this ongoing experience. [SFFAS 25, par. 21]

The SFFAS 5 insurance standard is intentionally very similar to FASB FAS 60, *Accounting for Insurance*. Both are predicated on the distinction between short- and long-duration insurance. Short-duration insurance differs from long-duration insurance in that the former provides insurance protection for a fixed period of short duration and enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period. A long-duration contracts, e.g., whole-life and guaranteed renewable term life contracts, generally are not subject to unilateral changes.

Examples of short-duration contracts include most property and liability insurance contracts and certain term life insurance contracts, such as credit life insurance. Accident and health insurance contracts may be short-duration or long-duration depending on whether the contracts are expected to remain in force for an extended period. For example, individual and group insurance contracts that are noncancelable or guaranteed renewable (renewable at the option of the insured), or collectively renewable (individual contracts within a group are not cancelable), ordinarily are long-duration contracts. [FAS 60, par. 8]

For both short- and long-duration insurance contracts, a liability would be accrued for unpaid claim costs when insured events occur, including estimates of costs relating to claims incurred but not reported (IBNR). The liability is based on the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. Changes in estimates of claim costs resulting from a continuous review process and differences between estimates and payments for claims are recognized as expense or losses or gains of the period in which the estimates are changed or payments are made.

Accounting for long-duration contracts also requires recognizing a liability for future policy benefits, as noted in SFFAS 5, par. 104 cited above. The liability represents the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. The liability is an estimate using methods that include assumptions

such as expected investment yields, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made.

Premium Deficiency

The accounting for both short- and long-term contracts requires analysis of premium deficiencies, which are characterized in FAS 60 as probable losses.

Short-Duration Contracts

A premium deficiency is recognized on short-duration contracts if the sum of expected claim costs, claim adjustment expenses, etc., exceed related unearned premiums. [FAS60, Par. 33] The affect of premium deficiency on short-duration contracts is limited.

Long-Duration Contracts

Original policy benefit assumptions for long-duration contracts ordinarily continue to be used during the periods in which the liability for future policy benefits is accrued. However, actual experience with respect to investment yields, mortality, morbidity, terminations, or expenses may indicate that existing contract liabilities, together with the present value of future gross premiums, will not be sufficient to cover the present value of future benefits and other costs to be paid relating to a block of long-duration contracts. In those circumstances, a premium deficiency is determined as follows:

Present value of future payments for benefits and related costs, determined using **revised assumptions** based on actual and anticipated experience	$XXX
Less the present value of future gross premiums, determined using **revised assumptions** based on actual and anticipated experience	XX
Liability for future policy benefits using **revised assumptions**	XX
Less the liability for future policy benefits at the valuation date, reduced by unamortized acquisition costs	XX
Premium deficiency	$XX

A premium deficiency is recognized as an expense and an increase in the liability for future policy benefits. If a premium deficiency does occur, future changes in the liability are based on the revised assumptions. No loss is reported currently if it results in creating future income. [FAS60, Par. 36]

SFFAS 5 requires premium deficiency consideration for federal life insurance programs, which might be taken as an implicit general preference for this approach for other long-duration contracts.

This issue is: should renewal be assumed for the SMI, i.e., should SMI be deemed a long-duration contract? If so, then future premiums and future cost projected and netted. If not, SMI will be treated as a short-duration contract and the projection would be limited to the claims of the reporting year and premium deficiency only to the extend of unearned premiums.

Staff Recommendation

Staff recommended at the August 2005 FASAB meeting and continues to recommend that SMI be treated as short-duration insurance. This recommendation is and for some time will remain tentative. Social insurance issues and insurance accounting are complex

subjects. The accounting concepts in this project are expected to develop and be refined as the project continues.

Does the Board agree with the August recommendation that SMI be accounted for as short-duration insurance?

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

1
2
3
4
5

	Board Majority View	Board Minority View
Question #1 – What attribute should be measured for social insurance? Staff recommends present value. The objective regarding the measurement attribute for social insurance should be the same as FASB's "fair value." Fair value is essentially market value but "for some assets and liabilities, management's estimates may be the only available information." Present value is a component of FASB's fair value hierarchy. Moreover, present value is required in various current FASAB standards that require long-range projections, including SFFAS 5 (for pension, retirement healthcare, insurance, and other liabilities), SFFAS 17, and others. Also, the Social Security Trustees use present value extensively in their Annual Report.	The members agreed with the recommendation.	No disagreement was expressed.

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
Question #2 – Should OASDI and Medicare liabilities include projected amounts in excess of the current statutory limit? Staff recommends including the full cost and full liability to the participants. The probability that the Government would ignore the shortfall and then default on a large percentage of the benefits is remote. [Staff Note: Regarding this issue, staff notes two points. First, the cap involves the open group projection, which, as the Board is well aware, includes all participants and all revenue and cost over 75 years. It is a different measure than the liability the staff recommended, which measures the gross cost of benefits for a specific, limited population group. No taxes to be paid in the future or benefits to be credited in the future would be included in the liability. Assets (i.e., Treasury securities), which represent accumulated excess revenue received as of the reporting date, would be accounted for separately under the proposal. Secondly, this appears to be a "funding" issue, and the Board has said that funding should not affect liability recognition.	Messrs. Patton, Schumacher, Reid, and Mosso, and Ms. Cohen agreed with the staff recommendation, with the statutory limitation reported either on the face of the financial statements or in a footnote. <u>Some of the rationales expressed</u>: Mr. Reid said that a computation that was limited to statutory provision would be incomplete. Ms. Cohen said that current law does not limit the benefits per se. The projection shows a shortfall, but the projection is based on assumptions and estimates and may be change. Current law merely makes it a self-financing program.	Three members disagree with recommendation (GAO, OMB, CBO). One member (Mr. Farrell) was concerned about what he viewed as inconsistent application of the current law notion, but he did not express a position. <u>Some of the rationales expressed</u>: Mr. Torregrosa said that since the Board is using current law as the basis for liability decisions and current law specifies that funding is cut off, the projection should be based on what is available. Mr. Dacey said that amounts should not be projected in excess of the statutory limit. Although accruing liabilities for other unfunded programs is appropriate, these programs are unique because of the public communication that full benefits will not be paid in the future. However, the full exposure or responsibility for the federal government should be communicated in the SOSI.

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
Also, the cap would affect the Medicare liability sooner than the Social Security. The statutory provisions for Medicare will be inefficient to pay 100 percent of HI claims (SMI, Part B, re doctor bills has access to the General Fund and therefore has no such "cap") will arrive much sooner than for Social Security.]		
Question #3 – What assumptions should be used in projecting cash flow? **The staff recommends a general requirement as in SFFAS 5 with a reference to actuarial standards of practice.** The recommendation is a pragmatic approach to this very difficult subject and has been effective for past FASAB standards. Also, from a cost-benefit perspective, one might question not availing of the current process.	The members agreed with the recommendation.	No disagreement was expressed.
Question #4 – How should uncertainty be illustrated? **In addition to the recommendations below regarding display, disclosure and RSI, the staff recommends exploring the use of "expected present value" as an alternative to present value based on the "best estimate."**	The members agreed with the recommendation and decided that the exploration would be part of the measurement project or at least not part of the Social Insurance Liability Project.	No disagreement was expressed.

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
The expected cash flow approach accommodates the use of present value techniques when the timing of cash flows is uncertain. The expected cash flow approach focuses on explicit assumptions about the range of possible estimated cash flows and their respective probabilities. The "best estimate" approach is well known and perhaps even "generally accepted" with respect to Social Security and Medicare, and yet the EPV approach is gaining is acceptance in the private sector and is worth exploring for social insurance.		
Question #5 – What should be recognized as social insurance "expense" or "cost"? **The staff recommends four components.** For OASDI and HI the four components of cost describe above – "service cost," interest on the liability, actuarial gains and losses, and prior service cost – are consistent with the benefit promise expressed for OASDI and HI as a given amount per year of work in covered employment as well as the changes therein in subsequent periods. For SMI staff recommends the insurance accounting provided in	A majority of the Board agreed with the recommendation.	No disagreement was expressed but Mr. Patton raised an issue regarding what the cost or expense would be for. He noted that the staff memo, on page 1, notes that a majority of the Board tentatively decided that the obligating event for Social Security and Medicare Hospital Insurance (HI) occurs when participants meet the 40-quarters of work in covered employment (or equivalent) condition. On page 2, the memo says that a key component of cost is the present value of future outflows attributable to obligating events occurring in the reporting period. He said these two statements did not appear to work together, unless work in covered employment after 40 quarters is also an obligating event. He asked what the obligation occurring at 40 quarters is for? He suggested it was for the present value of the full amount due when the participant retires rather than only the amount credited to the participant at 40 quarters, plus the annual increments after that,

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
SFFAS 5 and FAS 60. The staff recommends that SMI be characterized as short-term health insurance because it has the short-term characteristics discussed in FAS 60, e.g., SMI provides insurance protection for a fixed period, and the Government may adjust the provisions of coverage at the end of any coverage period. The cost of SMI would be the all claims incurred during the period, including, when appropriate, those not yet reported and contingencies that meet the criteria for recognition; and a provision for premium deficiency, if any. As short-duration insurance SMI is not likely to have premium deficiency. The SMI would involve a shorter-range estimate than Social Security and HI, but where longer-range estimates were necessary, present value would be appropriate. In the case SMI cost would include components like those measure for OASDI and HI, i.e., present value, interest on the obligation, actuarial gains and losses.		based on work covered employment to the reporting date. He said the subsequent increments were being treated as if an earnings process was taking place, which he disagreed with. But if the latter is the Board's position, then the subsequent work in covered employment was also an obligating event. Mr. Dacey said he also saw a comparison issue between the staff recommendation for measuring Social Security as an incremental cost versus the SMI approach. He said future revenue should be included because it is a realistic assumption that participants will be paying the premium when they are getting the benefits. He said he did not know why that was not being recommended for Social Security as well. Mr. Torregrosa said that CBO does not distinguish between Social Security and Medicare Hospital Insurance, Part A, on the one hand and Medicare SMI, Part B, on the other. Thus, CBO would reject the insurance accounting approach for SMI, Part B, and in particular would not count any future premium income in the estimate because that would not be done for Social Security. He said CBO favors accelerating the recognition point for SMI to 40 quarters.
Question #6 – What should be recognized as the social insurance liability? **The staff recommends that liability be the accumulated cost.** Accrued costs and liabilities for social insurance would exclude costs attributable to obligating events	Chairman Mosso polled the Board. A majority agreed with the staff recommendation that the liability is the accumulated cost.	No disagreement was expressed regarding the notion that the liability should be the accumulated cost. Mr. Patton raised an issue discussed in Question #5 above. Mr. Zavada said that the staff paper had only been available for a short period of time and he had not had time to consult with SSA or HHS on the different questions, which he wanted to do before weighing-in.

	Board Majority View	Board Minority View
occurring in the future.		
Question #7 – What should be displayed for social insurance on the statement of net cost, balance sheet, and other statements? **The Social Insurance project staff recommends a total amount for cost on the statement of net cost and liability on the balance sheet representing all components of accrued cost and liability. The totals could be disaggregated by, for example, age cohort, and/or by degree of uncertainty, and/or by "service cost" plus interest on the liability and actuarial gains and losses.** With respect to employee pensions and other retirement benefits the FASAB precedent is to recognize all components of net cost in the year of incurrence. The conclusion has been that, for example, amortizing actuarial gains and losses over X number of years produces a "smoothing" effect that can be misleading and in the private sector has allowed the preparer to manage earnings.	The Board did not have an opportunity to address this question at this time. Mr. Reid suggested a separate presentation for actuarial gains and losses for social insurance and all other programs where they are significant. He said he has a very strong preference for not commingling operating expenses with changes actuarial assumptions and for finding some place other than the statement of net cost to put the effects of changes in assumptions. Mr. Reid said his goal is to display the components of a change in the liability rather than aggregating it in one number. This would highlight, for example, frequent changes in assumptions that have little economic justification. He said he wants to avoid having hundred billion(s) dollar swings affecting the statement of net cost. He prefers that the latter display the cost of running the government for a year. Mr. Reid said there would be several choices for displaying actuarial gains and losses when they arise. He suggested, for example, that they could be capitalized and amortized; or, they could be booked directly to a statement that displays these effects, which could be closed to net position; or they could be displayed as a line item on the statement of changes in net position so that, in effect, they do not hit the operating cost in the year the changes in assumptions occur. He said that changing the bottom line on this statement to "operating cost" would be a possibility.	

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
	Chairman Mosso said he preferred that actuarial gains and losses not be reported directly to net position. They ought to flow through a statement.	
Question #8 – What should be disclosed about social insurance in the notes? **The staff recommends … to be determined.**	The Board did not have an opportunity to address this question at this time.	
Question #9 – What should be done with RR Retirement, Unemployment Insurance, and Black Lung Benefits? **Staff recommends the following:** **Railroad Retirement – analogize to OASDI and SMI.** **Unemployment Insurance – continue to apply SFFAS 17** **Black Lung Benefits – continue to apply SFFAS 17** Railroad Retirement program features are similar enough to OASDI and Medicare to apply the same approach. Unemployment insurance is unlike OASDI and SMI and for the present the SFFAS 17 is adequate. Black Lung Benefits is immaterial and is phasing-out and SFFAS 17 requirements are adequate.	The Board did not have an opportunity to address this question at this time.	

Appendix 1 – Table of Decisions from August 2005 FASAB Meeting

	Board Majority View	Board Minority View
Question #10 – What is the reporting objective for social insurance? The staff recommends that the objective should be to report the costs incurred in during the reporting period based on obligating events in that period. The objective of the communication should be to report the costs incurred in during the reporting period and the amount of those costs that will have to be financed in future budgets. The latter are sometimes referred to as "legacy costs" or "sunk costs." They represent the accrued liability portion of long-term actuarial projections. Other measures are either macro economic or pertain to a specific aspect of the plan, e.g., return on investment.	A majority of the Board agreed with the recommendation.	No disagreement was expressed, but see Mr. Patton's issue in Question #5 above.

Appendix 2 – Selected SSA FY 2004 Financial Statements for Reference

Balance Sheet

	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Other	1,205
Total Liabilities	62,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	1,605,203
Total Net Position	1,606,692
Total Liabilities and Net Position	$1,668,907

1

Appendix 2 – Selected SSA FY 2004 Financial Statements for Reference

1

Statement of Net Cost

	2,004 (millions)
OASI Program	
Benefit Payments	412,474
Operating Expenses	2,537
Total Cost of OASI Program	415,011
Less: Exchange Revenues	16
Net Cost of OASI Program	414,995
DI Program	
Benefit Payments	75,169
Operating Expenses	2,221
Total Cost of DI Program	77,390
Less: Exchange Revenues	15
Net Cost of DI Program	77,375
SSI Program	
Benefit Payments	35,216
Operating Expenses	2,872
Total Cost of SSI Program	38,088
Less: Exchange Revenues	293
Net Cost of SSI Program	37,795
Other	
Benefit Payments	13
Operating Expenses	1,279
Total Cost of SSI Program	1,292
Less: Exchange Revenues	15
Net Cost of Other	1,277
Total Net Cost:	
Benefit Payments	522,872
Operating Expenses	8,909
Total Cost of Other	531,781
Less: Exchange Revenues	339
Total Net Cost	$531,442

2

Appendix 2 – Selected SSA FY 2004 Financial Statements for Reference

Statement of Changes in Net Position

	2,004 (millions) Cumulative Results of Operations	2,004 (millions) Unexpended Appropriations
Net Position, Beginning Balance	1,453,080	705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out		
Trust Fund Draws and Other - In	1,740	
Trust Fund Draws and Other - Out	(13,958)	
Railroad Retirement Interchange	(3,788)	
Net Transfers-In/Out	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers In-Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost of Operations	531,442	
Ending Balances	1,605,203	1,489

Appendix 3– Pro Forma Financial Statements, Example A

1

Pro Forma *Balance Sheet*, Example A

	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued SS Liability [Max. Transition Cost]	15,000,000
Other	1,205
Total Liabilities	15,062,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,394,797)
Total Net Position	(13,393,308)
Total Liabilities and Net Position	$1,668,907

Appendix 3– Pro Forma Financial Statements, Example A

Pro Forma *Statement of Changes in Net Position,* Example A

	2,004 Cumulative Results Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	(13,034,563)	705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost of Operations	(1,043,799)	
Ending Balances	(13,394,797)	1,489

Pro Forma Entries for Example A

Entries to record 2004 expense:		
DR -- Social Security Accrued Expense	1,000,000	
CR -- Accrued SS Liability		1,000,000
Entries to record the 2004 payments to beneficiaries:		
DR -- Accrued SS Liability	487,643	
CR -- Fund Bal w/Treasury		487,643

Appendix 4 – Pro Forma Financial Statements, Example B

1

Pro Forma Balance Sheet, Example B

	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	$3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	$1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	$3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued SS Liability [Max. Transition Cost]	15,000,000
Participants who have attained age 62	XXX
Participants ages 15-61	XXX
Other	1,205
Total	15,062,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,394,797)
Total Net Position	(13,393,308)
Total Liabilities and Net Position	$1,668,907

2

Appendix 4 – Pro Forma Financial Statements, Example B

1

Pro Forma Statement of Net Cost, Example B

	2,004 (millions)
Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Actuarial Loss	100,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Cost	1,044,138
Less: Exchange Revenues	339
Net Cost	$1,043,799

2

Pro Forma Statement of Changes in Net Position, Example B

	2,004 Cumulative Results of Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($13,034,563)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost of Operations	1,043,799	
Ending Balances	($13,394,797)	$1,489

Appendix 5 – Pro Forma Financial Statements, Example C

Pro Forma Balance Sheet, Example C

	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	$3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	$1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	$3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued SS Liability [Max. Transition Cost]	15,000,000
Liability for payments due 2004-2014	XXX
Liability for payments due after 2014	XXX
Other	1,205
Total Liabilities	15,062,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,394,797)
Total Net Position	(13,393,308)
Total Liabilities and Net Position	$1,668,907

1

Appendix 5 – Pro Forma Financial Statements, Example C

Pro Forma Statement of Net Cost
Example C

	2,004 (millions)
Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	944,138
Less: Exchange Revenues	339
Net Operating Cost	943,799
Actuarial Losses	100,000
Net cost	$1,043,799

Pro Forma Statement of Changes in Net Position
Example C

	2,004 Cumulative Results of Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($13,034,563)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost	1,043,799	
Ending Balances	($13,394,797)	$1,489

Appendix 5 – Pro Forma Financial Statements, Example C

1

Pro Forma Entries for Example C

Entries to record the 2004 expense:		
DR -- Social Security Accrued Expense	$900,000	
DR -- Actuarial Gain(CR)/Loss(DR)	$100,000	
CR -- Accrued SS Liability		1,000,000
Entries to record the 2004 payments to beneficiaries:		
DR -- Accrued SS Liability	$487,643	
CR -- Fund Bal w/Treasury		$487,643

Appendix 6 – Pro Forma Financial Statements, Example D

Pro Forma Balance Sheet, Example D

	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	$3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	$3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued SS Liability [Max. Transition Cost]	14,910,000
Other	1,205
Total Liabilities	14,972,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,304,797)
Total Net Position	(13,303,308)
Total Liabilities and Net Position	$1,668,907

Appendix 6 – Pro Forma Financial Statements, Example D

Pro Forma Statement of Net Cost
Example D

	2,004 (millions)
Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	944,138
Less: Exchange Revenues	339
Net Operating Cost	943,799
Actuarial Losses	10,000
Net cost	$953,799

Pro Forma Statement of Changes in Net Position
Example D

	2,004 Cumulative Results of Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($13,034,563)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost	(953,799)	
Ending Balances	($13,304,797)	$1,489

Appendix 6 – Pro Forma Financial Statements, Example D

Pro Forma Note Disclosure, Example D

Note Disclosure:	
Note No. X: Unamortized Gain/(Loss)	
Beginning balance	$0
Addition gain/(loss)	(100,000)
Current period amortization	10,000
Ending balance	($90,000)

Pro Forma Entries, Example D

Entries to record the 2004 expense:		
DR -- Social Security Accrued Expense	$900,000	
DR -- Actuarial Gain(CR)/Loss(DR)	$10,000	
CR -- Accrued SS Liability		$910,000
Entries to record the 2004 payment to beneficiaries:		
DR -- Accrued SS Liability	$487,643	
CR -- Fund Bal w/Treasury		$487,643

Appendix 7 – Pro Forma Financial Statements, Example E

Pro Forma Balance Sheet, Example E	
	2,004 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	$3,148
Investments	1,635,398
Interest Receivable	22,315
Accounts Receivable	624
Total Intragovernmental	1,661,485
Accounts Receivable, Net	6,182
Property, Plant and Equipment, Net	1,231
Other	9
Total Assets	$1,668,907
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	$3,712
Accounts Payable	4,993
Other	247
Total Intragovernmental	8,952
Benefits Due and Payable	51,569
Accounts Payable	489
Accrued SS Liability [Max. Transition Cost]	15,000,000
Other	1,205
Total Liabilities	15,062,215
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(13,304,797)
Unamortized Actuarial (Gains)/Losses	(90,000)
Total Net Position	(13,393,308)
Total Liabilities and Net Position	$1,668,907

Appendix 7 – Pro Forma Financial Statements, Example E

Pro Forma Statement of Net Cost
Example E

	2,004 (millions)
Accrued Cost of Social Security:	
Service Cost	$500,000
Interest on the Obligation	400,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	944,138
Less: Exchange Revenues	339
Net Operating Cost	943,799
Actuarial Losses	10,000
Net cost	$953,799

1

Pro Forma Statement of Changes in Net Position
Example E

	2,004 Cumulative Results of Operations (millions)	2,004 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($13,034,563)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost	(953,799)	
Ending Balances	($13,304,797)	$1,489
Unamortized Gain/Loss	($90,000)	

Appendix 7 – Pro Forma Financial Statements, Example E

1

Pro Forma Entries for Example E		
Entries to record the 2004 expense:		
DR -- Social Security Accrued Expense	$910,000	
DR -- Unamortized Gains(CR)/Losses(DR)	$90,000	
CR -- Accrued SS Liability		$1,000,000
Entries to record the 2004 payment to beneficiaries:		
DR -- Accrued SS Liability	$487,643	
CR -- Fund Bal w/Treasury		$487,643
Entries to record amortization in subsequent years:		
DR -- Social Security Accrued Expense	$10,000	
CR -- Unamortized Gains(CR)/Losses(DR)		$10,000

Appendix 8 – Pro Forma Statement of Social Insurance
Illustrating a Line for an Accrued Liability.

The following table contains a pro forma statement of social insurance (SOSI) that illustrates what the SOSI might look like if it added lines linked to accrued liabilities on the balance sheet. The table presents disaggregated information regarding the present SOSI line item for Social Security participants age 15-61. It presents lines for (1) benefits accrued for participants having attained 40 quarters of work in covered employment (40 QC), which would relate to the balance sheet if the 40 QC obligating event were used for liability determination; (2) benefits accrued for participants without 40 QC; and (3) benefits to be accrued by these participants in the future. Similar pro forma lines are added to the Medicare sections. This pro forma SOSI also illustrates a total "accrued benefit obligation," which would represent the accrual of all costs attributable to past work in covered employment for all participants regardless of whether they have attained 40 QC. It leaves open decisions about measurement methodology.

United States Government Statement of Social Insurance
Present Value of Long-Range (75-Years) Actuarial Projections

	2004	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security)					
Contributions and Earmarked Taxes from:					
1. Participants who have attained age 62……..	411	359	348	309	266
2. Participants ages 15-61 ……..	14,388	13,576	13,048	12,349	11,335
3. Future participants (< age 15 + births + immigrants during the periods)	12,900	12,213	11,893	11,035	10,088
4. All Current and future participants (lines 1 + 2 + 3)……	27,699	26,147	25289	23,693	21,689
Expenditures for Scheduled Future Benefits for:					
5. Participants who have attained age 62……	4,933	4,662	4,401	4,256	4,020
6. Participants ages 15-61:	[22,418]	[21,015]	[20,210]	[18,944]	[17,217]
6a. Benefits accrued for those with 40 QC ……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
6b. Liability on the balance sheet (lines 5 + 6a) ……..…...	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
6c. Benefits accrued for those without 40 QC ……..…...	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
6d. Accrued benefit obligation (lines 6b + 6c) ……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
6e. Benefits to be accrued in future……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
7. Future participants (< age 15 + births + immigrants during the periods)	5,578	5,398	5,240	4,700	4,297
8. All Current and future participants (lines 6d + 6e + 7)……	32,928	31,075	29,851	27,900	25,534
9. Present value of future expenditures less future revenue (lines 8 – 4)……..	5,229	4,927	4,562	4,207	3,845

Appendix 8 – Pro Forma Statement of Social Insurance based on Consolidated Financial Report of the United States Government, 2004 Financial Statements

Federal Hospital Insurance (Medicare Part A):					
Contributions and Earmarked Taxes from:					
10. Participants who have attained eligibility age……..	148	128	125	113	97
11. Participants who have not attained eligibility age…….	4,820	4,510	4,408	4,136	3,757
12. Future participants ……	4,009	3,773	3,753	3,507	3,179
13. All Current and future participants (lines 10 + 11 + 12)……	8,976	8,411	8,286	7,756	7,033
Expenditures for Scheduled Future Benefits for:					
14. Participants who have attained eligibility age ……..	2,168	1,897	1,747	1,693	1,681
15. Participants who have not attained eligibility age:	[12,054]	[10,028]	[9,195]	[8,568]	[6,702]
15a. Benefits accrued for those with 40 QC ……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
15b. Liability on the balance sheet (lines 14 + 15a) ……..…..	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
15c. Benefits accrued for those without 40 QC ……..…	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
15d. Accrued benefit obligation (lines 15b + 15c) ……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
15e. Benefits to be accrued in future ……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
16. Future participants ……	3,246	2,653	2,470	2,225	1,349
17. All Current and future participants (lines 15d + 15e + 16) ……..	17,468	14,577	13,412	12,487	9,732
18. Present value of future expenditures less future revenue (lines 17 – 13) …	8,492	6,166	5,126	4,730	2,699
Federal Supplementary Medical Insurance (Medicare Part B):					
Contributions and Earmarked Taxes from:					
19. Participants who have attained eligibility age ……	332	284	252	258	234
20. Participants who have not attained eligibility age ……...	2,665	2,148	1,856	1,845	1,527
21. Future participants ……	891	688	600	593	404
22. All Current and future participants (lines 19 + 20 + 21)……	3,889	3,120	2,708	2,696	2,165
Expenditures for Scheduled Future Benefits for:					
23. Participants who are enrolled in SMI/Part B – balance sheet liability	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
24. Participants who have attained eligibility age without enrolling……	**XXX**	**XXX**	**XXX**	**XXX**	**XXX**
25. Participants who have attained eligibility age (lines 23 + 24) …….	1,475	1,306	1,132	,159	1,051
26. Participants who have not attained eligibility age……..	10,577	[8,845]	[7,463]	[7,415]	[6,094]
27. Future participants ……	3,277	2,622	2,238	2,205	1,514
28. All Current and future participants (lines 25 + 26 + 27)……	15,329	12,773	10,833	10,780	8,659
29. *Present value of future expenditures less future revenue (lines 28 – 22)…..*	11,440	9,653	8,125	8,084	6,494
Federal Supplementary Medical Insurance (Medicare Part D:					
Premiums:					
30. Participants who have attained eligibility age ……	176				
31. Participants who have not attained eligibility age ……...	1,857				
32. Future participants ……	618				
33. All Current and future participants (lines 30 + 31 + 32)……	2,651				

Appendix 8 – Pro Forma Statement of Social Insurance based on Consolidated Financial Report of the United States Government, 2004 Financial Statements

Expenditures for Scheduled Future Benefits for:					
34. Participants who are enrolled in SMI/Part D – balance sheet liability	**XXX**				
35. Participants who have attained eligibility age without enrolling……	**XXX**				
36. Participants who have attained eligibility age……...	773				
37. Participants who have not attained eligibility age……..	7,566				
38. Future participants …….	2,431				
39. All Current and future participants (lines 36 + 37 + 38)……	10,770				
40. Present value of future expenditures less future revenue (lines 39 – 33) …..	8,119				

GLOSSARY

Accrued Benefit Obligation

The accrued benefit obligation reflects future benefit obligations based on past earnings as of the valuation date. Accrued benefit obligations are based on the ***primary insurance amount*** (PIA), the early retirement or delayed retirement factors, and other rules of payment. The accrued benefit obligations include:

- Benefits scheduled to be paid for current
    - retired-worker beneficiaries and
    - disabled-worker beneficiaries who continue to be disabled after the valuation date.
- Retired worker benefits based on PIAs determined as of the valuation date for workers who have reached benefit eligibility age (62) and are not yet receiving benefits.
- Benefits calculated on a proportional past-service-credit basis determined as of the valuation date for current active participants under age 62. These benefits require a computation of a PIA, as of the valuation date, as if the worker had just became eligible to receive a disabled-worker benefit. These benefits are then adjusted so they may be viewed as benefit levels of a worker aged 62. The adjustments are made depending on the type of worker.
- For workers who survive to age 62 and are not disabled after the valuation date, PIA would be indexed to age 62 by the Social Security Average Wage Index, and would then be multiplied by the fraction (age as of the valuation date - 22) / 40.
- For workers who survive to age 62, are not disabled as of the valuation date, and become disabled before age 62, PIA_{DIB} would be indexed to the date of disability by the Social Security Average Wage Index, and would then be multiplied by the fraction (age as of the valuation date - 22) / (age as of the date of disability - 22).
- For beneficiaries who are disability beneficiaries as of the valuation date, recover from disability before age 62, and survive to age 62, benefits would equal the disability benefit scheduled to be paid until recovery. After reaching age 62, benefits would be computed based on indexing the final disability benefit received before recovery ($PIA_{DIB\text{-}RECOV}$) to age 62 by the Social Security Average Wage Index, and would then be multiplied by the fraction (age as of recovery from disability - 22)/40.
- Benefits for auxiliary beneficiaries would be based on the primary worker's benefits as described above.

[*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Average Indexed Monthly Earnings

The dollar amount used to calculate a worker's Social Security benefit if he or she attained age 62 or became disabled (or died) after 1978. To arrive at average indexed monthly earnings (AIME), the Social Security Administration (SSA) adjusts the worker's actual past earnings using an "average wage index." If he or she attained age 62 or became disabled (or died) before 1978, SSA uses Average Monthly Earnings (AME).

A certain number of years of earnings are needed to compute the average indexed monthly earnings. After SSA determines the *number* of years, SSA chooses those years with the highest indexed earnings, sums such indexed earnings, and divides the total amount by the total number of months in those years to derive the *average indexed monthly earnings.*

A worker becomes eligible for retirement benefits when he or she attains age 62. For example, a worker reaches age 65 in 2005 and therefore becomes eligible that year, SSA would divide the national average wage index for 2003 ($34,064.95) by the national average wage index for each year prior to 2003 in which the worker had earnings and multiply each such ratio by the worker's earnings. This would give the indexed earnings for each year prior to 2003. The year 2003 is significant because it is the year in which the worker reaches 60 years of age, which is the base year for the index, i.e., it equal "1." SSA considers any earnings in or after 2003 at face value, without indexing. Then SSA computes the average indexed monthly earnings. [*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI*. SSA Web site]

Benefit Formula, Social Security

A participant's benefit is based on his or her average wage over 35 years, indexed for wage inflation. SSA calculates a worker's average indexed earnings (see *Average Indexed Monthly Earnings* above) during the 35 years in which the worker earned the most. To arrive at average earnings, SSA adjusts the worker's actual past earnings using an "average wage index." If a worker has less than 35 years of earnings, SSA averages in years of zero earnings to bring the number of years to 35.

SSA applies a formula to the participant's average earnings to arrive at his or her basic benefit, or "primary insurance amount" (PIA). The PIA depends on the *year* in which a worker attains age 62, becomes disabled before age 62, or dies before attaining age 62. This is the amount the worker would receive at the worker's full retirement age (FRA), which, for most people, is age 65. (FRA is gradually increasing.) A worker receives a different amount if he or she retires early or late. Also, retirees receive an annual COLA.

The PIA is weighted toward lower wage earners. The PIA formula is the sum of three separate percentages applied to three separate portions of AIME. For 2005 these portions are the first $627 (90%), the amount between $627 and $3,779 (32%), and the amount over $3,779 (15%). These dollar amounts are also called "bend points."

Most social insurance programs base non-medical benefits on work in covered employment and wages earned therein. The dollar amount of Medicare benefits obviously naturally tied to the treatment received.

Closed Group

See Closed Group (to New Entrants)

Closed Group (to New Entrants)

Those persons who, as of a valuation date, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums. [FASAB *Consolidated Glossary*]

Closed Group Transition Cost

The closed group transition cost measure is computed like the open group unfunded obligation except that future participants are excluded. Only current participants' future cost and future scheduled tax income are included in the calculations, along with the trust fund assets at the start of the period. The period is extended to 100 years past the valuation date in order to capture the lifetime of all the current participants included in the valuation. The "closed group transition cost" is similar to the "maximum transition cost" except that the future cost and future taxes for current participants are included in the calculations. SSA's calculated the "closed group transition cost" as $11.2 trillion.

SSA's calculated the "closed group transition cost" as $11.2 trillion. Using this amount and the FY 2004 Statement of Social Insurance, the staff illustrates the relationship between the MTC and the closed group transition cost in the table immediately below.

"Closed Group Transition Cost"

Existing Participants			
(trillions)	"Max. Trans. Cost" (1)	Future Taxes and Benefits (2)	"Closed Group Trans. Cost" (3) [(1)+(2)]
Revenue	$ 0	$14.8[9]	$14.8
Cost	15.0	12.3[10]	27.3[11]
Net	(15.0)	2.3	(12.7)
Less: Assets	1.5[12]		1.5
Maximum Transition Cost	$(13.5)[13]	$2.3	$11.2

[9] Derived from FY 2004 SOSI. Participants 62+ ($.4 trillion) plus participants 15-61 ($14.4 trillion).
[10] Derived from FY 2004 SOSI. Participants 62+ ($4.9 trillion) plus participants 15-61 ($22.4 trillion) less the staff's estimate of "gross" "maximum transition cost" ($15.0 trillion).
[11] Derived from FY 2004 SOSI. Participants 62+ ($4.9 trillion) plus participants 15-61 ($22.4 trillion).
[12] From FY 2004 FRUSG.

The "closed group transition cost" is similar to the "premium deficiency" liability recognized in the insurance industry for future policy benefits relating to long-duration contracts (see below).

SFFAS 5 similarly requires life insurance programs to recognize a liability for future policy benefits for current policyholders that relates to insured events, such as death or disability, in addition to the liability for unpaid claims incurred. [SFFAS5, ¶104]

The "closed group transition cost" might also be said to reflect the "risk assumed" information required by SFFAS 5 as required supplementary information. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force.
[SFFAS5, ¶105 as amended by SFFAS 25, ¶4.]

Current participants

All individuals (generations) who are age 15 and older as of the valuation date. This includes all individuals who have been, are, or will be workers and/or beneficiaries. [*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Delayed Retirement Credit

Social Security benefits are increased (by a certain percentage depending on a person's date of birth) if retirement is delayed beyond full retirement age (FRA). Increases based on delaying retirement no longer apply when people reach age 70, even if they continue to delay taking benefits. For example, if the participant were born in 1944 with an NRA age of 66 years and intend to retire at age 68, his or her delayed retirement credit would be 8 percent per year. The difference between his or her retirement age and NRA is 2 years, so his or her benefit would be 8 percent times 2, or 16 percent, higher than his or her primary insurance amount.
[SSA Web site]

Disability Insured

A worker has disability-insured status if he or she (1) has earned at least 20 credits during the last 10 years, and (2) is "**fully insured**" (see below). Exceptions apply for those under age 31 and in certain other cases.

A participant can get disability benefits if he or she:

- Is under full retirement age
- Has enough Social Security credits and
- Has a severe medical impairment (physical or mental) that's expected to prevent him or her from doing "substantial" work for a year or more, or have a condition that is expected to result in death.

[13] From SSA. See Appendix B of this memo.

[SSA Web site]

Disability Benefits, Social Security

In addition to meeting SSA's definition of disability, the claimant must have worked long enough--and recently enough--under Social Security to qualify for disability benefits.

Social Security work credits are based on the claimant's total yearly wages or self-employment income. The claimant can earn up to four credits each year.

The amount needed for a credit changes from year to year. In 2004, for example, participants earned one credit for each $900 of wages or self-employment income. In 2005, that amount increases to $920. When the he or she has earned $3,600 ($3,680 in 2005), the participant has earned his or here four credits for the year.

The number of work credits the claimant needs to qualify for disability benefits depends on the claimant's age when he or she became disabled. Generally, the claimant needs 40 credits, 20 of which were earned in the last 10 years ending with the year the claimant becomes disabled. However, younger workers may qualify with fewer credits.

Whatever his or her age, the claimant must have earned the required number of work credits within a certain period ending with the time he or she became disabled. The participant's Social Security statement shows whether he or she meets the work requirement at the time it was prepared. If the participant stops working under Social Security after the date of the Statement, he or she may not continue to meet the disability work requirement in the future.
[SSA Web site]

Fully Insured

To be fully insured, a participant generally needs at least one credit for each calendar year after he or she turns 21 and the earliest of the following:

- ✓ the year before he or she attains age 62,
- ✓ the year before he or she dies, or
- ✓ the year he or she becomes disabled.

The minimum number of credits needed is 6. The maximum number needed is 40. Any year (all or part of a year) that was included in a period of disability is not included in determining the number of credits he or she needs.
[SSA Web site]

Future participants

Future workers and beneficiaries, who are under age 15 or not yet born, as of the valuation date.
[Based on *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Interest Cost Component (of annual social insurance cost)

The increase in the obligation due to the passage of time. [Based on FAS 87 Glossary]

Maximum Transition Cost

The "maximum transition cost" (MTC) represents the cost of meeting the ***accrued benefit obligations*** of the old form while continuing the Social Security program in a completely different form, with all payroll taxes for work after the valuation date credited to the new benefit form. The MTC is determined as of the valuation date for current and past participants only. It is computed as the difference between:

(a) The present value of all future accrued benefit obligations payable on the old form; and
(b) The value of the assets on the valuation date plus the present value of revenue from taxation of future accrued benefit obligations payable on the old form.

The projection period ends 100 years past the valuation date in order to capture the lifetime of all the current participants included in the valuation. [Based on *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

For 2004, SSA estimates the MTC to be $13.5 trillion. The MTC is net of assets in the trust fund and adding back the assets yields an obligation of $15 trillion.

Open Group

Those persons who are participating or who eventually will participate, during a specified period, in a social insurance program as contributors or beneficiaries. They include, for example, current workers, retirees, survivors, disabled persons, and new participants entering the workforce or becoming beneficiaries, including those who will be born or immigrate to the United States in the future. [FASAB *Consolidated Glossary*]
All current participants, as well as future participants to the system, over the specified time period. [Based on *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Open Group Unfunded Obligation

The open group unfunded obligation is determined as of the valuation date over a specified time period (such as over the long-range 75-year period). It is computed as the difference between:

(a) The present value of the future cost of the program between the valuation date and the end of the specified time period, and

(b) The sum of the assets in the trust fund as of the valuation date and the present value of the future scheduled tax income of the program between the valuation date and the end of the specified time period.

Future scheduled tax income and cost are projected using the intermediate assumptions for the indicated Trustees Report (the year of the Trustees Report corresponds with the year of the valuation date). [Based on *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Since it does not include future participants, the accrued benefit obligation measured at 40 quarters differs from the "open group." The open group unfunded obligation focuses on the adequacy of funding rather than the amount or net amount accrued or credited benefits as of the reporting date. Thus, it would be inappropriate for measuring the liability solely to current participants. It has, however, often been used as an indicator of the sustainabiltiy or actuarial status of the program. These measures are presented below for comparison.

"Open Group Unfunded Obligation"

(trillions)	Existing Participants			Future Participants	Existing and Future Participants
	"Max. Trans. Cost" (1)	Future Taxes and Benefits (2)	"Closed Group Trans. Cost" (3) [(1)+(2)]	Future New Entrants (75-year horizon) (4)	"Open Group Unfunded Obligation" (75-year horizon) (5) [(3)+(4)]
Revenue	$ 0	$14.7[14]	$14.7	$12.9[15]	$27.6
Less: Cost	15.0[16]	12.4[17]	27.4	5.5[18]	32.9
subtotal	(15.0)	2.3	(12.7)	7.4	(5.3)
Less: Assets	1.5[19]		1.5		1.5
Net or "unfunded" amount	$(13.5)[20]	$2.3	$(11.2)	$7.4	$(3.8)[21]

Past participants

Those who contributed money to the program or received benefits from the program and are no longer alive as of the valuation date. [*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

[14] From FY 2004 SOSI in FRUSG, total for participants 62+ and 15-61 years of age.
[15] From FY 2004 SOSI in FRUSG, total for future participants 2004-2078.
[16] This amount was "backed into" using $13.5 trillion from SSA's "maximum transition cost" and the asset amount from the FY 2004 FRUSG.
[17] This amount was "backed into" by subtracting the $15.0 amount in column (1) from $27.4 trillion, the total cost for participants 62+ and 15-61 years of age from the FY 2004 SOSI in FRUSG.
[18] From FY 2004 SOSI in FRUSG, total for future participants 2004-2078.
[19] From FY 2004 FRUSG.
[20] From SSA. See Appendix B of this memo.
[21] The open group unfunded obligation for the infinite horizon is $10.4 trillion. See Appendix B.

Permanently Insured

A participant is permanently insured if he or she is **fully insured** and he or she will not lose his or her fully insured status when he or she stops working in covered employment. Examples:

He or she has earned the maximum 40 credits, so is permanently (and fully) insured.

- ✓ He or she was:
  - Born in 1949 and worked under covered employment in 1971-77, earning a total of 28 credits.
  - Attained age 21 in 1970.
  - Were fully insured after earning 6 credits and continued to be fully insured through 1998 (1998 less 1970 is 28).
  - After 1998 he or she was no longer fully insured. He or she earned only 28 credits and was never permanently insured.

[SSA Web site]

Premium Deficiency

The present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums and assets for the current "book of business" or policies in force. Changes in the liability for future policy benefits that result from its periodic estimation for financial reporting purposes are recognized in income in the period in which the changes occur. [See SFAS 60, ¶21]

Primary Insurance Amounts

The PIA is the sum of three separate percentages of portions of average indexed monthly earnings. The portions depend on the *year* in which a worker attains age 62, becomes disabled before age 62, or dies before attaining age 62. The "bend points" of the PIA formula are the dollar amounts that govern the portions of the average indexed monthly earnings. The bend points in the year 2005 PIA formula, $627 and $3,779, apply for workers becoming eligible in 2005.

For example, a person who had maximum-taxable earnings in each year since age 22, and who retires at age 62 in 2005, would receive a reduced benefit based on a PIA of $1,926.60. This individual would not receive the 2.7-percent COLA for December 2004, but would instead receive the COLA effective for December 2005. [SSA Web site]

Prior Service Cost

The cost of retroactive benefits in a plan amendment. [Based on FAS 87 Glossary]

Service

Employment taken into consideration under a pension plan. Years of employment before the inception of a plan constitute an employee's past service; years thereafter are classified in relation to the particular actuarial valuation being made or discussed. Years of employment (including past service) prior to the date of a particular valuation constitute prior service; years of employment following the date of the valuation constitute future service; a year of employment adjacent to the date of valuation, or in which such date falls, constitutes current service. [From FAS 87 Glossary]

Survivor Benefits, Social Security

When a person who has worked and paid Social Security taxes dies, certain members of the family may be eligible for survivor benefits. For many survivor cases, the number of required earnings credits is based on the worker's age at the time of death. In general, younger workers need fewer earnings credits than older workers. However, no worker needs more than 40 earnings credits (10 years of work) to be fully insured for any Social Security benefit.

- ✓ A widow or widower -- full benefits at full retirement age (currently age 65), or reduced benefits as early as age 60
- ✓ A disabled widow or widower -- as early as age 50
- ✓ A widow or widower at any age if he or she takes care of the deceased's child who is under age 16 or disabled, and receiving Social Security benefits
- ✓ Unmarried children under 18, or up to age 19 if they are attending high school full time. Under certain circumstances, benefits can be paid to stepchildren, grandchildren, or adopted children.
- ✓ Children at any age who were disabled before age 22 and remain disabled.
- ✓ Dependent parents age 62 or older

A former spouse can receive benefits under the same circumstances as a widow/widower if the marriage lasted 10 years or more. Benefits paid to a surviving divorced spouse who is 60 or older will not affect the benefit rates for other survivors receiving benefits. A widow/widower cannot receive benefits if they remarry before the age of 60 (50 if disabled) unless the latter marriage ends, whether by death, divorce, or annulment. However, remarriage after age 60 (50 if disabled) will not prevent payments on a former spouse's record.

The amount of the survivors benefit is based on the earnings of the person who died. The more he or she paid into Social Security, the higher the benefits will be. The amount a survivor receives is a percentage of the deceased's basic Social Security benefit. The following provides the most typical situations:

- ✓Widow or widower full retirement age or older-100 percent.
- ✓Widow or widower age 60 to 64-about 71 - 94 percent.
- ✓Widow or widower at any age with a child under age 16 - 75 percent.
- ✓Children - 75 percent.

If a person is receiving widow/widower's benefits, they can switch to their own retirement benefits (assuming they are eligible and their retirement rate is higher than the widow/widower's rate) as early as age 62. In many cases, a widow/widower can begin receiving one benefit at a reduced rate and then switch to the other benefit at an unreduced rate at full retirement age. However, they will not be paid both benefits - they will be paid the higher of the two benefits.

Sustainable Solvency

This term is used to indicate that the combined OASDI Trust Funds are expected to be able to pay all scheduled benefits on time over the 75-year projection period and to continue paying all benefits on time for the foreseeable future. Thus, the following two conditions are required to be met:

(a) The level of the trust funds at each point in time during the 75-year projection period is zero or positive, and

(b) The level of the trust funds, expressed as a percent of annual program cost, is stable or rising at the end of the 75-year period.
[*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI, Glossary*. SSA Web site]

Tax Income

Payroll tax and income tax paid on Social Security benefits.

Taxes, Income on Social Security Benefits

Some people who get Social Security benefits have to pay income taxes on them. This applies to beneficiaries with other substantial income in addition to Social Security benefits (for example, wages, self-employment, interest, dividends and other taxable income reported on the tax return). No one pays taxes on more than 85

percent of his or her Social Security benefits and some pay on a smaller amount, based on these IRS rules:

- ✓ If the beneficiary files a federal tax return as an "individual" and has combined income* between $25,000 and $34,000, he or she may have to pay income tax on 50 percent of Social Security benefits. If his or her combined income is above $34,000, up to 85 percent of Social Security benefits is subject to income tax.

- ✓ If a joint return is filed, the beneficiary may have to pay taxes on 50 percent of his or her benefits if he or she and spouse have a combined income* that is between $32,000 and $44,000. If the combined income is more than $44,000, up to 85 percent of Social Security benefits is subject to income tax.

[SSA Web site]

Valuation date

Beginning of the projection period or January 1 of the starting projection year. This date defines the point in time for determining present values. [*Actuarial Note: Unfunded Obligation and Transition Cost for OASDI*. SSA Web site]