



Federal Accounting Standards Advisory Board

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October 3, 2008

TO: Members of FASAB

FROM: Richard Fontenrose, Assistant Director

THROUGH: Wendy Payne, Executive Director

SUBJECT: Accounting for Social Insurance, Revised – Tab A<sup>1</sup>

## **MEETING OBJECTIVES**

To review and approve the social insurance exposure draft for publication.

## **BRIEFING MATERIAL**

This memo conveys (1) a track changes version of the exposure draft showing changes since the September 16<sup>th</sup> pre-ballot draft, (2) a clean version of the exposure draft and (3) a ballot.

## **BACKGROUND**

At the August FASAB meeting the Board approved the staff's plan to e-mail a pre-ballot draft of the proposed standard *Accounting for Social Insurance, Revised* to members for final comments. After receiving comments, a ballot draft was to be prepared for the October meeting.

A pre-ballot draft of the exposure draft (ED) was sent to members September 16. Comments from several members were received during September. A "track changes" version of the ED is at Tab A-1. The format is as follows: the changes pursuant to the August meeting that were shown in the September 16<sup>th</sup> ED I sent you were "accepted," and additional changes and comments on the September 16<sup>th</sup> draft ED are now shown in the "track changes" edition.

A "clean" edition of the ED is at Tab A-2. The ballot is at Tab A-3.

Regarding the September 16<sup>th</sup> draft ED, a member questioned the need for paragraph 33 in the September 16<sup>th</sup> edition I sent out for comment (it is still paragraph 33 in editions at Tabs A-1 and

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<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at Board meetings. This material is for discussion purposes only; it is not intended to reflect the authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

A-2). Paragraph 33 is the first paragraph in the section dealing with the statement of social insurance (SOSI) and states that a SOSI is required. The member noted that SFFAS 17 already requires the SOSI. I believe that paragraph 33 helps introduce the section, although technically it is not needed. I think it helps the reader understand what follows in paragraphs 34-36.

Also, several members asked about the purpose of paragraph 47 in the September 16<sup>th</sup> edition (it is still paragraph 47 in editions at Tabs A-1 and A-2). The purpose of paragraph 47 is to show the effect of the standard on SFFAS 17. Providing such a paragraph has become the norm in our standards.

In the basis for conclusions, several members noted the term "Primary View" appears in the first paragraph, which is the boilerplate paragraph explaining that members may have weighed factors differently in reaching their individual conclusions. The paragraph was carried over from the *Preliminary Views* template and the term "Primary View" was inadvertently not deleted. It has been deleted now.

I also note that a member found paragraph A116 of the September 16<sup>th</sup> draft ED confusing. Paragraph A116 of that draft asked respondents to comment on the merits of a line item on the cost statement for the change in social insurance during the reporting period, and directed the reader's attention to Question for Respondents 6 on that subject. To clarify the discussion on this question, I have added a section, with a section heading, dealing with the statement of net cost and placed the paragraphs discussing the cost issue there, along with an introductory sentence. The section concludes with what was paragraph A116. See paragraphs A101-A113 in the EDs at Tabs A-1 and A-2.

Mr. Werfel is planning to submit an alternative view for inclusion in the ED. We will forward it to you as soon as we receive it. I will draft several paragraphs that will present the Board's response to the alternative view and circulate them to you for your consideration. I will incorporate both the alternative view and the response in the ED and adjust the dates shown for release of the ED and comments, if necessary.

We are seeking your vote on the ED as amended at the October meeting. A ballot is included at Tab A-3 for your convenience. "Officially" the members have until November 10 to submit their ballots, which is 10 working days after October 22. Alternative views are due by November 10. The ED will be released when six affirmative votes are received.



Federal Accounting Standards Advisory Board

## **Accounting for Social Insurance, Revised**

**Statement of Federal Financial Accounting Standards XX**

**Exposure Draft**

**Written comments are requested by February 9, 2009**

**DRAFT**

**October 24, 2008**

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## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

*The Federal Accounting Standards Advisory Board ("FASAB" or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget ("OMB"), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles ("GAAP") for the Federal Government.*

*An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.*

*Additional background information is available from the FASAB or its website:*

- *"Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*
- *"Mission Statement: Federal Accounting Standards Advisory Board"*

*Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at [www.fasab.gov](http://www.fasab.gov).*

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## Federal Accounting Standards Advisory Board

October 24, 2008

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (“FASAB” or “the Board”) is requesting comments on this exposure draft regarding a proposed Statement of Federal Financial Accounting Standards entitled *Accounting for Social Insurance, Revised*. Social Insurance comprises five programs; however, two programs, Social Security and Medicare, are of special significance because of the high rate of participation among citizens, the fiscal challenges related to the programs, and the challenges associated with incorporating estimates of future cash flows of this magnitude in financial statements. Specific questions for your consideration appear on page 9, but you are welcome to comment on any aspect of this proposal. Your response would be more helpful to the Board if you explain the reasons for your position, whether you agree or disagree.

Because of continuing concerns about the accounting for social insurance programs, in 2003 the Board decided to evaluate the existing social insurance accounting standard. The Board’s evaluation led, in October 2006, to the publication of a *Preliminary Views* document and, in May 2007, to a public hearing on the subject. After carefully considering the comments received, the Board is issuing this exposure draft.



Fundamental questions about social insurance programs can be addressed by financial reporting. These include whether programs are sustainable as currently constructed; whether the Government’s financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and what is the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information provided as a result of this proposed standard should help users make these assessments.

From the outset of this project, members have agreed on the objectives of financial reporting for social insurance programs and yet have had different views about how best to achieve the objectives. For example, all members have agreed that it is extremely important to provide useful financial information about the sustainability of social insurance programs, and that in the consolidated *Financial Report of the United States Government* such information should be

presented for the Government as a whole.<sup>1</sup> Members have agreed that social insurance information should be included in the basic financial statements, should be audited, and should be “transparent” – that is, readily understandable to an interested, non-expert reader. Members also have agreed that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. However, members have had different views about what should be reported on certain financial statements.

The key difference is in regard to the timing of the recognition of expense and liability for social insurance programs. Some members believe that an expense is incurred and a liability arises for social insurance programs during the working lives of participants, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability. Other members agree with Statement of Federal Financial Accounting Standards 17, *Accounting for Social Insurance* that an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the amount is “due and payable.”

All members have supported several innovations. They have supported a new basic statement presenting changes in the amounts displayed on the statement of social insurance. Moreover, all members have supported new reporting on fiscal sustainability in the consolidated Financial Report of the United States Government.

This exposure draft represents a compromise. [It proposes enhanced reporting but does not resolve the](#)  strongly held views regarding when the obligating event occurs for social insurance programs and, thus, when the liability and expense definitions are met within those programs. The proposed standard provides additional information not currently provided. The Board has conceptual projects underway and will consider in due course whether the new reporting [should](#) affect [developing](#) concepts. 

Responses in electronic form should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please also mail your comments to:

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

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<sup>1</sup> [To that end the Board initiated a project that has produced the exposure draft, \*Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government\*, issued on August 29, 2008, and for which comments are requested by January 5, 2009.](#)

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

If you have questions regarding this request, please contact the Board's Executive Director, Wendy M. Payne at 202 512-7350.


The Board's rules of procedure provide that it may hold one or more public hearing on any exposure draft document. A public hearing is tentatively scheduled for [April 22](#), 2009, for this exposure draft document. Notice of the date and location of public hearings are published in the Federal Register and in the FASAB newsletter.

Tom Allen  
Chairman


### Executive Summary

#### What is proposed?

Social Insurance programs include Social Security, Medicare, Railroad Retirement, Black Lung and Unemployment Insurance. Extensive information on social insurance programs is currently required by generally accepted accounting principles. The Federal Accounting Standards Advisory Board (“FASAB” or “the Board”) is proposing improvements in the information provided about the effect of social insurance programs.

The proposed standard does not change the liability and expense recognition and measurement from Statement of Federal Financial Accounting Standards (“SFFAS”) 17, *Accounting for Social Insurance*. The entities responsible for social insurance reporting will recognize a social insurance liability (and a related expense) when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods or services)  and the benefits are “due and payable.”<sup>2</sup>

The proposed standard requires the addition of the following information:

1. Critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the “fiscal gap” in a “highlights” section in management’s discussion and analysis
2. A new line item representing the closed group measure that would be presented [on the balance sheet](#)  low assets, liabilities, and net position and that would not be included in the totals for these classifications
3. A new summary section for the statement of social insurance presenting the closed and open group summary totals
4. A new basic financial statement to display the reasons for changes during the reporting period in the closed group measure reported on the statement of social insurance
5. Other information

#### Why do the members support these views?

Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy in government

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<sup>2</sup> SFFAS 17 established a “due and payable” liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims incurred but not reported.



## Executive Summary

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accounting. In its fifteen years of operation the Board has issued several exposure drafts and a preliminary views document related to social insurance reporting. The three principal exposure drafts and one preliminary views document that led to the current reporting model were

- a 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*,
- a 1998 exposure draft entitled *Accounting for Social Insurance*,
- a 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, and
- the 2006 preliminary views document entitled, *Accounting for Social Insurance, Revised*.

In each of these documents, the issue of an accrual accounting measure for social insurance programs has been controversial.

The issue of social insurance accounting was addressed in SFFAS 17 through compromise between strongly held views. The resulting statement of social insurance and accompanying disclosures and required supplementary information marked substantial improvement in the information presented in general purpose external financial reports of the U.S. Government and its component entities.

Although opinions continue to differ regarding when the obligating event occurs for social insurance programs, and thus the question of when the liability and expense occur in those programs continues to be discussed, the proposed standard represents a desire to present other information that will significantly improve readers' understanding of the status and results of the Government's social insurance programs. The Board has conceptual projects underway and will consider in due course whether the new reporting should affect developing concepts.

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## Request for Comments

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### Request for Comments

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at [www.fasab.gov/exposure.html](http://www.fasab.gov/exposure.html). Your responses should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

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

All responses are requested by *February 9, 2009*.

### Questions for Respondents:

Q1. The Board proposes to require [social insurance component entities and the governmentwide entity](#) discuss and analyze critical measures from the basic financial statements in the financial statement section of the management's discussion and analysis ("MD&A"). See paragraphs 26–30 in the proposed standard and paragraphs A74–A79 in the basis for conclusions.

**Do you believe that a highlights summary for the MD&A as described in this exposure draft enhances readers' understanding of the Federal Government's financial condition?**

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

Q2. In order to reflect the magnitude of the Federal Government's liabilities and commitments for social insurance programs, the Board is proposing to add a line for the **closed group measure** [to the balance sheet](#) show assets, liabilities, and net position and not included in the totals for these classifications.<sup>3</sup> See paragraphs 31–32 in the proposed standard and paragraphs A80–A100 in the basis for conclusions.

**Do you believe that the balance sheet should display a line item for the closed group measure as described in this exposure draft?**

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

Q3. In order to provide a concise summary of social insurance net present values, the Board proposes to add a new summary section of the statement of social insurance ("SOSI") to display the closed and open group measures. See paragraphs 33–36 in the proposed standard and paragraphs A114–A116 in the basis for conclusions.

**Do you believe that the SOSI should have a summary section as described in this exposure draft?**

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

Q4. In order to [improve understanding of](#) reasons why the social insurance commitments change from the end of the previous reporting period, the Board proposes a new basic financial statement entitled "statement of changes in social insurance amounts." The new statement would explain the changes during the reporting period in the present value amounts [for the closed group measure](#) included

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<sup>3</sup> Definitions of certain terms are provided in the Definitions section and Appendix F: Glossary of this proposed standard.

1 in the statement of social insurance. See paragraphs 37—38 in the proposed  
2 standard and paragraph A116 in the basis for conclusions.

3  
4 **Do you believe there should be a new basic financial statement explaining**  
5 **changes to the present value amount included in SOSI?**

6 **Please provide the rationale for your answers.**  
7

8 Q5. In order to provide information about social insurance programs in the context of  
9 traditional pension and post-employment deferred benefits, the Board proposes to  
10 disclose an accrued benefit obligation in notes to the financial statements. See  
11 paragraph 39 in the proposed standard and paragraphs A117—A123 in the basis for  
12 conclusions.



13  
14 **Do you believe that the accrued benefit obligation should be disclosed as**  
15 **described in this exposure draft?**

16  
17 **Please provide the rationale for your answers.**  
18

19 Q6. In order to reflect in one place the overall change in the Government's financial  
20 condition, the Board considered but decided not to propose adding a line item to the  
21 statement of net cost ("SNC") for the change during the reporting period in the  
22 closed group measure that would be presented below exchange revenue and  
23 expenses and not included in the totals for these classifications. Some believe the  
24 change is an economic cost that belongs on the SNC. Others argue that this  
25 measure should not be displayed on the SNC because it is a fundamentally different  
26 measure. See paragraphs A101—A113 in the basis for conclusions.

27  
28 **Do you believe that a line item below exchange revenue and expenses and not**  
29 **included in the totals for these classifications should be included on the SNC?**

30  
31 **Please provide the rationale for your answers.**  
32

33 Q7. In order to achieve a compromise between two opposing views, the Board decided  
34 to feature the **closed group measure** (CGM) (defined in paragraph 19) as a  
35 common thread among the proposed new reporting. The proposal requires that the  
36 CGM and other key measures from the financial statements be discussed in  
37 management's discussion and analysis; that the CGM be displayed on the balance  
38 sheet below assets, liabilities and net position (without being  luded in the totals for  
39 those categories); and that the changes in the CGM during the reporting period be  
40 displayed and explained in the new summary section of the statement of social  
41 insurance and the new statement of changes in social insurance. The Board  
42 considered the **open group measure** (defined in paragraph 24) instead of the  
43 closed group measure as the focus for the disclosure.  s exposure draft discusses  
44 both the closed group measure and the open group measure throughout.  
45 Paragraphs A68—A73 provide the basic rationale for the Board's selection of the

1 closed group measure.

2  
3 **Do you agree with the Board's decision to feature the closed group measure?**

4  
5 **Please provide the rationale for your answers.**

6  
7 **Q8.** In order to make the sensitivity analysis for social insurance programs concise and  
8 yet more informative, the Board is proposing to eliminate the requirement currently in  
9 SFFAS 17 for specific sensitivity analysis and instead allow the preparer to decide  
10 the best approach [and](#) at the same time encourage [stochastic modeling](#). [See](#)  
11 [paragraphs 44—45 of the standard and paragraphs A125—A137 of the basis for](#)  
12 [conclusions](#).

13  
14 **Do you believe that an approach that relies on the preparer's judgment rather**  
15 **than requiring a specific approach will produce better information regarding**  
16 **the sensitivity of social insurance programs?**

17  
18 **Please offer any comments that you wish to make on these provisions.**

### 1 Introduction

#### 2 Purpose

1. Federal financial reporting should provide accurate and transparent information to citizens so that they can make well-informed decisions for themselves and their Government. In this regard, such reporting must include information on the Government's long-term commitments for social insurance as well as all other Government programs. This proposed standard supports that objective.
2. This proposed standard amends Statement of Federal Financial Accounting Standards ("SFFAS") 17, *Accounting for Social Insurance*. In addition to the [current](#) requirements in SFFAS 17, the standard requires:
  - a. [for social insurance component entities and the governmentwide entity](#) highlights summary in the management's discussion and analysis ("MD&A") providing critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the fiscal gap;
  - b. an amount displayed on the balance sheet representing the net present value of the projected cash flows attributable to current participants in SI programs, also known as the **closed group measure**. This amount would be presented below the assets, liabilities, and net position and not included in the totals for these classifications (see Appendix C: Pro Forma Balance Sheet);
  - c. a new summary section within the statement of social insurance ("SOSI") summarizing the net [present values of](#) cash flows displaying certain subtotals and totals (see Appendix D: Pro Forma Statement of Social Insurance);
  - d. a new "statement of changes in social insurance [amounts](#)" ("SCSIA") displaying the reasons for changes in the closed group measure [from the end of the previous](#) reporting period (see Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts); and
  - e. a new note disclosure of the **accrued benefit obligation**.
3. The Federal financial reporting model is unique. The [model](#) includes, in addition to a balance sheet and statements of net cost [and changes in net position](#), unique [financial](#) statements designed for the Federal Government, including a statement of budgetary resources and [a statement of social insurance \(SOSI\) and a](#)



1 [“management’s discussion and analysis.”](#) This proposed [standard would provide for](#)  
2 [ditional reporting within this model.](#)


### 3 Background

- 4
- 5 4. As noted in SFFAC 1, *Objectives of Federal Financial Reporting*, the Federal  
6 Government is unique when compared with any other entity in the country. In  
7 SFFAC 1, the Board established four major reporting objectives for Federal  
8 accounting standards:  
9
- 10 1. Budgetary Integrity (the integrity and legality with which [the Federal](#)  
11 [Government](#) uses the people’s money);
  - 12 2. Operating Performance (the effectiveness and efficiency with which [the](#)  
13 [Federal Government](#) operates and delivers services);
  - 14 3. Stewardship (the sustainability of [the Federal Government’s](#) service  
15 delivery, [considering its current and projected](#) revenues); and
  - 16 4. Systems and Control (the quality of its data, systems and controls).  
17
- 18 5. Although all four of the objectives are equally important, Objectives 2 and 3 guided  
19 the development of the social insurance standard. Objective 2 states that Federal  
20 financial reporting should assist report users in evaluating the service efforts, costs,  
21 and accomplishments of the reporting entity; the manner in which these efforts and  
22 accomplishments have been financed; and the management of the entity’s assets  
23 and liabilities.  
24
- 25 6. Objective 3 states that Federal financial reporting should assist users in assessing  
26 the impact of the Government’s operations and investments for the period and how  
27 the Government’s and the Nation’s financial condition has changed and may change  
28 in the future. This objective is based on the Government’s responsibility for the  
29 general welfare of the Nation in perpetuity. It focuses not on the provision of specific  
30 services, but on the requirement that the Government report the broad outcomes of  
31 its actions.  
32
- 33 7. In light of Objective 3, fundamental questions about social insurance programs  
34 [should](#) [be](#) addressed by accounting standards. These include whether these  
35 programs are sustainable as currently constructed; whether the Government’s  
36 financial condition improved or deteriorated as a result of its efforts to provide these  
37 and other programs; and how long these programs will be able to provide benefits at  
38 current levels. The information that is proposed will help users address these  
39 questions.  
40
- 41 8. The SOSI [is](#) a first step in the process of developing information for an  
42 assessment of sustainability of specific programs in governmentwide and component  
43 entity financial reports. The SOSI is based on long-range actuarial estimates of  
44 future costs. SFFAS 17 required certain supplementary information as well, including





## Introduction

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1 graphic displays of future cash flow in nominal dollars and as a percentage of taxable  
2 payroll and GDP. The SOSI and required supplementary information (RSI) provide  
3 information that helps users analyze the effect of benefit payments to different  
4 participants under current law, as well as economic and demographic changes (e.g.,  
5 in the cost of health care and in life expectancies).

- 6 9. [Social insurance is a dominant program. It is not only a component of Federal](#)  
7 [operations, but an essential part of the national economy. Context is needed.](#) The  
8 proposed standard provides critical information not currently provided. [Specifically,](#) it  
9 requires management to discuss and analyze [in the MD&A](#) critical measures of  
10 social insurance in the context of other critical measures [presented in](#) the [financial](#)  
11 [basic statements. It would introduce a critical heretofore undisclosed](#) measure, the  
12 closed group measure.. A line item [representing the present value of the social](#)  
13 [insurance commitments, which is not included in the assets, liabilities, and net](#)  
14 [position, would be presented](#) on the balance sheet [below those](#) classifications; a new  
15 summary section [would be included](#) on the SOSI; a new statement [of changes in](#)  
16 [social insurance would be presented](#); and the accrued benefit obligation [would be](#)  
17 [disclosed in the footnotes.](#) 

## 18 Scope

- 19  
20 10. This [proposed](#)  standard is applicable to the consolidated financial report of the U.S.  
21 Government as well as component entity financial reports required to include a  
22 Statement of Social Insurance (SOSI). [Social insurance standards for these entities](#)  
23 [are provided in SFFAS 17.](#) 
- 24  
25 11. This [proposed](#)  standard amends SFFAS 17. It does not affect provisions of SFFAS  
26 17 that are not explicitly described [in the proposed standard](#) and illustrated in  
27 paragraph 47. [For social insurance entities and the governmentwide entity, the](#)  
28 [proposed standard supplements](#) SFFAS 15, *Management's Discussion and Analysis*;  
29 it does not affect [the MD&A requirements of other entities; nor does it change](#)  
30  [element of Federal Financial Accounting Concepts \("SFFAC"\) 3, Concepts for](#)  
31 [management's Discussion and Analysis, or SFFAC 5, Definitions of Elements and](#)  
32 [Basic Recognition Criteria for Accrual-Basis Financial Statements.](#)
- 33  
34 12. The following five programs are the sole programs subject to social insurance  
35 amendments [addressed in](#) this proposed standard:  
36  
37 a. Old-age, Survivors, and Disability Insurance ("OASDI" or "Social Security");  
38 b. Medicare Hospital Insurance ("Medicare HI") ("Part A") and Medicare  
39 Supplementary Medical Insurance (Medicare SMI) ("Part B" and "Part D");

## Introduction

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- c. Railroad Retirement benefits ("RRB");
- d. Unemployment Insurance for the general public ("UI"); and
- e. Black Lung benefits ("BLB").

### Materiality

13. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

### Effective Date

14. The standard is effective for periods beginning after September 30, 2009.

### Accounting Standard

#### Scope

15. This standard amends SFFAS 17. It does not affect provisions of SFFAS 17 that are not explicitly described and illustrated in paragraph 47 of this proposed standard. [For social insurance entities and the governmentwide entity, the proposed standard supplements SFFAS 15, \*Management's Discussion and Analysis\*; it does affect the MD&A requirements of other entities; nor does it change](#) Statement of Federal Financial Accounting Concepts ("SFFAC") 3, *Concepts for Management's Discussion and Analysis*, or SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*.

16. The following five programs are the sole programs subject to social insurance amendments adopted through this standard:

- a. Old-age, Survivors, and Disability Insurance ("OASDI" or "Social Security");
- b. Medicare Hospital Insurance ("Medicare HI") ("Part A") and Medicare Supplementary Medical Insurance (Medicare SMI) ("Part B" and "Part D"),<sup>6</sup>
- c. Railroad Retirement benefits ("RRB")<sup>7</sup>;
- d. Unemployment Insurance for the general public ("UI"); and
- e. Black Lung benefits ("BLB").

#### Definitions

##### **17. Accrued benefit obligation**

An accrued benefit obligation is a measure of the present value of future benefits [scheduled](#) to be paid to or on behalf of current participants based on past events (e.g., for Social Security and Medicare Hospital Insurance (Part A), work in

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<sup>6</sup> Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("MMA") created the Medicare Advantage ("MA") program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to beneficiaries, and must provide all Medicare covered services. Many MA plans offer additional services Medicare such as prescription drugs, vision and dental benefits to beneficiaries. The Federal Government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and would be accounted for accordingly.

<sup>7</sup> Legislation enacted in 1974 restructured railroad retirement benefits into two tiers, so as to coordinate them more fully with social security benefits. The first tier is based on combined railroad retirement and Social security credits, using social security benefit formulas. The second tier is based on railroad service only and is comparable to the pensions paid over and above social security benefits in other industries.

covered employment; or, Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in effect) as of the **valuation date**. Because it is based on past events, the accrued benefit obligation applies only to **current participants** in the programs as of the valuation date..

### 18. Closed group population

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.

### 19. Closed group measure

The closed group measure is the net present value of all expenditures to or on behalf of the [closed group population](#) participating in a social insurance program and all contributions or other income from or on behalf of those participants over a given projection period.

### 20. Closed group unfunded obligation

The closed group unfunded obligation is the **closed group measure** plus or minus the value of the assets held by the program at the beginning of the reporting period. It is computed like the **open group unfunded obligation** (see below) except that it involves the closed group population.

### 21. Current participants

All individuals currently participating in a social insurance program, e.g., for Social Security, all retirees and those working in covered employment as of the valuation date. An entry age for work in covered employment of 15 years is assumed.

### 22. Future participants

[Individuals who are not currently participating in a social insurance program but who are projected to participate in the future over a given projection period as contributors or benefits or both. For example, for Social Security, those who are less than 15 years old, those yet to be born, and future immigrants.](#)

23. Open group population

The open group population includes [current and future participants](#).

24. Open group measure

The open group measure is the net present value of all expenditures to or on behalf of the **open group population** and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years.

25. Open group unfunded obligation

The open group measure plus or minus the value of assets held by the program at the beginning of the reporting period.

Highlights Summary

26. Social insurance component entities and the governmentwide entity should discuss critical measures from their basic statements in the section of their management's discussion and analysis ("MD&A") devoted to financial statement analysis. They should explain the significance of key amounts. For example, the entity should explain the major changes in amounts reported for key items during the reporting period, and the causes thereof. In particular, the entity should explain why the changes occurred and what that indicates or implies for the program's operation. The entity should explain how costs and commitments incurred during the period were or will be financed. The section of the MD&A devoted to financial statement analysis should describe important existing and currently-known demands, risks, uncertainties, events, conditions—both favorable and unfavorable—that affect the amounts reported in the basic financial statements. The discussion should go beyond a mere description of existing conditions to include possible future effects of those factors. The discussion should encompass the possible future effects of anticipated future events, conditions, and trends. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

27. At a minimum, all entities should present and explain, as described in paragraph 26, the following measures except as noted:

a. Costs as follows:

- i. Net costs (for component entities and the governmentwide entity),
- ii. Total financing sources and net change of cumulative results of operations (for component entities only), and
- iii. Total revenue and net operating costs (for the governmentwide entity)

only).

b. Net position as follows (for both component entities and the governmentwide entity):

- i. Total assets,
- ii. Total liabilities, and
- iii. Net position.

c. Social insurance commitments as follows (for both component entities and the governmentwide entity except as noted):

- i. The closed group measure, which presents the net present value (“NPV”) of cash flow for or on behalf of current participants over a projection period sufficient to illustrate long-term sustainability (e.g., traditionally a period of 75 years has been the primary period used by the Social Security Administration for long-term projections).<sup>8</sup> This amount will be shown on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications, and on the statement of social insurance (“SOSI”) as well.
- ii. The change in the closed group measure during the reporting period(s). This amount will also be shown on the statement of changes in social insurance amounts (“SCSIA”).

d. Key budgetary amounts as follows:

- i. Key amounts from the statement of budgetary resources (for component entities only).
- ii. Key budgetary amounts (for the governmentwide entity only):
  - (a) Total unified budget receipts,
  - (b) Total unified budget outlays, and
  - (c) Total unified budget deficit or surplus.

e. **Fiscal gap** (for the governmentwide entity only). [This measure is discussed extensively in the exposure draft *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government* (“Projections ED”).]

28. The MD&A may include a table containing these measures (see the illustration for the governmentwide entity at Appendix B: Highlights Table). Alternatively or

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<sup>8</sup> The terms “current participants” and “closed group of participants” are used synonymously in this standard. See the definitions section of this ED for more on the “closed group” and “open group” of participants.

combined with a tabular illustration the entity may provide the critical measures in a narrative format. The table in Appendix B is for purposes of illustration only. The preparer should determine the most effective format for communicating the critical financial information and the reasons for changes during the prior period.

29. Each critical measures above (costs, net position, etc., see paragraphs 26 and 27) may be disaggregated into sub-measures. For example, regarding assets, component entities may separately display Treasury securities held, and “liabilities” may be disaggregated into major elements, i.e., into line items for employee pension liabilities, environmental liabilities, etc.

30. The amounts discussed in the highlights section of the MD&A for the closed group measures will be the same as the amounts of the line items presented on the balance sheet (discussed below and in Appendix C: Pro Forma Balance Sheet), SOSI (discussed below and in Appendix D: Pro Forma Statement of Social Insurance), and the SCSIA (discussed below and in Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts).

### Balance Sheet

[See Appendix C: Pro Forma Balance Sheet.]

31. Liability and Expense – This Statement does not change the SFFAS 17 liability and expense recognition standard. See SFFAS 17, paragraphs 22-23 and 30.<sup>9</sup>

32. Balance Sheet Display of Closed Group Measure – Each governmentwide and component entity presenting a SOSI should present closed group measure on its balance sheet. Its amount will be the same as the amount discussed in the financial section in the MD&A (see par. 27.c.i), and presented on the SOSI (see par. 34), and as the end-of-year balance on the SCSIA (see par. 37). The amount should be presented below assets, liabilities, and net position and not included in any of the totals for these classifications. (See pro forma balance sheet at Appendix C.)

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<sup>9</sup> SFFAS 17, paragraphs 22-23 and 30 state that, except for Unemployment Insurance, the governmentwide and component entities should recognize a liability (and a related expense) for those social insurance benefits that are due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (“IBNR”). For UI, a liability (and related expense) would be recognized for (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which the states and territories have not withdrawn funds from the federal unemployment trust fund (“UTF”) as of fiscal year end, and (2) estimated amounts to be withdrawn from UTF and benefits paid by states and territories after fiscal year end for compensable days occurring prior to fiscal year end. A UI expense will also be recognized for the reporting period for amounts withdrawn from the Federal UTF by states and territories to pay benefits to beneficiaries that pertain solely to the current reporting period. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior reporting period pursuant to this paragraph, items (1) and (2), would not be recognized as an expense of the current reporting period.



### Statement of Social Insurance

[See Appendix D: Pro Forma Statement of Social Insurance. *There are two illustrations, one for the CFR Illustrative CFR SOSI (Part I) and another for the component entity Illustrative SOSI for Component Entity (Part II).*]

33. [As required in SFFAS 17, paragraph 27](#), component entities administering the Social Security, Medicare, Railroad Retirement and Black Lung programs and the governmentwide entity should present a statement of social insurance as a basic financial statement. The SOSI would contain present values as described in SFFAS 17, paragraph 27, as amended by SFFAS 26, par. 5.
34. The component entity and governmentwide SOSI [should](#) include with a summary section displaying the closed group measure and open group measure (see Appendix D). The closed group measure line item [should](#) be the same as lines on the balance sheet (see above and Appendix C), and the beginning-of-year and end-of-year amounts on the SCSIA (see below and Appendix E).
35. The summary section of the component entity SOSI [should](#) include the assets held by the programs, if any, and totals for the **closed group unfunded obligation** and **open group unfunded obligation** (see Appendix D, Part II, summary section).
36. This standard should not be construed to preclude displaying subtotals by age cohort.

### Statement of Changes in Social Insurance Amounts

[See Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts.]


37. The governmentwide and component entities presenting a SOSI should present a statement of changes in social insurance amounts (SCSIA) (see pro forma example at Appendix D). The SCSIA will reconcile beginning and ending closed group measures [and display the reasons for changes in the closed group measure from the end of the previous reporting period \(see Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts\)](#).
38. The SCSIA should display the significant components of the change e.g., interest on the obligation due to present valuation; changes in demographic, economic, and healthcare assumptions; changes in law, regulation, and policy; [and the amounts associated with each type of change](#) (see Appendix D). The SCSIA should disclose in notes on the face of the statement and/or in notes to the financial statements the reasons [for the changes. The reasons should be explained as briefly as possible without detracting from understanding](#). The most significant changes should be explained in the entity's MD&A as well as in disclosures associated directly with the SCSIA.

### 1 Required Disclosure

- 2 39. The entity should disclose an **accrued benefit obligation** amount in the notes to the  
3 financial statements. The preparer should select and describe in the notes to the  
4 financial statements the method used for calculating the accrued benefit obligation.  
5 [In addition, the preparer should explain that the disclosure provides a perspective on](#)  
6 [social insurance programs from the point of view of a deferred benefit or an](#)  
7 [insurance obligation for those users who value such information.](#)



### 8 Required Supplementary Information other than MD&A

- 9 40. [As required in SFFAS 17, paragraph 27\(1\)](#), actuarial projections of annual cashflow  
10 as a percentage of taxable payroll and Gross Domestic Product (GDP) are required  
11 for component entities and for the governmentwide entity. For the OASDI and HI  
12 programs, the actuarial projections should be expressed as a percentage of taxable  
13 payroll and gross domestic product (GDP). For the SMI program, the actuarial  
14 projections should be expressed as a percentage of GDP. For the RRB program, the  
15 actuarial projections should be expressed as a percentage of taxable payroll. For the  
16 Black Lung and UI programs, the actuarial projections should be expressed in  
17 inflation-adjusted or constant dollars. The [percentages or](#) amounts should be  
18 reported for at least every fifth year in the projection period  total cash inflow  
19 excluding net interest on intragovernmental borrowing/lending and total cash outflow.  
20 Actuarial projections of annual cashflow in nominal dollars are no longer required of  
21 component and governmentwide entities.

### 22 Valuation Date

- 23  
24 41. All projections and estimates should be made as of a date (the valuation date) as  
25 close to the end of the fiscal year being reported upon as possible and no more than  
26 one year prior to the end of the reporting period. The estimate should include  
27 projections to the end of the fiscal year, if feasible, taking into account major factors  
28 that affect the results that are known at the time of the projection. If projections to the  
29 end of the fiscal year are not feasible, the entity should disclose an estimate of the  
30 magnitude of the effect of changes in major factors on the projection or, if not  
31 possible, disclose that it was not possible to reasonably estimate the effect. In any  
32 case, the nature of the change should be disclosed. This valuation date should be  
33 consistently followed from year to year.  
34  
35 42. If, after the valuation date, but prior to the end of the fiscal year, policy reforms are  
36 enacted that could materially affect the basic statement, the projections should be  
37 adjusted, if feasible, as if the policy reforms had taken place as of the valuation date.

If policy reforms are enacted after the end of the fiscal year, but prior to the issuance of the financial statements, the financial statements should disclose the nature of the policy reform and, if known, the estimated effect on the projections.

43. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may, sometimes greatly, from the estimated cost. For example:

### APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

### Sensitivity Analysis

44. The entity should provide sensitivity analysis of the closed and open group measures appropriate for their particular social insurance program.<sup>11</sup> The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change.
45. When determining the type of sensitivity analysis to provide, the entity should consider future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of **stochastic modeling** as an augment or alternative to sensitivity analysis.

### Governmentwide Entity Accounting and Reporting

46. The proposed standard for governmentwide accounting and reporting for social insurance programs is the same as that for component entities. However, the level of detail at the governmentwide level should be less than at the component level.

### Effect on SFFAS 17

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<sup>11</sup> See ASP 32, paragraph 3.5.

1 47. The proposed Statement provides additional requirements for display, disclosure,  
2 and supplementary reporting for social insurance programs. SFFAS 17 is amended  
3 as follows:  
4

26. ~~Projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.~~

27

(1) Cashflow Projections – ...

(a) Actuarial projections of the annual cashflow, ~~in nominal dollars~~, with amounts reported for at least every fifth year in the projection period. The cashflow information should show

i. total cash inflow from:

- a. all sources and
- b. excluding net interest on intragovernmental borrowing/lending, and

ii. total cash outflow.

~~b) The actuarial estimate provided in 27(1)(a)(i)2) and 27(1)(a)(ii) immediately above as a percentage of (i) taxable payroll<sup>7</sup> and (ii) Gross Domestic Product (GDP).<sup>8</sup>~~

For the OASDI and HI programs, the actuarial projections should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

<sup>7</sup> Certain social insurance programs (i. e., SMI , Black Lung benefits, and UI) are either not financed by earmarked payroll taxes or are financed by state-determined payroll taxes on employers that can vary by state and by employer; therefore these programs are not required to provide this estimate.

<sup>8</sup> This requirement does not apply to the RRB, Black Lung, and UI programs.

...

(4) Sensitivity Analysis –

- (a) For ~~a~~All programs except UI, illustrate the sensitivity of the projections and present values required by paragraph 27(1) and 27(3) to change in the most significant individual assumptions. For example, using the entity's "best estimates" cost assumptions as a baseline, show the effect of varying several significant assumptions one at a time to show the effect on the projection. At a minimum, the OASDI and Medicare programs should analyze assumptions regarding the birth and death rates, net immigration, the real wage differential, and the real interest rate. The real wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI. The Medicare program should also analyze the health care cost factors and their trend. should provide sensitivity analysis appropriate for their particular social insurance program. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The SSA, Medicare and Railroad Retirement programs should provide sensitivity analysis of the the closed and open group measures in the SOSI summary. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of stochastic modeling as an augment or alternative to sensitivity analysis. The entity should state that the amounts of the closed and open group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.
- (b) For UI, illustrate the sensitivity of the projections required by paragraph 27(1) to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate

the largest recession occurring within the last 25 years).

32. ... (4) *Sensitivity Analysis* – For all social insurance programs, indicate that relevant sensitivity analysis is available in the component entity's financial report. ~~provide a summary of the sensitivity analysis required under the standard for component entities (see par. 27(4)). At a minimum, the summary should present the OASDI, HI, SMI, and UI separately.~~

Effective Date

41. This standard would be effective for periods beginning after September 30, 2009.

The provisions of this statement need not be applied to immaterial items.

## Appendix A: Basis for Conclusions

### Appendix A: Basis for Conclusions

A1. This appendix discusses factors considered significant by Board members reaching the conclusions in [this Statement](#). It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

### Background

A2. Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy. In its 18 years of operation the Board has issued several exposure drafts, a standard, and a preliminary views document related to social insurance reporting as follows:

- A 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*
- A 1998 exposure draft entitled *Accounting for Social Insurance*
- SFFAS 17, *Accounting for Social Insurance*, in August 1999
- A 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which resulted, in 2003, in SFFAS 25 of the same title
- A 2004 exposure draft entitled *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, which resulted, in 2004, in SFFAS 26 of the same title
- A 2006 preliminary views document entitled *Accounting for Social Insurance, Revised*


A3. The issue of social insurance accounting was addressed in SFFAS 17 through compromise between strongly opposing views. The compromise featured:


- a. liability recognition at the point when social insurance benefit payments are due and payable and with revenue and expenses on a cash flow basis, plus or minus the change in the due and payable liability during the reporting period;
- b. a statement of social insurance ("SOSI") and accompanying disclosures; and
- c. other narrative and graphic information, e.g., graphs of long-term cash flows projections using nominal dollars and as percentages of taxable payroll and GDP, the "dependency ratio," and sensitivity analysis.

A4. In SFFAS 26, the Board re-classified the SOSI from "required supplementary



## Appendix A: Basis for Conclusions

stewardship information” to basic information, [and the SOSI became subject to a full audit in fiscal year 2006](#);  required significant assumptions to be disclosed.

- A5. SFFAS 17 and 26 substantially improved the information presented in general purpose external financial reports of the U.S. Government and its component entities. However, in 2004 the Board decided to reconsider the question of liability and expense recognition. A majority of members serving at that time concluded that the compromise that produced SFFAS 17 [did not](#) recognize the accruing cost of social insurance programs in each reporting period and the accumulated liability for benefits payable at a determinable date under current law. [Nor did it](#) fully explain the change in the net present value of program-related cash flows. Hence, in 2004, the Board initiated a new social insurance project, and a *Preliminary Views* document was issued in October 2006. 

### What the *Preliminary Views* Document Proposed

- A6. In the *Preliminary Views* document, the Board presented two views of proposed improvements in the information provided about the effect of social insurance programs. The Primary View proposed to change the SFFAS 17 requirements for:



- a. expense and liability recognition and measurement for Social Security, Medicare, and Railroad Retirement programs, and
- b. the statement of social insurance (“SOSI”).

Under the Primary View proposal, social insurance expense would have been recognized on the statement of net cost when participants become **fully insured** and thus substantially meet the eligibility conditions for future benefits and as scheduled benefits increase due to additional work in covered employment by fully insured individuals. For Social Security, Medicare, and Railroad Retirement programs, participants become fully insured when they complete sufficient work in covered employment, e.g., for Social Security and Medicare, 40 quarters of work in covered employment, or the equivalent thereof. The liability would have been the accumulated unpaid expense as of the reporting date. Those members who supported the Primary View believed that their proposed recognition and measurement standard conformed to the definition for liability and expense in FASAB’s new concepts statement SFFAC 5, *Definition of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*.

- A7. In addition to changing the expense and liability recognition points, the Primary View would have linked the SOSI amounts with amounts reported for social insurance on the balance sheet and statement of net cost. For the Primary View members, such linkage or “articulation” would have illustrated how the amounts reported on the basic financial statements relate to the present values of the cash inflow and outflow over the next 75-years that are presented in the SOSI.




## Appendix A: Basis for Conclusions

- 1  
2 A8. The Alternative View proposed to maintain the recognition and measurement of  
3 expense and liability for Social Security, Medicare, and Railroad Retirement  
4 programs currently required in SFFAS 17. That is, the entity would recognize a  
5 liability and a related expense for social insurance benefits when all eligibility criteria  
6 are met such that an individual beneficiary is entitled to receive a benefit (e.g., a  
7 cash payment, goods or services), which includes the point when benefit payments  
8 are “due and payable”.<sup>15</sup>  Thus, under the Alternative View the amounts reported on  
9 the balance sheet, statement of net cost, and statement of social insurance  
10 presentation would not have changed from what is currently reported under SFFAS  
11 17.  
12
- 13 A9. Those members who supported the Alternative View also believed their proposed  
14 recognition and measurement standard would have conformed to the new definition  
15 for liability and expense in the recently issued SFFAC 5, *Elements*.  
16
- 17 A10. The Alternative View would have added a new basic financial statement entitled the  
18 “statement of changes in social insurance amounts,” that would show the reasons  
19 for all changes during the period in the amounts (net benefits less receipts)  
20 presented in the statement of social insurance. The Primary View members agreed  
21 in principle that such a statement should be required.  
22
- 23 A11. In addition, the Alternative View members proposed to break new ground. They  
24 proposed a new statement of “**fiscal sustainability**” for the consolidated *Financial*  
25 *Report of the United States Government (CFR)* that would provide sustainability  
26 information on the entire Government, including information necessary to assess the  
27 sustainability of social insurance programs and information on intergenerational  
28 equity, as required supplementary information. Members who supported the  
29 Alternative View believed that such reporting would reflect the unique nature of  
30 social insurance programs, the extent of the Government’s responsibilities for these  
31 and other programs, and the Government’s ability to adjust these responsibilities.  
32 The Alternative View pointed out that a statement of fiscal sustainability would  
33 present  fiscal sustainability of social insurance in the context of sustainability of  
34 the Government as a whole in the *CFR*.  
35
- 36 A12. The members supporting the Primary View welcomed and encouraged the  
37 development of additional supplementary sustainability information. However, they  
38 believed it should be the subject of a separate project because it has implications for  
39 a wide variety of issues.

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<sup>15</sup> SFFAS 17 established a “due and payable” liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims IBNR.

## Appendix A: Basis for Conclusions

A13. The FASAB subsequently undertook a project on sustainability that resulted in the *ED Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government* (“*Projections ED*”). [The Projections ED](#)  currently out for comment.

A14. Further, members who supported the Alternative View believed that any analysis of scheduled future benefits must include a consideration of future earmarked revenues, as these programs are pay-as-you-go in nature.

A15. The Primary View did not consider future revenues in its liability calculation, other than premiums for Medicare-SMI. However, some note that the Social Security programs hold \$2 trillion of assets and, since the 1983 amendments, is intended to be partially advance funded.

A16. Both the Primary and Alternative Views would have retained the supplemental information now required in SFFAS 17, such as the “dependency ratio” of contributors to beneficiaries, and the sensitivity analysis.

### Different Views Regarding the Obligating Event

A17. Supporters of both the Primary and Alternative Views believed that financial statements resulting from Federal financial accounting standards are intended to be accrual-based. That is, the statements strive to recognize the financial effects of events and transactions as they occur rather than only when the cash transfers take place. The members differed as to the event or transaction that would trigger an expense and a liability for social insurance programs.


A18. The members supporting the Primary View believed the critical point at issue among Board members and generally among participants in the debate involved the timing of the event that creates a liability. The Primary View was that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities.


A19. The Primary View’s principal focus was on the economic cost being incurred for social insurance programs and the accumulation thereof. The Board members supporting the Primary View believed that a key objective of the basic financial statements should be to report the estimated economic costs incurred during the reporting period and the amount of those costs that will have to be financed in future periods. They believed the payroll tax contributions received during the reporting period should be matched against such costs rather than against the benefits paid out during the reporting period to truly evaluate the inter-period equity of the program. Supporters of the Primary View believed such present value of accumulated costs represent the accrued liability portion of long-term actuarial

## Appendix A: Basis for Conclusions

projections

A20. The members who supported the Primary View believed that the distinction between exchange and nonexchange transactions that was among the points emphasized in the Alternative View is not determinative. For them, an expense may be incurred and a liability may arise equally for exchange, nonexchange, or quasi-exchange transactions so long as a present obligation exists. The Government has many programs for which it incurs large liabilities and yet receives nothing or little in exchange other than promotion of the general welfare. In addition, members supporting the Primary View noted the quasi-exchange features of social insurance programs such as the relationship between wages earned in covered employment and benefits accrued and payroll taxes paid, both of which are based on wages in covered employment. They noted also the way the programs are structured, including the use of “trust funds” and the “investment” of excess payroll taxes in special Treasury securities, arguably creates a constructive obligation at a point much earlier in time than when the payments are due and payable.

A21. [Members supporting the Alternative View saw a fundamental distinction in financial reporting of exchange transactions, which are voluntary market exchanges of goods and services for a price, and nonexchange transactions resulting from decisions made collectively by the Congress and the President to levy taxes and to authorize programs. They noted that this distinction is made in FASAB concepts, standards, and statements, e.g., the statement of net cost, as well as by other standard setters, including the Governmental Accounting Standards Board \(GASB\) and the International Public Sector Accounting Standards Board \(IPSASB\); and that it is also the difference between offsetting collections and governmental receipts in the Budget.](#) 

A22. Members who supported the Alternative View believed that [although](#) the basis for recognition of a liability and cost for social insurance established in SFFAS 17 (e.g., due and payable) remains appropriate, the set of information required by SFFAS 17 was inadequate. They argued that SFFAS 17 does not (1) recognize important information concerning the fiscal sustainability of social insurance programs, or (2) fully explain the change in the net present value of program related cash flows. They believed that the fundamental nature of social insurance is richer and more complex than the Federal Government's current [accounting model](#) could accommodate. 

A23. The Alternative View was that social insurance programs comprise two separate nonexchange transactions – the compulsory payment of taxes during an individual's working life and the Government's payment of benefits after the individual has satisfied all eligibility criteria. Hence, the Alternative View was that benefits beyond the due and payable amount are not present obligations of the Government and should not be recorded as current expenses or current liabilities. In addition, the Alternative View was that:

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- a. recognition of such future social insurance benefits as current expenses and liabilities would result in a substantial mismatch of net costs for nonexchange programs in the current year and the services provided in that year;
- b. inclusion of such large amounts as proposed in the Primary View, which in the Alternative View were not current expenses or liabilities, on the financial statements would diminish significantly the relative size and importance of valid expense and liabilities shown on the financial statements, providing misleading information about the Government's true financial position and lessening the focus on non-social insurance programs; and
- c. given the ability of the Federal Government to change the laws relating to social insurance programs and the unsustainability of current benefit payments with current financing, about which beneficiaries are on notice, amounts are uncertain and not reliably estimable.

A24. In addition, the members who supported the Alternative View believed that characterizing future benefits as current expenses and liabilities may undermine needed efforts to reform these programs.


A25. The Board members who supported the Alternative View agreed that a key objective of the basic financial statements should be to report the costs incurred during the reporting period. However, they believed that the costs are incurred when all eligibility requirements are met and benefits are due and payable.

A26. In addition to the due and payable amount, members who supported the Alternative View believed that recognition of deferred revenue equal to the earmarked social insurance program revenues in excess of program costs should be considered. If this option were adopted, earmarked revenues collected for social insurance programs in excess of program liabilities (as defined above and in existing liability standards) incurred would be recorded as deferred revenues. The members supporting this view believed, however, that this concept should be considered by the Board as a separate project. It would have required revising portions of SFFAS 7 and the supporting arguments also may have applied to numerous other funds with earmarked receipts.

A27. It is extremely important to note that both the Primary View and the Alternative View called for sustainability reporting. These members who supported the Primary View believed that the Board should consider additional sustainability reporting in a future project. As noted above, the FASAB subsequently undertook a project on the subject that resulted in the *Projections* ED. However, the members who supported the Primary View believed that reporting on sustainability is not a substitute for or alternative to their proposal to alter expense and liability recognition on the statement of net cost and balance sheet. They believed that [the balance sheet and statement of net cost](#) serve different objectives [than a statement of fiscal](#)

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[sustainability.](#) 

A28. The members who supported the Alternative View  eved that an appropriate understanding of the sustainability of social insurance requires a consideration of not only the social insurance programs, but also of the Government as a whole because of the significant interrelationship between the two and the need to consider tradeoffs.

### Respondents Comments

A29. The *Preliminary Views* document received 67 responses as follows:

	FEDERAL (Internal)	NONFEDERAL (External)
Users, academics, others	5	47
Auditors	5	3
Preparers and financial managers	7	0

### Question No. 1: Obligor Event Giving Rise to a Liability

A30. The *Preliminary Views* document asked respondents to consider six questions, as well as to submit any other comments they wished. Question 1 asked respondent which of four possible obligor events<sup>17</sup> they favored for creating a social insurance liability. A slight majority of respondents who commented on this question favored either the Primary View's attain-fully-insured-status obligor event (e.g., when participants complete 40 quarters or equivalent of work in covered employment) (22 respondents) or an even earlier event, "work in covered employment" (11 respondents). The Alternative View proposed continuation of the SFFAS 17 obligor event, and this position received the single most favorable responses among the four obligor event options (30 respondents).<sup>18</sup> No

<sup>17</sup> (1) when participants become **fully insured** under the terms of the programs, (2) when the participant meets all eligibility requirements and payments become "due and payable," (3) when participants begin work in covered employment and continuing as long as such work continues, and (4) "threshold eligibility" at age 62 for Social Security and 65 for Medicare.

<sup>18</sup> These counts and the others below are approximate. Some responses were difficult to classify. For example, one stated that the respondent concurred with the Primary View but would not report the 40-QC liability on the balance sheet, suggesting limited disclosure instead. This response was counted as favoring the Primary View regarding Question 1 but not regarding Question 2.

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respondents commented on the fourth obligating event, “threshold eligibility.”

A31. Those favoring the attain-fully-insured-status obligating event commented that:

- a. Financial statements should display elements based on current law rather than possible changes in law, and current law requires that social insurance benefits be provided to those who attain fully insured status.<sup>19</sup>
- b. Some argue that social insurance is not a “legal liability” at the point when insured status is attained but, even if the question of the legal standing of the claim to future benefit payments at that point were clear cut, legal arguments are set aside when feasibility and likelihood of future payments are judged largely in economic terms.<sup>20</sup>
- c. The attain-fully-insured-status obligating event best meets the expectations of financial statement users.
- d. The attain-fully-insured-status obligating event is appropriate because Social Security is equivalent to a mandatory retirement savings plan.
- e. The attain-fully-insured-status obligating event promotes comprehensive accounting.
- f. *Social Security Statement* that the Social Security Administration sends to participants each year acknowledges a liability based on attaining fully insured status and the sum of these amounts is similar to the attain-fully-insured-status obligating event amount.
- g. Social insurance is based on a promise that contributions will be held in trust and will be paid out in retirement.
- h. Social insurance contributions and benefits are linked.
- i. Social insurance is a well-established social contract.

<sup>19</sup> In November 2004 GASB decided, relative to its net asset reporting ED (*Net Assets Restricted by Enabling Legislation*), that judicial or constitutional provisions indicating that one legislature cannot bind another does not preclude a government from determining it has legally enforceable enabling legislative restrictions on certain assets.

<sup>20</sup> The same uncertainty regarding the meaning of “legal enforceability” that is evident when discussing Social Security also exists at the state and local arena. The state of Texas recently enacted a law (May 2007) offering state and local governments in Texas an alternative to GASB 45 for reporting OPEB obligations in response to GASB 45. The position of some state officials is that retiree health benefits are not a contractual obligation but are budgeted during each biennial budget cycle. These officials argue that because the benefits are not a legal obligation, they should not be reported as a liability of the state or local governments. State and local governments in Texas may use GASB 45 or a statutory method. However, the Texas Comptroller of Public Accounts is required to use the latter, which requires reporting only OPEB expenditures during the current reporting period; and disclosure of future benefit obligations would be optional and would appear in the statistical section of an annual report. [*Business Wire*, July 17, 2007]

The Fitch rating service stated that the commitment to fund OPEB in Texas is similar to that in other states where Fitch expects widespread compliance with GASB 45. Non-compliance may result in qualified auditor opinions. Fitch considers non-compliance with GASB 45 a managerial weakness. It views positively governments that are forward-thinking: anticipating potential issues, and then taking action to deal with them. Fitch sees compliance with GASB 45 as a first step in a multi-year process of addressing what in many cases will be sizable liabilities. [*Business Wire*, July 17, 2007]

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- j. Social insurance rights and obligations are established in law.
- k. The FASAB liability definition (either in SFFAS 5, *Liabilities* or SFFAC 5, *Elements*) is met when fully insured status is attained.
- l. The attain-fully-insured-status obligating event is a reasonable balance between the events when a participant (a) begins work in covered employment and (b) a “threshold” event, e.g., becoming eligible for immediate benefits at 62 years of age.
- m. Some respondents favoring the work-in-covered-employment obligating event found the attain-fully-insured-status obligating event acceptable because it approximates a “work-in-covered-employment” obligating event.

A32. Those favoring the work-in-covered-employment obligating event commented that:

- a. The work-in-covered-employment obligating event is consistent with real world experience.
- b. The Federal Government recognizes as revenue the payroll tax contributions that participants are required to make in conjunction with their work in covered employment.
- c. The work-in-covered-employment obligating event results in a better match of benefits earned with the earning period.
- d. Social Security and Medicare are like pensions and other post-employment benefits and should follow accounting rules developed for such programs.
- e. Government action has created expectations and reliance beginning with work in covered employment.
- f. Financial statements should reflect accounting based on current law rather than possible changes in law, and the law provides benefits based on work in covered employment.
- g. According to SFFAC 5, *Elements*, power to change law does not preclude liability recognition and therefore possible changes in law should not preclude recognition of a liability based on work in covered employment.
- h. Social insurance is not like Medicaid and other annual programs because there is a past event.
- i. The obligating event should be wages earned subject to social insurance payroll taxes.
- j. Social insurance benefits are based on both time worked and wages received over a participant’s lifetime.
- k. The SFFAC 5, *Elements*, liability definition is met when participants work in covered employment.
- l. Payroll tax contributions, which are collected concurrently with work in covered employment, are exchanged for a promise of future benefits.

A33. Those opposed to the attain-fully-insured-status obligating event commented that:

- a. Financial statements would lack integrity if a liability were recognized when fully insured status is attained due to the uncertainty of the necessary estimates.



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- b. Social insurance significantly differs from private sector retirement programs and an attain-fully-insured-status obligating event would negatively affect the decision usefulness of government financial statements.
- c. Attaining fully-insured-status event has no economic relevance and is a mere legal formality.
- d. The attain-fully-insured-status obligating event, as proposed in the *Preliminary Views* document, does not consider future income as it should.
- e. Since accounting rules do not allow future taxes to be recognized as assets, recognizing future benefits as liabilities when participants attain fully insured status would be misleading.
- f. The Supreme Court has ruled that Social Security benefits are not property or a contractual right and Congress can change benefits.
- g. The attain-fully-insured-status obligating event is an insufficient obligating event because under certain circumstances a worker who attains fully insured status can subsequently lose it; and even the attaining of permanently insured status is an insufficient obligating event because future benefits are too uncertain and there is no binding contract or obligation until benefits are due and payable.
- h. Social insurance benefits are not guaranteed or contractual, or advance funded, or promised.
- i. Social insurance benefits are not part of an exchange but rather are a welfare program and/or an annual general fund program like Medicaid and defense – which are as likely as social insurance but for which early accrual is not proposed.
- j. The attain-fully-insured-status obligating event could diminish the likelihood of reform because, although recent proposals have promised not to alter benefits to retirees and near-retirees, the proposals could affect other benefits included in the “fully insured” group. Thus, the attain-fully-insured-status obligating event could create anti-reform political pressure.
- k. The attain-fully-insured-status obligating event is based on private sector pension accounting and is unsuitable for the Government, which has unique characteristics.
- l. The Government can and no doubt will change the social insurance obligation that would be displayed as “accrued” under the attain-fully-insured-status event substantially.
- m. The attain-fully-insured-status obligating event does not meet the SFFAS 5 liability definition.
- n. The current FASAB social insurance standards are accepted and workable and the attain-fully-insured-status obligating event does not make a compelling case for change.
- o. Those favoring the attain-fully-insured-status obligating event are wrongly changing the liability definition to accommodate preconceived preference.
- p. Social insurance and other nonexchange transactions are unique to the Government. They are fundamentally different from exchange transactions and should be accounted for differently.



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A34. Those favoring the due-and-payable obligating event commented that:

- a. The due-and-payable obligating event is consistent with the liability definition in SFFAC 5, *Elements*, with FASAB's long-held views, and with the pay-as-you-go financing of social insurance.
- b. The due-and-payable obligating event is useful to lawmakers and the public.
- c. Social insurance benefits do not meet the criteria even for constructive liabilities and therefore recognizing a liability earlier than the due-and-payable event is inappropriate.
- d. The SFFAC 5, *Elements*, liability definition requires that the obligor not be able to change the liability unilaterally, which Congress can do until social insurance benefits are due and payable.
- e. Recognizing pension liabilities is appropriate in the private sector where advance funding is a concern, but the federal budget and most federal programs are not advance funded. Social Security is a pay-as-you-go program.
- f. Social insurance benefits are non-binding obligations.
- g. The due-and-payable obligating event maintains the accepted and workable SFFAS 17 standard and is consistent with SFFAC 5, *Elements*.
- h. Social insurance funds are similar to government funds in state and local governments.

A35. Those opposed to the due-and-payable obligating event commented that:

- a. The argument for due-and-payable obligating event that the collection of taxes and payment of benefits are two separate non-exchange transactions and that the Government is free to walk away from social insurance commitments is unsupportable from accounting, public administration, and political perspectives. Social insurance programs have citizens' support because they perceive an exchange and Congress and SSA have reinforced that perception.
- b. The argument for the due-and-payable obligating event that there is a mismatch of cost and service with the early-accrual obligating event approach is inappropriate because accrued expenses are economic events; they are current expenses even though cash outflow will occur in the future.
- c. The due-and-payable obligating event implies a "stay-alive" criterion that is a very narrow interpretation of liabilities.
- d. The large size of the social insurance liability under the attain-fully-insured-status obligating event should not deter reporting; it illustrates the importance of these programs.

### Question No. 2: Measurability

A36. The respondents' answers to Question 2, which asked whether respondents believe that the Social Security and Medicare obligations are measurable for the purposes of recording a liability when participants complete 40 quarters of work in covered

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employment and attain fully insured or equivalent status, generally reflected their position on Question 1. Those believing Social Security and Medicare obligations are measurable for the purposes of recording a liability commented that the attainment-fully-ensured-status obligating event – or earlier event – would be measurable and auditable. The rationales included that the SOSI is basic information now and is audited; that actuarial practice currently accommodates large estimates; and that SFFAC 5, *Elements*, does not require certainty; that the SSA distributes *Social Security Statements* that are presumably accurate enough to send to participants for the purposes of long-range planning. Those not believing Social Security and Medicare obligations are measurable for the purposes of recording a liability and expense commented that the amount is too uncertain, that assumptions, law, and/or insured status change and such changes would cause great fluctuations. One respondent commented that the future cost of Medicare is unknown or unknowable.

### Question No. 3: Reporting Changes

A37. Part one of Question 3 asked respondents whether (1) the new SOSI line items that tied to the balance sheet and operating statement as proposed by the Primary View members should be adopted (Question 3.1) and (2) they favored reporting the components of the change in the SOSI present values and, if so, which approach for such reporting they favored – the Primary View approach featuring an expanded SOSI, or the Alternative View featuring a new statement (Question 3.2).

A38. Respondents favoring the new SOSI line items commented that adding such line items would illustrate relationship for unfamiliar users. Respondents not favoring new SOSI lines items commented that the current SOSI or SFFAS 17 approach is appropriate; that additional line items would make the SOSI more complex without increasing understandability; and that there should be a “bright line” distinction between primary financial statements and SOSI.

A39. Regarding Question 3.2, almost all respondents who commented on it favored reporting changes, although some preferred that it be RSI. The majority of respondents favored a separate statement rather than new SOSI line items. Some commented that a new statement would be concise and simple and therefore promote discussion of context.

### Question No. 4: Statement of Fiscal Sustainability

A40. Question 4 asked respondents whether they favored the statement of fiscal sustainability proposed by the Alternative View members (and not opposed in principle by the Primary View members). Those favoring a SOFS commented that:

- a. A SOFS would help explain long-term effects without compromising the financial statements.

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- b. Sustainability information is vital for federal managers, elected officials, citizens, and holders of Treasury debt. And,
- c. Intergenerational information is of the highest importance.

A41. Some who favored a SOFS preferred to develop it via a separate project. The FASAB subsequently undertook a project on the subject that resulted in the *Projections* ED.

A42. Respondents not favoring a SOFS commented that:

- a. A SOFS would be too costly to prepare and audit and of little practical use.
- b. Present value “point estimates” and per capita ratios and/or infinite horizons are inappropriate for sustainability reporting for pay-as-you-go programs like social insurance. Sustainability reporting for social insurance requires analysis of the timing and trends of future cash flow on an annual basis and as a percentage of GDP, taxable payroll, and possible other measures of the economy; and/or
- c. that the estimates would be too subjective or too uncertain or just would be just one more competing view.
- d. One respondent commented that the information that would be provided via the Primary View proposal is more appropriate than a SOFS for GAAP financial statement. However, this respondent did not oppose research and development of guidance for sustainability reporting, but not as a substitute for financial statements.

### Question No. 5: Deferred Revenue

A43. Question 5 asked respondents whether the Board should consider recognizing deferred revenue in excess of related program costs as a liability. Some of the respondents who did not believe the Board should consider recognizing deferred revenue commented that:

- a. The information provided under the Primary View proposal properly matches costs and revenues, and/or that current revenue recognition standards were appropriate.
- b. Some commented that earmarked taxes were the same as non-earmarked; or that payroll taxes were mandatory and not “deferred” for anything.
- c. One respondent noted that the concept of deferred revenue may be contradictory to the Alternative View that there are no present obligations until benefits are due and payable. Another respondent said that deferred revenue pertains to exchanges.

A44. Respondents favoring the Board’s consideration of recognizing deferred revenue did not provide specifics as to their rationale. Some said that, if the attain-fully-insured-status obligation event or other early accrual were not adopted, then the notion of

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deferred revenue should be considered.

A45. One respondent commented that the *Preliminary View* document did not provide sufficient information to respond to the question.

### The Board's Conclusions and the Proposed Standard

#### Fiscal Sustainability Reporting

A46. After the public hearing on social insurance on May 23, 2007 and initial discussions in the summer of 2007, the Board decided to develop fiscal sustainability reporting further before considering social insurance. The *Preliminary Views* document mentioned the Board's unanimous interest in fiscal sustainability reporting and the Alternative View presented examples of what it might look like. The members wanted to know if the fiscal sustainability project would address some of the objectives of the social insurance project.

A47. The Board developed and has now issued the exposure draft, *Projections ED*.<sup>21</sup> In the *Projections ED*, the Board is proposing to require that the *CFR* present information addressing the fundamental question of whether the Government can sustain public services and meet its obligations as they come due, including social insurance. The Board concluded that answering this question requires analyzing current and projected levels of all federal spending, federal receipts and federal debt in relation to the economy. Such an analysis is complex and the result is challenging to communicate.

A48. The fiscal sustainability [standard](#) would be comprehensive. It would consist of an analytical narrative that integrates a basic financial statement and illustrations. The [standard](#) includes what the Board notes is information that is consistently found in reports of U.S. entities and many other countries. For example,

- a. Information on the present value of receipts and spending to convey the magnitude of policy changes that would be required to sustain delivery of goods and services. Presenting this information in relation to a meaningful base such as GDP is required to assist readers in understanding large dollar amounts.
- b. [Information on the](#) trajectory of spending and receipts to show the timing of the Government's need for financing and allow for comparison to historic financing needs on an annual basis.

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<sup>21</sup> Issued August 29, 2008, comments due January 5, 2009, and a public hearing scheduled for February 25, 2009.

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- 1 c. [Information on](#) the trend in debt-to-GDP ratios in graphic form to facilitate an  
2 understanding of when the rising drain on financial markets might constrain  
3 borrowing.



5 A49. The proposed fiscal sustainability standards in the *Projections* ED would require:

- 7 a. A basic financial statement presenting the present value of projected receipts  
8 and spending for all activities of the Federal Government, including social  
9 insurance; how those amounts relate to projected GDP; and the summary  
10 measure “**fiscal gap**.”

- 12 b. Disclosures explaining and illustrating the projected trends in:

- 14 1. The relationship between all Federal Government receipts and  
15 spending,  
16 2. Deficits or surpluses, and  
17 3. Treasury debt as a share of GDP.

- 19 c. Disclosures also explaining and illustrating:

- 21 1. The assumptions underlying the projections,  
22 2. Factors influencing trends,  
23 3. The range of possible results using alternative assumptions, and  
24 4. The likely impact of delaying corrective action when a fiscal gap exists.

26 A50. The Board believes that these projections will provide meaningful information  
27 essential to assessing whether future budgetary resources will likely be sufficient to  
28 sustain public services and to meet obligations as they come due, including SI  
29 obligations. However, this ED is proposing that the fiscal sustainability [standard](#) is  
30 not a substitute for presenting the amount of social insurance commitments on the  
31 balance sheet below assets, liabilities, and net position and not included in the  
32 totals of those classifications.

### 33 Social Insurance Revisited

35 A51. Having developed the proposed fiscal sustainability standard, the Board returned to  
36 social insurance. On the fundamental question of liability and expense recognition  
37 for social insurance, the Board notes the division of opinions among respondents  
38 reflected the *Preliminary Views* document itself. Indeed, the difference of opinion  
39 has persisted since the Board’s initial consideration of the social insurance liability  
40 question during the development of SFFAS 5 and especially during the  
41 development of SFFAS 17.

43 A52. SFFAS 17 presented a compromise between two strongly held views regarding  
44 liability and expense recognition for social insurance programs. For SFFAS 17, the  
45 Board concluded that the best approach was to recognize the annual cash flow

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effects of the social insurance programs in the basic financial statements; that is, revenue is the cash inflow during the reporting period from payroll tax contributions and income tax on social insurance benefits and expenses are the cash outflow during the year plus or minus the change in a “due and payable” liability. However, the Board also required a package of information that it characterized as “required supplementary stewardship information” (“RSSI”).

A53. For the RSSI section, the Board required an array of present values by age cohort in what became the statement of social insurance (“SOSI”). The SOSI is required to have five years of data and thereby provide an historical perspective. In addition, the Board required other narrative and graphic information, e.g., graphs of cash flows over long-term projection periods using nominal dollars and as percentages of taxable payroll and GDP. The graphs show the timing of future cash flows that present values cannot do and thereby provide a future perspective. The information is to include the point when benefit payments begin to exceed social insurance income, which is sometimes called the “cross-over point.” The RSSI was also to include the ratio of beneficiaries to workers also known as the “dependency ratio,” as well as extensive explanatory material.

A54. The Board decided that the “bottom line” of the SOSI should be an open group measure. That bottom line represents the total excess of actuarial present values of future benefit payments over future contributions and tax income for current and future participants over a period sufficient to illustrate long-term sustainability. There had been much debate during the development of the standard over whether to display the open group measure or the closed group measure.

### *The Closed Group Measure*

A55. The term “group” simply refers to the participants included in a measure. The “closed group” includes current participants only, e.g., for Social Security, current retirees and covered workers. It does not include future participants; those projected to become participants during the projection period but after the valuation date. It contrasts with what is known as the “open group” that does include those who are currently participating and those who will participate in the future during the projection period. The open and closed group measures include all future flows related to the specified group. These measures contrast with an accrued benefit obligation measure which includes only future benefits attributed to past work in covered employment by current participants as of the reporting date.

A56. The closed group measure has been an option for Federal financial reporting for a long time. From 1985 through 1994, the closed group measure was disclosed in a footnote in the “prototype” *Consolidated Financial Statements of the United States* (“prototype CFS”). Before that, from 1976 to 1985, a liability had been recognized for Social Security in the prototype CFS, using a calculation similar to that called for


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by private sector accounting standards.

A57. The original exposure draft leading to SFFAS 17 had required disclosure of the closed group measure as part of a package of RSSI. The Board noted that the closed group measure is sometimes referred to as the actuarial liability for certain social insurance programs related to the closed group of current participants. The Board noted that some believe it is analogous to the liability that would be recognized on the face of the balance sheet if social insurance programs were accounted for like federal pensions and retiree health care benefits. Others dispute this, pointing to different financing arrangements, legal status, and the nature of social insurance and pensions.

A58. At that time the Board noted that some people believe that the closed group measure gives a rough idea of the implicit intergenerational transfer taking place in social insurance programs. Others disagree because they believe there has been no intent for individuals or cohorts of individuals to make contributions commensurate with the benefits they receive.

A59. The Board had also noted that some believe the closed group measure is analogous to the measure of “risk assumed” that would be reported as supplementary information if social insurance programs were accounted for like other federal insurance programs. SFFAS 5, *Accounting for Liabilities of the Federal Government*, defines “risk assumed” as the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force (i.e., the expected loss on the “current book of business”). The Board noted that, in the context of social insurance, one would use the term “closed group” instead of “current book of business.”<sup>22</sup>

A60. SFFAS 5 requires insurance programs, other than social insurance programs, to report risk assumed amounts if they differ from the amount recognized as a liability. The Board noted that some people believe that it is useful to report this information, for the same reason that it is useful to report [amounts of a similar nature](#)  other kinds of government programs: that as a general principle, decision-making is best informed if the government recognizes the costs of its commitments at the time it makes them. The Board noted government analysts had argued in a similar vein for recognition of the economic costs of federal insurance in the budget, as is done for federal credit programs. Accrual-based information offers the potential to overcome a number of the deficiencies of cash-basis information. In concept, risk assumed information would permit policymakers to consider these costs in relation to other priorities and improve the measurement of a program’s impact on private economic behavior. In most cases, the Board agreed that the risk-assumed approach to

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<sup>22</sup> In insurance accounting, the term “book of business” refers to the total amount of insurance in force on an insurance entity’s books at a particular date. AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*, Glossary.



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accrual would be analogous to a premium rate-setting process in that it looks at the long-term expected cost of an insurance commitment at the time the insurance commitment is extended.

A61. Ultimately, for SFFAS 17, the Board decided, [as part of a compromise solution](#), to develop the SOSI that provided actuarial present values of future contributions and benefits for [the open group of participants](#) but not the closed group per se. Board concluded that the SOSI so constituted would be useful for analysis of sustainability and financial position of social insurance programs.

A62. The vote for SFFAS 17 was not unanimous. Three members dissented. They focused primarily on the switch from the closed to the open group bottom line. One of the dissenting members said the closed group deficit was a very important measure in evaluating alternative proposals for social insurance financing. Even though SFFAS 17 required instructions in a footnote on how to calculate the closed group measure, the member felt that, if the Board truly wished to establish standards that meet the information needs of citizens, elected officials and program managers, the standard should require the prominent display and explanation of the closed group measure rather than a [footnote explaining](#) how to calculate the closed group deficit. The member did not see how that could possibly be interpreted as satisfying the mission of the Board.

A63. Another member dissented because he felt SFFAS 17 did not require a clear unambiguous disclosure of a reasonable estimate of the Government's social insurance liability/obligation. That member argued that the due and payable liability would result in a reported financial position that will appear to many as significantly misleading, at best, and clearly not commensurate with the significant financial implications of this critical national issue. The member noted that SFFAS 17 required the NPV of future benefits related to the open group but not the closed group; and that the absence of the specified closed group measure is significant because some suggest that the closed group measure represents an appropriate estimate of the social insurance liability.

A64. Lastly, a third dissenter argued that the removal of the closed group number from the published financial statements removed any forthright indication of the existence of any obligations to participants. He asked what the Government's repeated promises meant if there is no obligation to the participating public. He argued that the closed group number is an important indicator of financial stress to be faced by the next generation of Americans, and is a proxy for an economic liability or an "implicit" liability. He mentioned that proposals to add social insurance benefits or increase social insurance taxes or to make other changes in the program should be evaluated by Congress and the public against these absolute numbers and the strength of the Government's commitment to honor the indicated obligations. Finally, he argued that the SOSI should be a basic financial statement, which it became with SFFAS 25 and SFFAS 26.



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A65. Some current Board members believe that the closed group measure is the best measure of the social insurance obligation.<sup>23</sup> However, they do not believe it is appropriate for the balance sheet or that the change in this measure during the reporting period is appropriate for the statement of net cost. They view future revenues that are included in the measure as contingent revenues, and they believe all other future inflows and/or revenues included in balance sheet and statement of net cost relate to earned revenues.

A66. Others counter that insurance accounting and fair value measures currently incorporate future inflows and outflows in the measure of liability and expense. Some argue that the basis for including future revenue in current year cost and liability measures depends on the obligating event to which they relate. If they related to a past event, e.g., an insured event, then they are appropriate measures of cost. If they relate solely to a future event, e.g., future insurance policies in the program, then they should be excluded from current costs and from liability measurement. The key is the event not the fact that the cash flow is in the future. They cite current FASAB insurance standards in SFFAS 5<sup>24</sup> that include future revenue when calculating the net liability.

A67. Some Board members argued against including the closed group measure for social insurance on the balance sheet. They said that the balance sheet displays accumulated assets and liabilities that are primarily accrual-based and impact the entity's net results of operations and net position. They believe that the use of the actuarially derived present values for the balance sheet for social insurance would put both accrual-based and actuarial-based estimates on the balance sheet, which they feel would be confusing. They point to GASB Statement 34 as an example of a standard that moves away from such commingling because it separates current financial resources from economic data. Other members believe that the actuarial assumptions and estimates are commonly used in measuring long-term liabilities such as for pension obligations and veteran's benefits.

### *The Current Proposal*

A68. Since the two views regarding liability and expense recognition persist and the likelihood of achieving a satisfactory majority one way or the other is remote, and

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<sup>23</sup> The current group of participants is also known as the closed group of participants.


<sup>24</sup> SFFAS 5, par. 113: The liability for life insurance includes both the liability for unpaid claims ... and a liability for net future policy benefit outflows.... The [latter] represents the expected present value of future outflows to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders. The liability is estimated using appropriate financial or actuarial methods that include assumptions ... applicable at the time the insurance contracts are made and in accordance with existing law and related policy .... Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in


## Appendix A: Basis for Conclusions

since the Board wishes to further improve social insurance reporting, the Board concluded that a compromise was in order. The Board believes that a fair presentation of the financial position, condition, and results of operations requires that the closed group measure be provided as part of a balanced package of information. The closed group measure represents a reasonably good estimate of the net responsibility of future taxpayers, under current laws, to pay benefits to current participants. Although this amount is subject to change due to changing long-range demographics, it is not as volatile as the computation under the open group measure that includes all current and future participants over a projection period, e.g., the next 75 years. It relates only to individuals who already are participating in the program.

A69. The open group measure represents the net present value of all expenditures to or on behalf of the open group population and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years. It is used to estimate the future financing shortfall in social insurance programs. The closed group measure involves only those participating in the social insurance program at the reporting date. It represents the same measurement approach as for the open group; that is, it is the net present value of all expenditures to or on behalf of the current participants and all contributions or other income from or on behalf of the current participants over a given projection period.

A70. The open group measure is inherently more sensitive to assumptions about the distant future than the closed group measure. The [greater sensitivity](#) is inevitably true, despite the best efforts of actuaries, economists, and other professionals involved in making these projections. [It](#) is mainly caused by the fact that a closed group dwindles over time, so that uncertainty about what will happen in the distant future has less impact than is the case for an open group that grows larger during the projection period.

A71. Federal accounting and financial reporting attempts to address the needs of users and to inform their decisions, [and particularly](#)  decisions on highly important and topical issues. The Board believes that the closed group measure is one way to quantify the financing challenges relating to social insurance programs. It is relevant to the concerns of users who are assessing options for dealing with those challenges. The measure not only draws attention to the challenge but also quantifies it in a way that can support further analysis and decision-making.

A72. For example, the closed group measure represents one way to consider the cost of transition from a current program to a new program. The transition cost [is also](#)  to evaluate the actuarial status of an existing plan when continuing the program in a different form. The closed group measure represents net benefits scheduled to be




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which the changes occur. ...

## Appendix A: Basis for Conclusions

paid to current retirees and to workers.

A73. The Board is proposing to require:

- a. a discussion and analysis by management of the closed group measure of social insurance along with other critical measures in the MD&A;
- b. a separate line presenting the closed group measure that would be displayed on the balance sheet  how assets, liabilities, and net position and not included in the totals for these classifications;
- c. new displays on the SOSI for closed and open group measures; 
- d. a new statement of changes in social insurance using the closed group measure; 
- e. note disclosure of an accrued benefit obligation; and
- f. continuing to require the projections and other supplementary reporting currently required by SFFAS 17, with the sensitivity analysis amended by this standard.

### *Management's Discussion and Analysis*

A74. The Board provided MD&A standards and guidance in SFFAS 15 and SFFAC 3, *Concepts for Management's Discussion and Analysis* ("SFFAC 3, MD&A"). SFFAS 15 requires the entity's financial report to include a MD&A, which it categorizes as required supplementary information. SFFAS 15 requires the entity's MD&A to address the entity's:

1. mission and organization structure;
2. performance goals and results;
3. financial statements; and
4. systems, controls, and legal compliance.<sup>25</sup>

A75. Very importantly, the MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known as well as anticipated demands, risks, uncertainties, events, conditions, and trends.<sup>26</sup> MD&A should deal with the "vital few" matters, i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the financial report, including the most important problems that need to be addressed and the actions taken or planned. SFFAC 3 provides examples of items that might be relevant.<sup>27</sup>

A76. The MD&A should discuss significant amounts that affect the financial statements,

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<sup>25</sup> SFFAS 15, par. 2.

<sup>26</sup> SFFAS 15, par. 3.


<sup>27</sup> SFFAC 3, pars. 31-39.

## Appendix A: Basis for Conclusions


the major changes during the reporting period, and the causes thereof. The entity should not report amounts merely because they are large, for example, the fund balance with Treasury, if the affects of such amounts and changes in amounts were insignificant with respect to the entity's operations during the period. The entity should explain why the changes occurred, not merely that change did occur.

A77. SFFAC 3 explains the conceptual basis for the role and importance of MD&A, the general content of the financial report, and the elements of MD&A. The concepts provide a foundation for the standards presented in SFFAS 15 as well as suggestions for the contents of the MD&A.

A78. This standard requires the governmentwide and component entities that present a SOSI to include certain information in their discussion of financial statements in the MD&A. (see paragraph 26). The discussion will relate costs, asset and liabilities, social insurance commitments, the budget, and, for the governmentwide entity, the fiscal gap.

A79. The closed group measure is important for analysis of programmatic changes. [Since it will be presented on the balance sheet, below assets, liabilities, and net position and not included in the totals for these classifications, it](#) should be [addressed](#) in the governmentwide and component entities' MD&A discussion of social insurance. 


### *The Balance Sheet*

A80. With respect to the balance sheet, the Board proposes to display new information on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications rather than to change the due and payable measure of the social insurance liability or change the basis for social insurance expense recognition. Again, under SFFAS 17, social insurance revenue is the payroll tax contributed and expense is the cash outflow during the period plus or minus the change in the due and payable liability. This would not change under the new standards. Instead, the Board is proposing to add to the reporting model to require the closed group measure to be displayed on the balance sheet but not included in the [amounts in the](#) totals for assets, liabilities, and net position (see Appendix C). 

A81. The closed group measure represents a point estimate of the program's shortfall over a projection period sufficient to illustrate long-term sustainability (e.g., traditionally a period of 75 years has been the primary period used by the Social Security Administration for long-term projections). It is the amount that will not be covered by payroll tax contributions from the current participants over that period. The closed group measure is a concise and familiar depiction. It is a "stock" number, rather than a "flow" number, and captures much information about the future. Many point estimates are used for reporting under general accepted accounting principles. However, the closed group measure does not address the timing of the shortfall.

## Appendix A: Basis for Conclusions

Timing is the subject of the social insurance RSI, which displays the cash flow projections graphically, in nominal dollars and as a percentage of taxable payroll and the GDP.

A82. The Board believes that the concept of a liability-commitment-[expectation](#) continuum is useful.  The Government's recognized liabilities include Treasury debt, pensions and medical benefits owed to Federal employees and veterans, environmental cleanup liabilities, and other liabilities. Employee liabilities are a form of deferred compensation. Liabilities also include accrued obligations for Government insurance policies and the estimated present value of failed loan guarantees and deposit insurance claims. However, liabilities are only a subset of the Government's overall commitments.


A83. The full extent of the Government's commitments dwarfs the outstanding total of all acknowledged Federal liabilities. Farther along the continuum the Government has a broad range of programs that dispense cash and other benefits to individual recipients. The Government also provides a wide range of public services that must be financed through the tax system. Some commitments relate to past events and transactions but are too uncertain as to their occurrence or are insufficiently measurable to be recognized as liabilities. Some of these uncertain or insufficiently measurable commitments are disclosed in notes to the financial statements or required supplementary information in accordance with relevant accounting standards. Other commitments are too remote for disclosure or relate entirely to future events. Pursuant to SFFAC 5, *Elements*, liabilities require the existence of a present obligation with a related past transaction or event, and, to be recognized as a liability, must be reasonably measurable.


A84. [Some components on the continuum are generally accepted as limited. These may be characterized as commitments.](#) Commitments relating solely to future events represent a claim on budgetary resources in the foreseeable future unless the law is changed. All of the Government's existing programs are reflected in the long-run budget projections for which reporting is proposed in the *Projections ED*. These future claims need to be discussed in the MD&A or RSI. Leaving these programmatic commitments out of projections of future claims on the Government or in calculating the Government's long-run fiscal imbalance would be misleading. However, they do not belong among liabilities on the balance sheet because they do not meet the definition and/or the recognition criteria for liabilities.

A85. Others [items](#) are even further along the continuum and may be characterized as expectations. They involve general assistance and Government service programs.

A86. The Board is proposing to add social insurance commitments to the balance sheet below assets, liabilities, and net position and not included in the totals for those classifications, as illustrated in Appendix C. In addition, the Board is proposing that the SOSI display the closed group measure as well as the open group measure, and

## Appendix A: Basis for Conclusions

to create a new statement to display the changes in the closed group measure during the reporting period. Finally, the Board is proposing note disclosure of the accrued benefit obligation because [users](#)  asked for this measure and because it is needed for analysis.

A87. Some members ask why social insurance should be treated differently than other programs that provide annual government services, and why social insurance should be selected for the balance sheet but not other programs, e.g., food stamps, school lunches. They note that some commentators say one area of difference is the dedicated taxes in social insurance programs, but these members note that a large part of Medicare is funded by general revenue. They do not believe that a strong basis has been established for saying social insurance programs are the ones to highlight and others can be excluded. In this regard some members believe one of the drawbacks of the SOSI is that it does not provide a comprehensive view of the continuum of Government [liabilities](#)-commitments-[expectations](#).  They note that the fiscal sustainability project will provide that view.

A88. Some assert that social insurance programs are indistinguishable from other federal programs for which no one argues that accrued liability treatment or unique displays should be developed. Thus, social insurance programs should not be afforded unique accounting treatment.

A89. For SFFAS 17 the Board identified five programs as social insurance programs.

- Old-Age, Survivors, and Disability Insurance ("OASDI" or "Social Security");
- Hospital Insurance ("HI") and Supplementary Medical Insurance ("SMI"), known collectively as "Medicare;"
- Railroad Retirement benefits;
- Black Lung benefits; and
- Unemployment Insurance ("UI").

A90. The Board noted that although they generally share certain characteristics, "social insurance" programs are too diverse to allow definitive criteria to be applied to include some and exclude others from the category. SFFAS 17 identifies the following five characteristics common among social insurance programs:

- (1) Financing is from participants' and/or their employers' payroll tax contributions and fees.
- (2) Eligibility is from payroll tax contributions/fees paid and time worked in covered employment.
- (3) Benefits not directly related to pay tax contributions/fees paid.
- (4) Benefits prescribed in law.
- (5) Programs intended for the general public and most citizens are eligible.

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- 1  
2 A91. After weighing these arguments carefully, the Board continues to believe that  
3 definitive criteria would be unworkable. Although these programs do generally share  
4 certain characteristics, they are complex. Each program has unique benefits,  
5 different eligibility requirements, and different financing arrangements. Because  
6 definitive criteria would be subject to interpretation, questions would arise about  
7 individuals programs that would require a response from the Board. The Board has  
8 decided to continue to identify social insurance programs that now exist and  
9 consider the classification of other programs as they may arise in the future.  
10  
11 A92. The Board is now proposing to amend SFFAS 17. In order to offer improvements in  
12 a timely manner, the Board will leave open certain questions regarding the reporting  
13 model and the elements of Federal financial reporting, as explained elsewhere in this  
14 basis for conclusion. However, the Board will indicate here areas where additional  
15 conceptual work will be undertaken.  
16  
17 A93. Some members argue that financial reporting geography matters. They argue that a  
18 SOSI and even a new SCSIA and note disclosure is no substitute for reporting the  
19 economic cost as an expense of the period and the accrued obligation as a liability.  
20  
21 A94. Others argue that the value and credibility of current financial reporting is negatively  
22 impacted by having three bottom lines: (1) the budget deficit, (2) the “GAAP” deficit,  
23 and (3) the government’s change in financial position taking into account social  
24 insurance programs. Even though the last of these three is not currently reflected in  
25 the financial statements, it is most important and the one on which the Board  
26 encourages others to focus their analysis.  
27  
28 A95. The social insurance programs are a challenge for the current model. The  
29 obligations and assets associated with these programs do not fit well within the  
30 existing model. Currently the model is outlined in FASAB Concepts Statements and  
31 calls for an MD&A; certain basic financial statements, especially a balance sheet, an  
32 operating statement (“statement of net cost”), a statement of changes in net position,  
33 a statement of social insurance, and other statements; and supplementary  
34 information.  
35  
36 A96. Members believe that the current financial statements need to do a better job of  
37 explaining the implications as to why the power to tax is not an asset but  
38 nonetheless relevant to assessing the sustainability or the financial condition of the  
39 Federal Government. For example, one can argue that current deficits are indeed  
40 bad but that the problem is actually long-range rather than short-range. Thus, the  
41 current financial statements need to explain the timing of the problem as well as  
42 providing point estimates like the closed group measure. The financial statements  
43 need to explain why the point estimates on the balance sheet have limitations for  
44 assessing financial condition. They believe that the fiscal sustainability reporting  
45 proposed in the *Projections* ED is moving in that direction.




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A97. The Board's current Financial Report Phase of the Concepts Project also will consider this issue. The Financial Report Phase will be conducted in four segments:

- a. determine user needs within certain cost/benefit constraints;
- b. determine the inventory of user needs and how they relate to the reporting objective;
- c. determine methods for meeting user needs; and
- d. determine presentation.

Ultimately, completing the phases could lead to conceptual guidance, standards, and/or educational material on the federal reporting model.

A98. For now, the Board is expanding the reporting without comprehensively addressing the model. The Board is identifying a "commitment" for special display and reporting but is not characterizing the new balance sheet information as an "element" of financial statements within the context of SFFAC 5, *Elements*, definitions.

A99. Some argue that there is a further, significant issue regarding the concept of articulation of the elements of the required financial statements. Articulation refers to the linkage of an item in one financial statement to an item reported on a different financial statement. Articulation demonstrates the interrelationships of the various financial statements. That linkage is demonstrated in Appendix 1- A thru 1- F of SFFAC 2, *Entity and Display*. The concept of linkage (described therein as "the order and flow of data in the financial statements") is also very clearly depicted in a chart on page 43 of the 2007 *Financial Report of the United States Government*. Since the other statements outlined in SFFAC 2 are prepared on an accrual basis, there is no linkage (articulation), as traditionally understood, between the basic financial statements described in SFFAC 2 and the SOSI. Some argue that that condition is technically unsound in basic financial statements. This was acceptable in SFFAS 25 and 26 and is proposed here as a compromise standard that requires disclosure and RSI. Being concerned that the lack of linkage to the other basic statements will not be easily understood by users willing to study the information with reasonable diligence, others might not believe the users of the SSA and CFR financial reports, particularly citizens and citizen intermediaries, will be well served by this proposal. Elevating the SOSI  become a basic financial statement without accruing a liability or recognizing an expense based on that information might increase confusion of users of Government reports.

A100. As with the current reporting model, changes in the closed group measure for social insurance programs will not impact financial position. Thus, the impact of changes in social insurance – and other programs – is not comprehensively captured in the financial statements of the period the changes are made. The Board has on-going projects on its agenda addressing both the reporting model and recognition and measurement, and the Board will consider the issues in due course.



## Appendix A: Basis for Conclusions

### The Statement of Net Cost

A101. The proposed standard does not affect the statement of net cost of social insurance entities and the governmentwide entity. Some argue that the change in the social insurance closed group measure or other net present value during the reporting period is an economic cost. The economic cost of social insurance programs has been debated by the Board over the years. Some current Board members are concerned that this cost is not highlighted in this compromise proposal. These members note the effect of changes in the closed group measure is not displayed on the statement of net cost.

A102. They note that SFFAC 5, *Elements*, defines expense as an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the Government's net position during the reporting period.<sup>28</sup> SFFAC 5, *Elements*, defines liabilities as a present obligation of the Federal Government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.<sup>29</sup> A present obligation requires a past transaction or other event.<sup>30</sup> These members believe that there is an economic cost being incurred as workers participate in social insurance programs.

A103. Some members note that accrual accounting has a universal definition: expenses are recognized when incurred. They believe that only through accrual accounting can cost or financial position of an entity be measured, which is why generally accepted accounting principles primarily require accrual accounting.

A104. As is discussed above and in the *Preliminary Views* document, Board members, respondents to the *Preliminary Views* document, and, historically, all groups who considered the question have disagreed over the past transaction or event that creates a liability and expense for social insurance programs.

A105. Those FASAB members who are concerned that the economic cost of social insurance is not being highlighted reference the FASAB Objectives when attempting to decide what should be recognized as social insurance expense. These members note that FASAB expectations regarding objectives of federal financial reporting in general and social insurance in particular are most clearly set forth in SFFAC 1, *Objectives*. The FASAB's *Strategic Directions* report, issued November 2006, focused on the objectives in SFFAC 1, *Objectives*, and established Objective 2, "Operating Performance," and Objective 3, "Stewardship," as FASAB's most important focus. With respect to social insurance, these members note especially

<sup>28</sup> SFFAC, par. 53.

<sup>29</sup> SFFAC, par. 39.

<sup>30</sup> SFFAC, par. 42.

## Appendix A: Basis for Conclusions

objectives 2A, 2B, and 3A regarding the need for information about costs:

2A. The cost of providing specific programs and activities and the composition of, and change in, these costs.

2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.

3A. Whether the government's financial position improved or deteriorated over the period.

A106. These three sub-objectives speak most clearly about financial statements showing costs associated with a specific period and the impact these costs have on an entity's financial position.

A107. Other FASAB Objectives speak about financial statements showing other elements of financial position. These members believe that SOSI and the new SCSIA will do a very good job of meeting SFFAC 1, *Objectives*, Objective 3B, "Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due." These statements will also contribute to meeting Objective 3C, "Whether government operations have contributed to the nation's current and future well being."

A108. In addition, information from the SOSI, if combined with other financial statement information, could help meet Objective 3A, which relates to changes in the Government's financial position. Moreover, the proposed SCSIA, which all members support, will help meet Objective 3A.


A109. However, these members note that the proposed standard can be criticized for failing to address Objective 2A and 2B, noted above, unless something is reported on the operating statement. They suggest adding a line item to the Statement of Net Cost to show the change in the social insurance commitment during the period in close proximity to other costs, an approach similar to the new line item that is proposed for the balance sheet.

A110. Other members disagree that the change in the social insurance commitment should be on the statement of net cost. They believe that cost should represent the goods and services provided during the period, and the change in social insurance, although meaningful, is not a good or service so provided, and should not be associated with such costs. They believe that displaying the change in the social insurance commitment on the statement of net cost would be misleading. They argue that the SOSI amounts are purporting to represent something entirely different from what is on the balance sheet and statement of net cost. They believe people expect customary elements on the operating statement, and that SOSI amounts are too uncertain for that purpose.


## Appendix A: Basis for Conclusions

1  
2 A111. They note that the Board made the SOSI a basic statement and proposes that the  
3 SCSIA be a basic statement, and that the SOSI and SCSIA are to be presented in  
4 close proximity to the balance sheet and operating statement. They believe that that  
5 approach is appropriate. For them, the change in the social insurance commitment  
6 during the reporting period should be presented apart from the costs of the period  
7 and clearly labeled as, for example, “social insurance exposures.” They conclude  
8 that associating the change with period costs is inappropriate because it does not  
9 represent the complete change in the Government’s financial condition, and that the  
10 fiscal sustainability reporting proposed in the *Projections* ED provides context and is  
11 more a measure of the Government’s financial condition.  
12

13 A112. This proposed standard does not require that the change in the closed group  
14 measure be recognized as an operating cost of the Government on the statement of  
15 net cost and the statement of changes in net position. The Board decided to  
16 continue the SFAS 17 approach.  
17

18 A113. The Board’s proposal [is an attempt to secure](#) all board members’ support [for a](#)  
19  tion that meets FASAB reporting Objectives while still being sensitive to the  
20 objectives of the Primary View, the Alternative View, and points made by  
21 respondents and testifiers that were somewhat different from both Board positions.  
22 The Board is asking respondents to comment on the question of how and where to  
23 display the effect of the change in the social insurance commitment, be it the closed  
24 group measure or another measure, on the Government’s financial condition (see  
25 Question Q6).

### [The Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts](#)

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27  
28   
29 A114. [Regarding the statement of social insurance, the Board has said that it believes the](#)  
30 [SOSI should be treated as a basic financial statement because it is essential to fair](#)  
31 [presentation and is important to achieve the objectives of federal financial](#)  
32 [reporting.<sup>31</sup> The Board is proposing a display of the closed and open group](#)  
33 [measures on the CFR SOSI in a summary section. The FY 2007 CFR provides this](#)  
34 [summary section for the first time, although SFFAS 17 does not require it. Again, the](#)  
35 [titles and amounts of these line items would match identical lines in the highlights](#)  
36 [section, the balance sheet, and the statement of changes in SOSI amounts. This](#)  
37 [summary section will provide present value information for all age cohorts, with sub-](#)  
38 [totals for the closed and open group measures.](#)  
39

40 A115. [Under the proposal, the component entity’s SOSI would display the closed group](#)  
41 [and open group measures, as shown in the pro forma illustration at Attachment D.](#)

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<sup>31</sup> SFFAS 25, par. 26-30.

## Appendix A: Basis for Conclusions

which is consistent with what is proposed for the *CFR SOSI*.

A116. The Board is also proposing a new basic statement, the statement of changes in social insurance amounts. This Statement presents the changes during the reporting period for the closed group measure (Attachment E). The Board considered requiring such a Statement for both the closed group measure and the open group measure, but decided that two statements and two primary measures would be somewhat overwhelming and perhaps confusing. The line items/components of the SCSIA are consistent with Social Security Trustees' Report (see, for example, the 2007 Trustees' Report, Table IV.B9, page 66). Thus, there are line items for:

- a. changes in the valuation period;
- b. interest on the obligation;
- c. changes in demographic, economic, and other assumptions;
- d. changes in law and policy;
- e. changes in methods, and
- f. other changes.

The format in Attachment E also includes beginning of the year and end of year present values, which would agree with the balances for the current year and immediate past year displayed in the SOSI for the closed group. This will illustrate the link between current and prior years.

### Note Disclosure

A117. The proposal also requires note disclosure of an accrued benefit obligation. The objective is to provide information for the many users who are interested in knowing what such an amount would be and in evaluating the obligation in this way. accrued benefit obligation is a measure of the present value of future benefits scheduled to be paid to or on behalf of current participants based on past events (e.g., for Social Security and Medicare Hospital Insurance (Part A), work in covered employment; or, Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in effect) as of the **valuation date**. Because it is based on past events, the accrued benefit obligation applies only to **current participants** in the programs as of the valuation date.

A118. There are several acceptable methods for calculating an accrued benefit obligation.<sup>32</sup> For example, the Social Security Administration provides, through its Office of the Actuary, an accrued benefit obligation for Social Security in a periodically updated Actuarial Note.<sup>33</sup> The Actuary Note discusses two liability-number candidates: the accrued benefit obligation and the **maximum transition**

<sup>32</sup> See <http://www.ssa.gov/OACT/NOTES/actnote.html>.

<sup>33</sup> *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI*.

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**cost** (“MTC”). The accrued benefit obligation is a measure of the future benefit obligation based on past earnings and past work in covered employment as of the valuation date. Only current participants are included.<sup>34</sup> Future payroll taxes to be paid by the current participants and benefits attributable to earnings and work in covered employment in the future are excluded. However, any income taxes to be paid by current participants on their future benefits under the current plan are subtracted. Assets in the form of Treasury securities held by the program at beginning of the projection period are not subtracted.

A119. The other measure in the Actuary Note is the MTC. The only difference between the accrued benefit obligation and the MTC is that assets held by the Social Security program are subtracted in calculating the MTC.

A120. The Board notes two other numbers used in pension accounting: the accumulated benefit obligation and the projected benefit obligation. The accumulated benefit obligation, for which the abbreviation “ABO” is frequently used, is the actuarial present value of benefits (whether vested or non-vested) attributed by the pension benefit formula to employee service rendered before a specified date and based on employee service and compensation prior to that date. The projected benefit obligation, for which the abbreviation “PBO” is frequently used, differs from the accumulated benefit obligation merely in that it includes assumptions about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.<sup>35</sup>

A121. Conceptually, there is some similarity between the SSA’s accrued benefit obligation and the PBO. SSA projects future wage levels via the “average wage index” and the PBO is measured using assumptions as to future compensation levels.

A122. Other approaches for calculating an accrued benefit obligation are acceptable. For example, the Primary View in the FASAB’s *Preliminary View: Accounting for Social Insurance, Revised*, provided methodology for calculating a liability amount for social insurance programs. Following that approach, the liability would be the present value of future expenditures for benefit payments to or on behalf of current participants, both those who have attained (1) fully insured status by completing sufficient work in covered employment as of the end of the reporting period and (2) retirement age or disability status; as well as current participants who have attained (1) fully insured


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<sup>34</sup> SSA Actuarial Note 2006-1, Definitions, page 3.

<sup>35</sup> SFAS 87, *Employers’ Accounting for Pensions*, Glossary, “Accumulated Benefit Obligation.” Users of federal financial reports have asked whether a given measure of the **SOSI NPV** is like the ABO or the PBO. They understandably want to know how **SOSI NPV** relate to private sector pension accounting standards. Although care is needed when comparing pension accounting methods with methods used for the national SI program, it may be helpful to stipulate – since the question persists – that SSA’s **accrued benefit obligation** is more like the PBO than the ABO. Both the **accrued benefit obligation** and the PBO attempt to project future wage levels, albeit for different orders of magnitude.

## Appendix A: Basis for Conclusions

status but (2) have not yet attained retirement age or disability status. The present value amount would include the future benefits attributed to past work completed in covered employment. Past work is work completed prior to the end of the reporting period. The present value amount would exclude any additional benefits attributable to future work in covered employment. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.<sup>36</sup> Also, SFFAS 5 provides a methodology for calculating pensions, disability, and post-employment healthcare and insurance liabilities. All of these approaches are acceptable. Finally, the Board proposes to require the entity to provide a description of the approach used.

A123. The accrued benefit obligation will give interested users a traditional frame of reference. The accrued benefit obligation is intended to provide a perspective on social insurance programs from the point of view of a deferred benefit or an insurance obligation for those users who value such information.  equivalent to the measure that the Board members who held the Primary View believe should be recognized as a liability. The amount thus provided can be compared to the other measures and provide a full array of information. Finally, this number is not currently available in Federal financial reports.

### *Required Supplementary Information*

A124. The proposal would continue the RSI currently required by SFFAS 17 except for the sensitivity analysis. The RSI calls for graphs of cash flow over long-term projection periods sufficient to illustrate long-term sustainability. The requirement calls for projections of annual cash flow in nominal dollars and as percentages of taxable payroll and GDP. This is critical because the graphs show the timing of future cash flows, which present value point estimates cannot do, and thereby provide a future perspective. Projections of future flows together the SOSI's historical flows provide a robust picture of the program cash flows. In addition, the RSI call for the ratio of beneficiaries to workers, also known as the "dependency ratio."

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<sup>36</sup> The prior note is applicable here as well: A projection period for future participants would cover their working and retirement years. The entity would make an assumption about the length of this period. For example, the OASDI program uses a projection period of 75 years. A projection period for current participants (i.e., for the people actually participating in the program) would theoretically cover all of their working and retirement years, a projection period that could be greater than 75 years in a few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years usually would not be material, and a 75 year projection period would include virtually all the future contributions, tax income, and benefit payments for current as well as future participants.

## Appendix A: Basis for Conclusions

### Sensitivity Analysis

A125. The proposal would amend the sensitivity analysis. The Board notes that it is adopting a new approach to illustrating uncertainty from that in SFFAS 17. The objective of sensitivity analysis is to illustrate how much an estimate or projection would change if the assumptions, data, methodologies, or other inputs change. The Board believes the requirements in SFFAS 17 resulted in voluminous narrative and graphs but was somewhat daunting to use. The Board believes that preparer-developed sensitivity analysis will be more informative and concise and therefore communicate better with users.

A126. According to SFFAC 1, *Objectives*, financial information has certain qualities, including reliability. In SFFAC 1 the FASAB stated that

[R]eliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.<sup>37</sup>

A127. Another equally important characteristic of financial information is relevance. SFFAC 1 states the familiar principle that a characteristic of relevant information is its capacity to make a difference in users' assessment of and decisions about a problem, condition, or event.<sup>38</sup>

A128. Relevant information frequently involves estimates, which necessitate some tolerance of uncertainty. Uncertainty can be tolerated if it is clearly explained and illustrated in the entity's financial statements, and there are many ways to do this. Uncertainty can be discussed and illustrated in the notes to the financial statements, in supplemental information, or even in the measurement of the liability and expense.

A129. SFFAS 17 focused sensitivity analysis on the long-term projections. SFFAS 17 required all component entities except Unemployment Insurance to illustrate the sensitivity of projections and present values to changes in the most significant assumptions.<sup>39</sup> The result had been a daunting array of narrative, charts, and graphs.

A130. The objective of the proposed standard is to make the sensitivity analysis more concise and more meaningful. The focus of the analysis will now be on the basic

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<sup>37</sup> SFFAC 1, par. 160

<sup>38</sup> SFFAC 1, par. 161

<sup>39</sup> See SFFAS 17, par. 27(4)(a).



## Appendix A: Basis for Conclusions

financial statements; specifically, on the balance sheet, where the closed group measure will now be displayed; on the SOSI, where both the closed and open group measures will be displayed; and on the proposed SCSIA. 

A131. This proposal would eliminate much of the sensitivity analysis requirement in SFFAS 17 and allow preparers to develop their own sensitivity analysis. The Board is proposing a very general approach for illustrating uncertainty. The Board anticipates that the preparers will streamline the presentation while at the same time making it more useful. Conciseness itself should make it more useful and less daunting.

A132. Entities would decide what is appropriate based on trends, the utility of the information to the users and policy-makers, and the relative burden of producing it. The entities are encouraged to explore areas of analysis. This will afford flexibility and allow best practices to develop. Entities may continue to vary key assumptions, as required by SFFAS 17, or pursue other methods. For example, this standard encourages stochastic modeling. The Board believes that a graph like figure “VI.E2” from the Trustees’ Annual Report shown below is a promising method for illustrating uncertainty. The Board believes that a stochastic presentation of the ranges of possible outcomes with respect to the present value estimates in the basic financial statements will provide useful information for users to consider.

A133. Each year the Social Security Trustees report on the financial condition of the system. The principal results from their report are generated by a **deterministic model** of the annual income and expenses of the system over the projection period. The Social Security Trustees carefully review and update assumptions used for projections on an annual basis. This helps ensure that they represent the Trustees’ best estimate of future possibilities.

A134. The Social Security Trustees illustrate uncertainty throughout their Annual Report. The results of their intermediate cost assumptions are contrasted in narratives, tables, and charts with estimates based on low- and high-cost assumptions. The latter vary all assumptions either low or high. This approach is characterized as “deterministic.”<sup>40</sup>

A135. The Trustees also present sensitivity analysis. Key assumptions are varied from the intermediate cost assumptions to illustrate how changes therein affect the estimates.

A136. In addition to this sensitivity analysis, starting in 2003 the Social Security Trustees’ Report began to illustrate uncertainty via a stochastic model that attempts to capture uncertainty by displaying ranges rather than point estimates.<sup>41</sup> The report of the 1999 Technical Panel<sup>42</sup> included the following observations under the heading,

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<sup>40</sup> The 2008 Trustees’ Annual Report, p. 166.

<sup>41</sup> 2008 Trustees’ Annual Report, pp. 166-171.

<sup>42</sup> Available at [http://www.ssab.gov/Rpt99\\_III.html#pgfld-1005309](http://www.ssab.gov/Rpt99_III.html#pgfld-1005309).



## Appendix A: Basis for Conclusions

“Illustrating Uncertainty”:

The current system of presenting low- and high-cost alternatives to the intermediate assumptions is inadequate. The alternatives are useful in demonstrating the sensitivity of the forecast to the underlying parameters . . . . However, without any model of the probabilities of the underlying parameters taking on the alternative values, there is no way to use the alternatives to form a distribution of possible outcomes. It is inadequate to show any forecast without an indication of the uncertainty that surrounds it. We follow previous panels in strongly recommending efforts toward stochastic modeling or similar techniques that are better able to capture the interrelationship among assumptions. We are not dogmatic in the recommendation, as we recognize that even stochastic modeling requires some set of assumptions about the variance in future outcomes—for example in fertility rates—that are hard to estimate. However, the assumptions are in some way embedded in current methods of projection in any case.

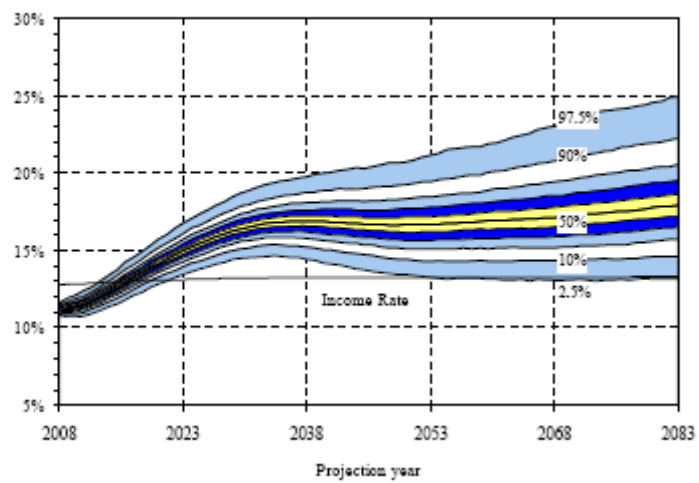
Some modeling techniques allow for graphical presentations that are better at displaying the range of uncertainty. What we seek is a method of displaying to policy makers and the public just how uncertain is some average cost outcome or date of exhaustion of the Trust Funds, and what are the probabilities that events will be close to or far from that result. That the system might have a very high probability of being out of balance by 2 or more percent of taxable payroll, for instance, may be worth knowing regardless of whether it has attained actuarial balance under some set of intermediate assumptions.

A137. Stochastic modeling represents a probability distribution of possible future outcomes centered on the Trustees’ intermediate assumptions. For example, the following figure (VI.E2) shows the probability distribution of the year-by-year Social Security cost rates (i.e., cost as a percentage of taxable payroll). The range of the cost rates widens as the projections move further into the future reflecting increasing uncertainty. The lines in the figure display different confidence intervals expected for future annual cost rates. For each given year, these lines represent the percentile distribution of cost rates based on all stochastic simulations for that year. The two extreme lines indicate, for example, the range within which future annual costs rates, as a percentage of taxable payroll, are expected to occur 95 percent of the time. In other words, actual future annual 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. Other lines in the figure display additional confidence intervals (80-percent, 60-percent, 40-percent, and 20-percent) around future annual cost rates. The 50-percent confidence level for each year indicates the annual cost rates which are projected by this model to fall exactly in the middle of possible outcomes for that year. The 50 percent confidence level aligns closely with the Trustees’ intermediate cost assumptions.<sup>43</sup>

<sup>43</sup> 2008 Social Security Trustees’ Report, p. 168-70.

## Appendix A: Basis for Conclusions

Figure VLE2.—Annual Cost Rates



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## Appendix B: Highlights Table

## Appendix B: Highlights Table

Highlights Statement			
	billions of dollars		
	2005	2006	2007
Costs			
Net costs	(\$2,945)	(\$2,890)	(\$2,903)
Total taxes and other revenues	2,186	2,441	2,627
Net operating cost	(760)	(450)	(276)
Net Position			
Assets	\$1,448	\$1,497	\$1,581
Less: Liabilities, comprising			
Federal debt held by the public	4,624	4,868	5,078
Federal employee & veterans benefits	4,492	4,679	4,769
Other liabilities	799	866	940
Total liabilities	9,915	10,413	10,787
Net position (assets net of liabilities)	(\$8,467)	(\$8,916)	(\$9,206)
Social Insurance Commitments			
Net present value (NPV) of future cash flows for current participants (closed group), end of fiscal year	(\$40,038)	(\$44,147)	(\$45,062)
NPV of future cash flow for current participants (closed group), beginning of fiscal year	(37,278)	(\$40,038)	(\$44,147)
Change in NPV	(2,760)	(4,109)	(915)
Budget Results			
Unified Budget Deficit	(\$319)	(\$248)	(\$163)
Fiscal Gap			
Fiscal Gap as of January 1	\$ XX,XXX	\$ XX,XXX	\$ 41,900

## Appendix C: Pro Forma Balance Sheet

## Appendix C: Pro Forma Balance Sheet

<b>United States Government</b> <b>Pro Forma Balance Sheet</b> <b>as of September 30, 2007, and September 30, 2006</b> (billions)			2007	2006
<b>Assets:</b>				
Cash and other monetary assets (Note 2)			\$128	\$98
Accounts and taxes receivable, net (Note 3)			88	69
Loans receivable, net (Note 4)			2,319	221
	***		***	***
Total assets			<u>\$ 1,581</u>	<u>\$ 1,497</u>
Stewardship property, plant, and equipment				
Stewardship Land (Note 24) and Heritage Assets (Note 25)				
<b>Liabilities:</b>				
Accounts payable (Note 9)			\$ 66	\$ 58
Federal debt securities held by the public and accrued interest			5,078	4,868
Federal employee and veteran benefits payable (Note 11)			4,769	4,679
Environmental and disposal liabilities (Note 12)			342	305
Benefits due and payable (Note 13)			134	129
Insurance program liabilities (Note 14)			71	73
Loan guarantee liabilities (Note 4)			69	66
Other liabilities (Note 15)			258	234
Total liabilities			<u>10,787</u>	<u>10,413</u>
Contingencies (Note 18) and Commitments (Note 19)				
Net position:				
Earmarked funds (Note 20)			614	419
Non-earmarked funds			(9,820)	(9,336)
Total net position			<u>(9,206)</u>	<u>(8,916)</u>
Total liabilities and net position			<u>\$1,581</u>	<u>\$1,497</u>
<b>Social Insurance Commitments:</b>				
Net present value of future cash flow for current participants			<u>(\$45,062)</u>	<u>(\$44,147)</u>

## Appendix D: Pro Forma Statement of Social Insurance

### Appendix D: Pro Forma Statement of Social Insurance, Part I, Governmentwide SOSI

United States Government					
Statements of Social Insurance					
*****UNAUDITED*****					
(In billions of dollars)	2007	2006	2005	2004	2003
<b>Federal Old-Age, Survivors and Disability Insurance (Social Security):</b>					
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained age 62	\$ 477	\$ 533	\$ 464	\$ 411	\$ 359
Participants ages 15-61	17,515	16,568	15,290	14,388	13,576
Future participants (under age 15 and births during period)	16,121	15,006	13,696	12,900	12,213
All current and future participants	34,113	32,107	29,450	27,699	26,148
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained age 62	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Participants ages 15-61	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Future participants (under age 15 and births during period)	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
All current and future participants	(40,876)	(38,557)	(35,153)	(32,929)	(31,075)
<i>Net present value (NPV) of future expenditures less future revenue (open group measure)</i>	\$ (6,763)	\$ (6,450)	\$ (5,703)	\$ (5,230)	\$ (4,927)

## Appendix D: Pro Forma Statement of Social Insurance

<b>Federal Hospital Insurance (Medicare Part A):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 178	\$ 192	\$ 162	\$ 148	\$ 128
Participants who have not attained eligibility age	5,975	5,685	5,064	4,820	4,510
Future participants	4,870	4,767	4,209	4,009	3,773
All current and future participants	11,023	10,644	9,435	8,977	8,411
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(2,558)	(2,397)	(2,179)	(2,168)	(1,897)
Participants who have not attained eligibility age	(15,639)	(15,633)	(12,668)	(12,054)	(10,028)
Future participants	(5,118)	(3,904)	(3,417)	(3,246)	(2,653)
All current and future participants	(23,315)	(21,934)	(18,264)	(17,468)	(14,578)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<u>\$(12,292)</u>	<u>\$(11,290)</u>	<u>\$ (8,829)</u>	<u>\$ (8,491)</u>	<u>\$ (6,167)</u>

### Illustrative CFR SOSI

<b>Federal Hospital Insurance (Medicare Part B):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 433	\$ 409	\$ 363	\$ 332	\$ 283
Participants who have not attained eligibility age	3,184	3,167	2,900	2,665	2,148
Future participants	1,172	906	924	891	688
All current and future participants	4,789	4,482	4,187	3,888	3,119
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(1,834)	(1,773)	(1,622)	(1,475)	(1,306)
Participants who have not attained eligibility age	(12,130)	(12,433)	(11,541)	(10,577)	(8,845)
Future participants	(4,257)	(3,407)	(3,408)	(3,277)	(2,622)
All current and future participants	(18,221)	(17,613)	(16,571)	(15,329)	(12,773)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<u>\$(13,432)</u>	<u>\$(13,131)</u>	<u>\$ (12,384)</u>	<u>\$ (11,441)</u>	<u>\$ (9,654)</u>

## Appendix D: Pro Forma Statement of Social Insurance

<b>Federal Hospital Insurance (Medicare Part D):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 167	\$ 173	\$ 185	\$ 176	
Participants who have not attained eligibility age	1,627	1,700	1,790	1,857	
Future participants	611	492	572	618	
All current and future participants	2,405	2,365	2,547	2,651	0
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(794)	(792)	(880)	(773)	
Participants who have not attained eligibility age	(7,273)	(7,338)	(7,913)	(7,566)	
Future participants	(2,699)	(2,121)	(2,440)	(2,431)	
All current and future participants	\$(10,766)	\$(10,251)	\$(11,233)	\$(10,770)	\$ -
<i>NPV of future expenditures less future revenue (open group measure)</i>	<i>\$ (8,361)</i>	<i>\$ (7,886)</i>	<i>\$ (8,686)</i>	<i>\$ (8,119)</i>	<i>\$ -</i>
<b>Railroad Retirement</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 5	\$ 5	\$ 4	\$ 4	\$ 4
Participants who have not attained eligibility age	41	40	37	37	40
Future participants	54	56	41	39	41
All current and future participants	100	101	82	80	85
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(93)	(92)	(84)	(81)	(80)
Participants who have not attained eligibility age	(86)	(84)	(73)	(72)	(73)
Future participants	(26)	(25)	(16)	(14)	(14)
All current and future participants	(205)	(201)	(173)	(167)	(167)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<i>\$ (105)</i>	<i>\$ (100)</i>	<i>\$ (91)</i>	<i>\$ (87)</i>	<i>\$ (82)</i>
<b>Black Lung (Part C):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>NPV of future revenue over future expenditures (open group measure)</i>	<i>\$ 5</i>	<i>\$ 4</i>	<i>\$ 5</i>	<i>\$ 4</i>	<i>\$ 4</i>
<b>Total NPV of future expenditures in excess of future revenue (open group measure)</b>	<b>\$(40,948)</b>	<b>\$(38,853)</b>	<b>\$(35,688)</b>	<b>\$(33,364)</b>	<b>\$(20,826)</b>

## Appendix D: Pro Forma Statement of Social Insurance

<b>Social Insurance Summary</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Participants who have attained eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes)	\$ 1,260	\$ 1,312	\$ 1,178	\$ 1,071	\$ 774
Expenditures for scheduled future benefits	(11,608)	(10,920)	(10,160)	(9,430)	(7,945)
Present value of future expenditures in excess of future revenue	(10,348)	(9,608)	(8,982)	(8,359)	(7,171)
<i>Participants who have attained age 15 up to eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes)	28,342	27,160	25,081	23,767	20,274
Expenditures for scheduled future benefits	(63,056)	(61,699)	(56,137)	(52,687)	(39,961)
Present value of future expenditures in excess of future revenue	(34,714)	(34,539)	(31,056)	(28,920)	(19,687)
<b>Closed group -- Total present value of future expenditures in excess of future revenue for current participants</b>	<b>(45,062)</b>	<b>(44,147)</b>	<b>(40,038)</b>	<b>(37,279)</b>	<b>(26,858)</b>
<i>Future participants (under age 15 and births during period):</i>					
Revenue (e.g., Contributions and earmarked taxes)	22,828	21,227	19,442	18,457	16,715
Expenditures for scheduled future benefits	(18,714)	(15,933)	(15,092)	(14,542)	(10,683)
Present value of future expenditures in excess of future revenue	4,114	5,294	4,350	3,915	6,032
<b>Open group -- Total present value of future expenditures in excess of future revenue for current and future participants</b>	<b>\$ (40,948)</b>	<b>\$ (38,853)</b>	<b>\$ (35,688)</b>	<b>\$(33,364)</b>	<b>\$(20,826)</b>



## Appendix D: Pro Forma Statement of Social Insurance

Illustrative SOSI for Component Entity

<b>Social Security Administration</b>					
<b>Pro Forma Statements of Social Insurance</b>					
*****UNAUDITED*****					
(In billions of dollars)	2007	2006	2005	2004	2003
<b>Federal Old-Age, Survivors and Disability Insurance (Social Security):</b>					
<i>Participants who have attained eligibility age:</i>					
Contributions and earmarked taxes	\$ 477	\$ 533	\$ 464	\$ 411	\$ 359
Expenditures for scheduled future benefits	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Present value of future expenditures in excess of future revenue	(5,852)	(5,333)	(4,931)	(4,522)	(4,303)
<i>Participants who have attained age 15 up to eligibility age:</i>					
Contributions and earmarked taxes	17,515	16,568	15,290	14,388	13,576
Expenditures for scheduled future benefits	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Present value of future expenditures in excess of future revenue	(10,413)	(9,643)	(8,652)	(8,030)	(7,439)
<b>Net present value of future expenditures in excess of future revenue for current participants (closed group measure)</b>	<b>(16,265)</b>	<b>(14,976)</b>	<b>(13,583)</b>	<b>(12,552)</b>	<b>(11,742)</b>
<b>Plus: Treasury securities and assets held by the programs*</b>	<b>2,048</b>	<b>1,859</b>	<b>1,687</b>	<b>1,531</b>	<b>1,378</b>
<b>Closed group unfunded obligation</b>	<b>(\$14,217)</b>	<b>(\$13,117)</b>	<b>(\$11,896)</b>	<b>(\$11,021)</b>	<b>(\$10,364)</b>
<i>Future participants (under age 15 and births during period):</i>					
Contributions and earmarked taxes	\$ 16,121	\$ 15,006	\$ 13,696	\$ 12,900	\$ 12,213
Expenditures for scheduled future benefits	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
Present value of future expenditures in excess of future revenue	9,502	8,526	7,880	7,322	6,815
<b>Net present value of future expenditures in excess of future revenue for current and future participants (open group measure)</b>	<b>(6,763)</b>	<b>(6,450)</b>	<b>(5,703)</b>	<b>(5,230)</b>	<b>(4,927)</b>
<b>Plus: Treasury securities and assets held by the programs</b>	<b>2,048</b>	<b>1,859</b>	<b>1,687</b>	<b>1,531</b>	<b>1,378</b>
<b>Open group unfunded obligation</b>	<b>(\$4,715)</b>	<b>(\$4,591)</b>	<b>(\$4,016)</b>	<b>(\$3,699)</b>	<b>(\$3,549)</b>

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

### Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

The following table contains a pro forma illustration of a statement of changes in social insurance amounts.

Illustrative Statement of Changes in Social Insurance Amounts  
Closed Group Measure  
For the Year Ended September 30, 2007  
(in billions of dollars)

	Social Insurance, Closed Group Measure				
	Social Security	Medicare HI	Medicare SMI	Other (e.g., Railroad Retirement)	Total
Closed group measure, beginning of year	\$(14,976)	\$(12,153)	\$(16,887)	\$ (131)	\$(44,147)
Changes in demographic data and assumptions <sup>1</sup>	XXX	XXX	XXX	XXX	XXX
Changes in economic data and assumptions <sup>2</sup>	XXX	XXX	XXX	XXX	XXX
Legislative changes <sup>3</sup>	XXX	XXX	XXX	XXX	XXX
Methodological changes <sup>4</sup>	XXX	XXX	XXX	XXX	XXX
Changes in Medicare healthcare trend assumptions	XXX	XXX	XXX	XXX	XXX
Other changes	XXX	XXX	XXX	XXX	XXX
Net change in closed group measure	(1,289)	109	267	(2)	(915)
Closed group measure, end of year	\$(16,265)	\$(12,044)	\$(16,620)	\$(133)	\$(45,062)

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

1. *[The following examples are adapted from the Social Security Trustees' Report. The explanations of the changes obviously will depend on the social insurance program in question.]* Changes in the demographic starting values and the transition to ultimate assumptions and changes in the ultimate mortality and legal immigration assumptions have largely offsetting effects. They combine to have little net effect on the closed group measure. Final mortality data for 2004 result in slightly lower starting death rates and faster near-term declines in death rates than in last year's report. Also, slightly faster rates of decline in death rates are assumed ultimately for ages 15-64 in this year's report. These changes in ultimate rates are based on the continuing strong declines in mortality recently experienced by men at these ages and a belief that the lower rates of decline experienced by women since 1982 will not continue in the future. All of the mortality changes result in a decrease (worsening) in the closed group measure of about \$106 billion. Partially offsetting the effect of the mortality changes is an increase in the assumed ultimate level of net legal immigration in this year's report. Based on data since 2000, the ultimate level of net legal immigration is assumed to increase from 600,000 to 750,000 persons per year. This change results in an increase (improvement) in the closed group measure of about \$103 billion. Other demographic changes are made to the starting values of birth rates and numbers of people in the Social Security area. Birth rates for the first 25 years of the projection period are higher than in last year's report, based on preliminary birth data for 2005 and 2006 which indicate higher than expected numbers of births. These changes in birth rates and the starting population result in an increase (improvement) in the closed group measure of about \$102 billion.
2. Ultimate economic assumptions are unchanged from last year's report. Changes in starting values for the economic assumptions and in the near-term transition to the ultimate economic assumptions have a negligible effect on the social insurance closed group measure.
3. There were no legislative changes since the last report that are projected to have a significant effect on the long-range OASDI actuarial balance.
4. Several methodological improvements and updates of program-specific data are included in the 2007 measures. These changes to programmatic data and methods result in a combined increase (improvement) in the closed group measure of about \$171 billion. The most significant of these changes is a major revision in the methods used for projecting the other-immigrant (other than legal permanent resident) population. In previous reports, the other-immigrant population was projected using assumed annual numbers of net other immigrants with a static age-sex distribution. For this year's report, the annual numbers of net other immigrants are projected by explicitly modeling other immigrants and other emigrants separately. Under this approach, a large number of other immigrants is assumed to enter the Social Security area at relatively young working ages, with the total annual number of other immigrants entering the area assumed to be about 1.5 million. Most of these immigrants are assumed to either: (1) leave the

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

Social Security area (i.e., to depart from the area without having attained the legal status or work credits needed to become eligible for retired-worker benefits); or (2) attain legal permanent resident (LPR) status after several years of being in the other-immigrant population. Thus, this year's report results in a much larger other-immigrant population projected at working ages and a smaller number remaining in the Social Security area into old age. This change, along with the additional births due to the larger other-immigrant population at younger ages, results in a substantial increase in the number of working-age individuals contributing payroll taxes, but a relatively smaller increase in the number of retirement-age individuals receiving benefits in the latter half of the long-range period. This revision results in an increase (improvement) in the closed group measure of about \$163 billion. Another area of methodological improvement is related to the projection of average benefit levels for workers who will become eligible in the future. The historical sample of new beneficiaries, which serves as the basis for the projection of average benefit levels, was updated from a 2003 sample to a 2004 sample. Also, additional records of beneficiaries who began receiving benefits after the year for which they were first found to be entitled are now included in the sample of newly entitled retired-worker beneficiaries. These changes in projecting average benefits, along with several other smaller changes, result in an increase (improvement) in the closed group measure of about \$101 billion.

The combined effects of changes made in data, assumptions, and methods for this report more than offset the decrease in the OASDI long-range actuarial balance due to the new valuation period. This effect is indicated by the total \$140 billion increase in the closed group measure, which, after rounding, changes the closed group measure from \$XX<sub>1</sub> trillion in last year's report to \$XX<sub>2</sub> trillion in this report.

### Appendix F: Glossary

#### Eligibility under Social Security

Eligibility for benefits under the Social Security program requires some minimal level of work in covered employment. This requirement is established by a worker's accumulation of quarters of coverage (QCs). A worker must be fully insured to be eligible for a primary retirement benefit, and for his or her spouse or children to be eligible for auxiliary benefits. A deceased worker must have been either currently insured or fully insured at the time of death for his or her children (and their mother or father) to be eligible for benefits. If there are no eligible surviving children, the deceased worker must have been fully insured at the time of death for his or her surviving spouse to be eligible.

#### Fiscal Gap

The fiscal gap is the change in spending and/or revenue that would be necessary to maintain public debt at or below a target percentage of GDP. The fiscal gap is the net present value of projected spending minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at the target level for the stated projection period. The fiscal gap may be expressed as: (a) a summary amount in present value dollars, (b) a share of the present value of the GDP for the projection period, and/or (c) a share of the present value of projected receipts or projected spending.

#### Fiscal Sustainability

The terms "sustainability" or "sustainable solvency" are used frequently with respect to social insurance programs. The dictionary definition of "sustain" that is closest to the financial accounting usage is "to keep up;" and "solvent" means to be able to pay all legal debts. The Government Accountability Office has defined "solvency" and "sustainable solvency" for Social Security as essentially being able to pay full benefits as they come due, permanently.

#### Fiscal Sustainability Reporting

In federal financial reporting, "Fiscal Sustainability Reporting" is the short term for "Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative in the Financial Report of the U.S. Government."

### Fully Insured

“Fully insured” status means that a social insurance participant is eligible for benefits. Social insurance benefits include pensions and health care for retirees and the disabled. For example, Social Security and Medicare participants become permanently fully insured when they attain at 40 quarters of work in covered employment (QC). Social Security and Medicare participants may be fully insured without being permanently fully insured. This is important with respect to disability benefits, which include subsistence payments and medical care. Disability benefits may be needed well before the participants attained retirement age. A participant who receives disability benefits for 24 consecutive months is eligible for Medicare and, when if he or she continues receiving disability benefits until attaining retirement age, he or she is converted to Social Security pension benefits. To be fully insured, participants generally need a minimum of 6 QC. Once a worker has accumulated 40 QCs, he or she remains permanently fully insured, that is, no further QCs are required.<sup>44</sup>

The table below illustrates the numbers of QC needed to qualify for disability benefits:

Age	QCs Needed
24 and younger	6
25	8
26	10
27	12
28	14
29	16
30	18
31	20
32	22
33	24
34	26
35	28
36	30
37	32
38	34
39	36
40	38
41	40
42 and over	40

### Intergenerational Equity

Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain Federal responsibilities. It is a concept involving

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<sup>44</sup> 2003 OASDI Trustees' Report, page 111.

## Appendix F: Glossary

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relative contributions of current and future citizens. This concept focuses on fiscal obligations and responsibilities being accumulated by the current generation, however one defines it, that are passed on to future generations.

### **Maximum transition cost**

As defined by the Office of the Actuary, Social Security Administration, this measure represents the cost of meeting the **accrued benefit obligations** (see above) 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 maximum transition cost 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. For Social Security, 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.

### **Present value**

Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

### **Projections**

A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions—for example, what if current policy without change regarding Federal Government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

### **Sensitivity Analysis**

An analysis of the sensitivity of the program’s closed group measure under reasonable, alternative scenarios that are different from expected experience. When the data used in setting assumptions is particularly sensitive to the assumptions, greater sensitivity testing is indicated.

### **Stochastic Model**

The Social Security Trustees’ Annual Report (“Trustees’ Report”) explains that its primary analysis utilizes estimates of the financial status of Social Security using a “deterministic” model. For Social Security’s deterministic model, certain assumptions are made regarding

1 levels of fertility, changes in mortality, legal and other immigration levels, legal and other  
2 emigration levels, the Consumer Price Index, average real wages, unemployment rates, trust  
3 fund real yield rates, and disability incidence and recovery rates. Each of these variables will  
4 reach an assumed ultimate value at a specific point during the long-range period and will  
5 maintain that value throughout the remainder of the period.  
6

7 However, the Trustees' Report also provides supplementary analysis using stochastic  
8 modeling. In contrast to deterministic models, stochastic modeling involves the results of  
9 many independent simulations. The Trustees' Report uses 5,000 each of which is  
10 determined by allowing the variables to vary throughout the long-range period. The  
11 fluctuation in each variable is projected by using standard time-series modeling, a method  
12 designed to help make inferences based on historical data. The Trustees' Report explains  
13 that, generally, each variable is modeled by an equation that captures a relationship between  
14 current and prior years' values of the variable and introduces year-by-year random variation,  
15 as reflected in the historical period. For some variables, the equations additionally reflect  
16 relationships with other variables. Parameters for the equations are estimated using  
17 historical data for periods between 20 years and 110 years depending on the nature and  
18 quality of data available. Each time-series equation is designed such that, in the absence of  
19 random variation, the value of the variable would equal the value assumed under Social  
20 Security's intermediate set of assumptions.  
21

22 For each simulation of the model, the values are determined for most of the variables via  
23 Monte Carlo techniques to randomly assign the year-by-year variations. Each simulation  
24 produces an estimate of the financial status of the combined Social Security program.  
25

26 The Trustees' Report urges caution when interpreting the results from stochastic simulations,  
27 which have inherent limitations. The Trustees' Report explains that the results are very  
28 sensitive to equation specifications, degrees of interdependence among variables, and the  
29 historical periods used for the estimates. For some variables, using the variations exhibited in  
30 a relatively recent historical period may not provide a realistic representation of the potential  
31 variation for the future. In addition, results would differ if random variations had been applied  
32 to additional variables. Furthermore, additional variability could result from incorporating  
33 statistical approaches that would more fully model change in the long-range central  
34 tendencies of the variables. The historical period available for most variables is relatively  
35 homogeneous and does not reflect many substantial shifts. The time-series modeling reflects  
36 what occurred in the historical period. As a result, the variation indicated in any given result  
37 should be viewed as the minimum plausible variation for the future. Substantial shifts, as  
38 predicted by many experts and as seen in prior centuries, are not fully reflected in the current  
39 model.<sup>45</sup>  
40

### 41 **Valuation date**

42  
43 Beginning of the projection period or January 1 of the starting projection year. This date  
44 defines the point in time for determining present values.  
45

---

<sup>45</sup> 2008 Trustees' Annual Report, pp. 166-7.



## Appendix G: List of Abbreviations

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### Appendix G: List of Abbreviations

ANPV	Actuarial net present value
APB	Accounting Principles Board
CFS	Consolidated financial statements
COLA	Cost of living adjustment
CPI	Consumer Price Index
DI	Disability Insurance (Social Security)
DOL	U.S. Department of Labor
ED	Exposure draft
ESAA	Employment Security Administration Account
EUCA	Extended Unemployment Compensation Account
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FECA	Federal Employees Compensation Account
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act
GAO	Government Accountability Office
GDP	Gross Domestic Product
IBNR	Incurred but not reported
Medicare HI	Hospital Insurance (Medicare)
Medicare SMI	Supplementary Medical Insurance (Medicare)
OASDI	Old-Age, Survivors, and Disability Insurance (Social Security)
OASI	Old-Age and Survivors Insurance (Social Security)
OMB	Office of Management and Budget
PV	Preliminary Views
RSI	Required supplementary information
SCNP	Statement of Changes in Net Position
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SNC	Statement of Net Change
SCSIA	Statement of Changes in Social Insurance Amounts
SOSI	Statement of Social Insurance
SSA	Social Security Administration
UI	Unemployment Insurance
UTF	Unemployment Trust Fund

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Federal Accounting Standards Advisory Board

## **Accounting for Social Insurance, Revised**

**Statement of Federal Financial Accounting Standards XX**

**Exposure Draft**

**Written comments are requested by February 9, 2009**

**“CLEAN”  
DRAFT**

**October 24, 2008**

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## THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

*The Federal Accounting Standards Advisory Board ("FASAB" or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget ("OMB"), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles ("GAAP") for the Federal Government.*

*An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation to comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard, with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Interpretations and also for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.*

*Additional background information is available from the FASAB or its website:*

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board"*
- "Mission Statement: Federal Accounting Standards Advisory Board"*

*Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at [www.fasab.gov](http://www.fasab.gov).*

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## Federal Accounting Standards Advisory Board

October 24, 2008

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (“FASAB” or “the Board”) is requesting comments on this exposure draft regarding a proposed Statement of Federal Financial Accounting Standards entitled *Accounting for Social Insurance, Revised*. Social Insurance comprises five programs; however, two programs, Social Security and Medicare, are of special significance because of the high rate of participation among citizens, the fiscal challenges related to the programs, and the challenges associated with incorporating estimates of future cash flows of this magnitude in financial statements. Specific questions for your consideration appear on page 9, but you are welcome to comment on any aspect of this proposal. Your response would be more helpful to the Board if you explain the reasons for your position, whether you agree or disagree.

Because of continuing concerns about the accounting for social insurance programs, in 2003 the Board decided to evaluate the existing social insurance accounting standard. The Board’s evaluation led, in October 2006, to the publication of a *Preliminary Views* document and, in May 2007, to a public hearing on the subject. After carefully considering the comments received, the Board is issuing this exposure draft.

Fundamental questions about social insurance programs can be addressed by financial reporting. These include whether programs are sustainable as currently constructed; whether the Government’s financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and what is the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information provided as a result of this proposed standard should help users make these assessments.

From the outset of this project, members have agreed on the objectives of financial reporting for social insurance programs and yet have had different views about how best to achieve the objectives. For example, all members have agreed that it is extremely important to provide useful financial information about the sustainability of social insurance programs, and that in the consolidated *Financial Report of the United States Government* such information should be

presented for the Government as a whole.<sup>1</sup> Members have agreed that social insurance information should be included in the basic financial statements, should be audited, and should be “transparent” – that is, readily understandable to an interested, non-expert reader. Members also have agreed that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. However, members have had different views about what should be reported on certain financial statements.

The key difference is in regard to the timing of the recognition of expense and liability for social insurance programs. Some members believe that an expense is incurred and a liability arises for social insurance programs during the working lives of participants, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability. Other members agree with Statement of Federal Financial Accounting Standards 17, *Accounting for Social Insurance* that an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the amount is “due and payable.”

All members have supported several innovations. They have supported a new basic statement presenting changes in the amounts displayed on the statement of social insurance. Moreover, all members have supported new reporting on fiscal sustainability in the consolidated Financial Report of the United States Government.

This exposure draft represents a compromise. It proposes enhanced reporting but does not resolve the two strongly held views regarding when the obligating event occurs for social insurance programs and, thus, when the liability and expense definitions are met within those programs. The proposed standard provides additional information not currently provided. The Board has conceptual projects underway and will consider in due course whether the new reporting should affect developing concepts.

Responses in electronic form should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please also mail your comments to:

Wendy M. Payne, Executive Director  
Federal Accounting Standards Advisory Board  
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<sup>1</sup> To that end the Board initiated a project that has produced the exposure draft, *Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government*, issued on August 29, 2008, and for which comments are requested by January 5, 2009.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

If you have questions regarding this request, please contact the Board's Executive Director, Wendy M. Payne at 202 512-7350.

The Board's rules of procedure provide that it may hold one or more public hearing on any exposure draft document. A public hearing is tentatively scheduled for April 22, 2009, for this exposure draft document. Notice of the date and location of public hearings are published in the Federal Register and in the FASAB newsletter.

Tom Allen  
Chairman

### Executive Summary

#### What is proposed?

Social Insurance programs include Social Security, Medicare, Railroad Retirement, Black Lung and Unemployment Insurance. Extensive information on social insurance programs is currently required by generally accepted accounting principles. The Federal Accounting Standards Advisory Board ("FASAB" or "the Board") is proposing improvements in the information provided about the effect of social insurance programs.

The proposed standard does not change the liability and expense recognition and measurement from Statement of Federal Financial Accounting Standards ("SFFAS") 17, *Accounting for Social Insurance*. The entities responsible for social insurance reporting will recognize a social insurance liability (and a related expense) when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods or services) and the benefits are "due and payable."<sup>2</sup>

The proposed standard requires the addition of the following information:

1. Critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the "fiscal gap" in a "highlights" section in management's discussion and analysis
2. A new line item representing the closed group measure that would be presented on the balance sheet below assets, liabilities, and net position and that would not be included in the totals for these classifications
3. A new summary section for the statement of social insurance presenting the closed and open group summary totals
4. A new basic financial statement to display the reasons for changes during the reporting period in the closed group measure reported on the statement of social insurance
5. Other information

#### Why do the members support these views?

Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy in government

---

<sup>2</sup> SFFAS 17 established a "due and payable" liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims incurred but not reported.



accounting. In its fifteen years of operation the Board has issued several exposure drafts and a preliminary views document related to social insurance reporting. The three principal exposure drafts and one preliminary views document that led to the current reporting model were

- a 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*,
- a 1998 exposure draft entitled *Accounting for Social Insurance*,
- a 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, and
- the 2006 preliminary views document entitled, *Accounting for Social Insurance, Revised*.

In each of these documents, the issue of an accrual accounting measure for social insurance programs has been controversial.

The issue of social insurance accounting was addressed in SFFAS 17 through compromise between strongly held views. The resulting statement of social insurance and accompanying disclosures and required supplementary information marked substantial improvement in the information presented in general purpose external financial reports of the U.S. Government and its component entities.

Although opinions continue to differ regarding when the obligating event occurs for social insurance programs, and thus the question of when the liability and expense occur within those programs continues to be discussed, the proposed standard represents a desire to present other information that will significantly improve readers' understanding of the status and results of the Government's social insurance programs. The Board has conceptual projects underway and will consider in due course whether the new reporting should affect developing concepts.

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## Request for Comments

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### Request for Comments

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at [www.fasab.gov/exposure.html](http://www.fasab.gov/exposure.html). Your responses should be sent by e-mail to [fasab@fasab.gov](mailto:fasab@fasab.gov). If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

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

All responses are requested by *February 9, 2009*.

### Questions for Respondents:

Q1. The Board proposes to require social insurance component entities and the governmentwide entity to discuss and analyze critical measures from the basic financial statements in the financial statement section of the management's discussion and analysis ("MD&A"). See paragraphs 26–30 in the proposed standard and paragraphs A74–A79 in the basis for conclusions.

**Do you believe that a highlights summary for the MD&A as described in this exposure draft enhances readers' understanding of the Federal Government's financial condition?**

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

Q2. In order to reflect the magnitude of the Federal Government's liabilities and commitments for social insurance programs, the Board is proposing to add a line for the **closed group measure** to the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications.<sup>3</sup> See paragraphs 31–32 in the proposed standard and paragraphs A80–A100 in the basis for conclusions.

**Do you believe that the balance sheet should display a line item for the closed group measure as described in this exposure draft?**

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

Q3. In order to provide a concise summary of social insurance net present values, the Board proposes to add a new summary section of the statement of social insurance ("SOSI") to display the closed and open group measures. See paragraphs 33–36 in the proposed standard and paragraphs A114–A116 in the basis for conclusions.

**Do you believe that the SOSI should have a summary section as described in this exposure draft?**

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

Q4. In order to improve understanding of the reasons why the social insurance commitments change from the end of the previous reporting period, the Board proposes a new basic financial statement entitled "statement of changes in social insurance amounts." The new statement would explain the changes during the reporting period in the present value amounts for the closed group measure included

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<sup>3</sup> Definitions of certain terms are provided in the Definitions section and Appendix F: Glossary of this proposed standard.

1 in the statement of social insurance. See paragraphs 37—38 in the proposed  
2 standard and paragraph A116 in the basis for conclusions.

3  
4 **Do you believe there should be a new basic financial statement explaining**  
5 **changes to the present value amount included in SOSI?**

6 **Please provide the rationale for your answers.**  
7

8 Q5. In order to provide information about social insurance programs in the context of  
9 traditional pension and post-employment deferred benefits, the Board proposes to  
10 disclose an accrued benefit obligation in notes to the financial statements. See  
11 paragraph 39 in the proposed standard and paragraphs A117—A123 in the basis for  
12 conclusions.

13  
14 **Do you believe that the accrued benefit obligation should be disclosed as**  
15 **described in this exposure draft?**

16  
17 **Please provide the rationale for your answers.**  
18

19 Q6. In order to reflect in one place the overall change in the Government's financial  
20 condition, the Board considered but decided not to propose adding a line item to the  
21 statement of net cost ("SNC") for the change during the reporting period in the  
22 closed group measure that would be presented below exchange revenue and  
23 expenses and not included in the totals for these classifications. Some believe the  
24 change is an economic cost that belongs on the SNC. Others argue that this  
25 measure should not be displayed on the SNC because it is a fundamentally different  
26 measure. See paragraphs A101—A113 in the basis for conclusions.

27  
28 **Do you believe that a line item below exchange revenue and expenses and not**  
29 **included in the totals for these classifications should be included on the SNC?**

30  
31 **Please provide the rationale for your answers.**  
32

33 Q7. In order to achieve a compromise between two opposing views, the Board decided  
34 to feature the **closed group measure** (CGM) (defined in paragraph 19) as a  
35 common thread among the proposed new reporting. The proposal requires that the  
36 CGM and other key measures from the financial statements be discussed in  
37 management's discussion and analysis; that the CGM be displayed on the balance  
38 sheet below assets, liabilities and net position (without being included in the totals for  
39 those categories); and that the changes in the CGM during the reporting period be  
40 displayed and explained in the new summary section of the statement of social  
41 insurance and the new statement of changes in social insurance. The Board  
42 considered the **open group measure** (defined in paragraph 24) instead of the  
43 closed group measure as the focus for the disclosure. This exposure draft discusses  
44 both the closed group measure and the open group measure throughout.  
45 Paragraphs A68—A73 provide the basic rationale for the Board's selection of the

## Request for Comments

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1 closed group measure.

2  
3 **Do you agree with the Board's decision to feature the closed group measure?**

4  
5 **Please provide the rationale for your answers.**

6  
7 Q8. In order to make the sensitivity analysis for social insurance programs concise and  
8 yet more informative, the Board is proposing to eliminate the requirement currently in  
9 SFFAS 17 for specific sensitivity analysis and instead allow the preparer to decide  
10 the best approach and at the same time encourage stochastic modeling. See  
11 paragraphs 44—45 of the standard and paragraphs A125—A137 of the basis for  
12 conclusions.

13  
14 **Do you believe that an approach that relies on the preparer's judgment rather**  
15 **than requiring a specific approach will produce better information regarding**  
16 **the sensitivity of social insurance programs?**

17  
18 **Please offer any comments that you wish to make on these provisions.**

### 1 Introduction

#### 2 Purpose

1. Federal financial reporting should provide accurate and transparent information to citizens so that they can make well-informed decisions for themselves and their Government. In this regard, such reporting must include information on the Government's long-term commitments for social insurance as well as all other Government programs. This proposed standard supports that objective.
2. This proposed standard amends Statement of Federal Financial Accounting Standards ("SFFAS") 17, *Accounting for Social Insurance*. In addition to the current requirements in SFFAS 17, the standard requires:
  - a. for social insurance component entities and the governmentwide entity, a highlights summary in the management's discussion and analysis ("MD&A") providing critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the fiscal gap;
  - b. an amount displayed on the balance sheet representing the net present value of the projected cash flows attributable to current participants in SI programs, also known as the **closed group measure**. This amount would be presented below the assets, liabilities, and net position and not included in the totals for these classifications (see Appendix C: Pro Forma Balance Sheet);
  - c. a new summary section within the statement of social insurance ("SOSI") summarizing the net present values of cash flows and displaying certain subtotals and totals (see Appendix D: Pro Forma Statement of Social Insurance);
  - d. a new "statement of changes in social insurance amounts" ("SCSIA") displaying the reasons for changes in the closed group measure from the end of the previous reporting period (see Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts); and
  - e. a new note disclosure of the **accrued benefit obligation**.
3. The Federal financial reporting model is unique. The model includes, in addition to a balance sheet and statements of net cost and changes in net position, unique financial statements designed for the Federal Government, including a statement of budgetary resources and a statement of social insurance (SOSI) and a



## Introduction

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“management’s discussion and analysis.” This proposed standard would provide for additional reporting within this model.

### Background

4. As noted in SFFAC 1, *Objectives of Federal Financial Reporting*, the Federal Government is unique when compared with any other entity in the country. In SFFAC 1, the Board established four major reporting objectives for Federal accounting standards:
  1. Budgetary Integrity (the integrity and legality with which the Federal Government uses the people’s money);
  2. Operating Performance (the effectiveness and efficiency with which the Federal Government operates and delivers services);
  3. Stewardship (the sustainability of the Federal Government’s service delivery, considering its current and projected revenues); and
  4. Systems and Control (the quality of its data, systems and controls).
5. Although all four of the objectives are equally important, Objectives 2 and 3 guided the development of the social insurance standard. Objective 2 states that Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity’s assets and liabilities.
6. Objective 3 states that Federal financial reporting should assist users in assessing the impact of the Government’s operations and investments for the period and how the Government’s and the Nation’s financial condition has changed and may change in the future. This objective is based on the Government’s responsibility for the general welfare of the Nation in perpetuity. It focuses not on the provision of specific services, but on the requirement that the Government report the broad outcomes of its actions.
7. In light of Objective 3, fundamental questions about social insurance programs should be addressed by accounting standards. These include whether these programs are sustainable as currently constructed; whether the Government’s financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and how long these programs will be able to provide benefits at current levels. The information that is proposed will help users address these questions.
8. The SOSI was a first step in the process of developing information for an assessment of sustainability of specific programs in governmentwide and component entity financial reports. The SOSI is based on long-range actuarial estimates of future costs. SFFAS 17 required certain supplementary information as well, including

1 graphic displays of future cash flow in nominal dollars and as a percentage of taxable  
2 payroll and GDP. The SOSI and required supplementary information (RSI) provide  
3 information that helps users analyze the effect of benefit payments to different  
4 participants under current law, as well as economic and demographic changes (e.g.,  
5 in the cost of health care and in life expectancies).

- 6 9. Social insurance is a dominant program. It is not only a component of Federal  
7 operations, but an essential part of the national economy. Context is needed. The  
8 proposed standard provides critical information not currently provided. Specifically, it  
9 requires management to discuss and analyze in the MD&A critical measures of  
10 social insurance in the context of other critical measures presented in the financial  
11 basic statements. It would introduce a critical heretofore undisclosed measure, the  
12 closed group measure.. A line item representing the present value of the social  
13 insurance commitments, which is not included in the assets, liabilities, and net  
14 position, would be presented on the balance sheet below those classifications; a new  
15 summary section would be included on the SOSI; a new statement of changes in  
16 social insurance would be presented; and the accrued benefit obligation would be  
17 disclosed in the footnotes.

## 18 Scope

- 19  
20 10. This proposed standard is applicable to the consolidated financial report of the U.S.  
21 Government as well as component entity financial reports required to include a  
22 Statement of Social Insurance (SOSI). Social insurance standards for these entities  
23 are provided in SFFAS 17.  
24  
25 11. This proposed standard amends SFFAS 17. It does not affect provisions of SFFAS  
26 17 that are not explicitly described in the proposed standard and illustrated in  
27 paragraph 47. For social insurance entities and the governmentwide entity, the  
28 proposed standard supplements SFFAS 15, *Management's Discussion and Analysis*;  
29 it does not affect the MD&A requirements of other entities; nor does it change  
30 Statement of Federal Financial Accounting Concepts ("SFFAC") 3, *Concepts for*  
31 *Management's Discussion and Analysis*, or SFFAC 5, *Definitions of Elements and*  
32 *Basic Recognition Criteria for Accrual-Basis Financial Statements*.  
33  
34 12. The following five programs are the sole programs subject to social insurance  
35 amendments addressed in this proposed standard:  
36  
37 a. Old-age, Survivors, and Disability Insurance ("OASDI" or "Social Security");  
38 b. Medicare Hospital Insurance ("Medicare HI") ("Part A") and Medicare  
39 Supplementary Medical Insurance (Medicare SMI) ("Part B" and "Part D");  
40 c. Railroad Retirement benefits ("RRB");  
41 d. Unemployment Insurance for the general public ("UI"); and  
42 e. Black Lung benefits ("BLB").

## Introduction

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### Materiality

13. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

### Effective Date

14. The standard is effective for periods beginning after September 30, 2009.

### Accounting Standard

#### Scope

15. This standard amends SFFAS 17. It does not affect provisions of SFFAS 17 that are not explicitly described and illustrated in paragraph 47 of this proposed standard. For social insurance entities and the governmentwide entity, the proposed standard supplements SFFAS 15, *Management's Discussion and Analysis*; it does affect the MD&A requirements of other entities; nor does it change Statement of Federal Financial Accounting Concepts ("SFFAC") 3, *Concepts for Management's Discussion and Analysis*, or SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*.

16. The following five programs are the sole programs subject to social insurance amendments adopted through this standard:

- a. Old-age, Survivors, and Disability Insurance ("OASDI" or "Social Security");
- b. Medicare Hospital Insurance ("Medicare HI") ("Part A") and Medicare Supplementary Medical Insurance (Medicare SMI) ("Part B" and "Part D");<sup>4</sup>
- c. Railroad Retirement benefits ("RRB")<sup>5</sup>;
- d. Unemployment Insurance for the general public ("UI"); and
- e. Black Lung benefits ("BLB").

#### Definitions

##### **17. Accrued benefit obligation**

An accrued benefit obligation is a measure of the present value of future benefits scheduled to be paid to or on behalf of current participants based on past events (e.g., for Social Security and Medicare Hospital Insurance (Part A), work in

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<sup>4</sup> Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 ("MMA") created the Medicare Advantage ("MA") program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to beneficiaries, and must provide all Medicare covered services. Many MA plans offer additional services Medicare such as prescription drugs, vision and dental benefits to beneficiaries. The Federal Government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and would be accounted for accordingly.

<sup>5</sup> Legislation enacted in 1974 restructured railroad retirement benefits into two tiers, so as to coordinate them more fully with social security benefits. The first tier is based on combined railroad retirement and Social security credits, using social security benefit formulas. The second tier is based on railroad service only and is comparable to the pensions paid over and above social security benefits in other industries.

covered employment; or, Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in effect) as of the **valuation date**. Because it is based on past events, the accrued benefit obligation applies only to **current participants** in the programs as of the valuation date..

### 18. Closed group population

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.

### 19. Closed group measure

The closed group measure is the net present value of all expenditures to or on behalf of the closed group population participating in a social insurance program and all contributions or other income from or on behalf of those participants over a given projection period.

### 20. Closed group unfunded obligation

The closed group unfunded obligation is the **closed group measure** plus or minus the value of the assets held by the program at the beginning of the reporting period. It is computed like the **open group unfunded obligation** (see below) except that it involves the closed group population.

### 21. Current participants

All individuals currently participating in a social insurance program, e.g., for Social Security, all retirees and those working in covered employment as of the valuation date. An entry age for work in covered employment of 15 years is assumed.

### 22. Future participants

Individuals who are not currently participating in a social insurance program but who are projected to participate in the future over a given projection period as contributors or benefits or both. For example, for Social Security, those who are less than 15 years old, those yet to be born, and future immigrants.

23. Open group population

The open group population includes current and future participants.

24. Open group measure

The open group measure is the net present value of all expenditures to or on behalf of the **open group population** and all contributions or other income from or on behalf of the open group population over a given projection period, e.g., 75 years.

25. Open group unfunded obligation

The open group measure plus or minus the value of assets held by the program at the beginning of the reporting period.

Highlights Summary

26. Social insurance component entities and the governmentwide entity should discuss critical measures from their basic statements in the section of their management's discussion and analysis ("MD&A") devoted to financial statement analysis. They should explain the significance of key amounts. For example, the entity should explain the major changes in amounts reported for key items during the reporting period, and the causes thereof. In particular, the entity should explain why the changes occurred and what that indicates or implies for the program's operation. The entity should explain how costs and commitments incurred during the period were or will be financed. The section of the MD&A devoted to financial statement analysis should describe important existing and currently-known demands, risks, uncertainties, events, conditions—both favorable and unfavorable—that affect the amounts reported in the basic financial statements. The discussion should go beyond a mere description of existing conditions to include possible future effects of those factors. The discussion should encompass the possible future effects of anticipated future events, conditions, and trends. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

27. At a minimum, all entities should present and explain, as described in paragraph 26, the following measures except as noted:

a. Costs as follows:

- i. Net costs (for component entities and the governmentwide entity),
- ii. Total financing sources and net change of cumulative results of operations (for component entities only), and
- iii. Total revenue and net operating costs (for the governmentwide entity)

- only).
- b. Net position as follows (for both component entities and the governmentwide entity):
- i. Total assets,
  - ii. Total liabilities, and
  - iii. Net position.
- c. Social insurance commitments as follows (for both component entities and the governmentwide entity except as noted):
- i. The closed group measure, which presents the net present value (“NPV”) of cash flow for or on behalf of current participants over a projection period sufficient to illustrate long-term sustainability (e.g., traditionally a period of 75 years has been the primary period used by the Social Security Administration for long-term projections).<sup>6</sup> This amount will be shown on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications, and on the statement of social insurance (“SOSI”) as well.
  - ii. The change in the closed group measure during the reporting period(s). This amount will also be shown on the statement of changes in social insurance amounts (“SCSIA”).
- d. Key budgetary amounts as follows:
- i. Key amounts from the statement of budgetary resources (for component entities only).
  - ii. Key budgetary amounts (for the governmentwide entity only):
    - (a) Total unified budget receipts,
    - (b) Total unified budget outlays, and
    - (c) Total unified budget deficit or surplus.
- e. **Fiscal gap** (for the governmentwide entity only). [This measure is discussed extensively in the exposure draft *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government* (“Projections ED”).]
28. The MD&A may include a table containing these measures (see the illustration for the governmentwide entity at Appendix B: Highlights Table). Alternatively or

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<sup>6</sup> The terms “current participants” and “closed group of participants” are used synonymously in this standard. See the definitions section of this ED for more on the “closed group” and “open group” of participants.

combined with a tabular illustration the entity may provide the critical measures in a narrative format. The table in Appendix B is for purposes of illustration only. The preparer should determine the most effective format for communicating the critical financial information and the reasons for changes during the prior period.

29. Each critical measures above (costs, net position, etc., see paragraphs 26 and 27) may be disaggregated into sub-measures. For example, regarding assets, component entities may separately display Treasury securities held, and “liabilities” may be disaggregated into major elements, i.e., into line items for employee pension liabilities, environmental liabilities, etc.

30. The amounts discussed in the highlights section of the MD&A for the closed group measures will be the same as the amounts of the line items presented on the balance sheet (discussed below and in Appendix C: Pro Forma Balance Sheet), SOSI (discussed below and in Appendix D: Pro Forma Statement of Social Insurance), and the SCSIA (discussed below and in Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts).

### Balance Sheet

[See Appendix C: Pro Forma Balance Sheet.]

31. Liability and Expense – This Statement does not change the SFFAS 17 liability and expense recognition standard. See SFFAS 17, paragraphs 22-23 and 30.<sup>7</sup>

32. Balance Sheet Display of Closed Group Measure – Each governmentwide and component entity presenting a SOSI should present the closed group measure on its balance sheet.. This amount will be the same as the amount discussed in the financial section in the MD&A (see par. 27.c.i), and presented on the SOSI (see par. 34), and as the end-of-year balance on the SCSIA (see par. 37). The amount should be presented below assets, liabilities, and net position and not included in any of the totals for these classifications. (See pro forma balance sheet at Appendix C.)

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<sup>7</sup> SFFAS 17, paragraphs 22-23 and 30 state that, except for Unemployment Insurance, the governmentwide and component entities should recognize a liability (and a related expense) for those social insurance benefits that are due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (“IBNR”). For UI, a liability (and related expense) would be recognized for (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which the states and territories have not withdrawn funds from the federal unemployment trust fund (“UTF”) as of fiscal year end, and (2) estimated amounts to be withdrawn from UTF and benefits paid by states and territories after fiscal year end for compensable days occurring prior to fiscal year end. A UI expense will also be recognized for the reporting period for amounts withdrawn from the Federal UTF by states and territories to pay benefits to beneficiaries that pertain solely to the current reporting period. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior reporting period pursuant to this paragraph, items (1) and (2), would not be recognized as an expense of the current reporting period.



### Statement of Social Insurance

[See Appendix D: Pro Forma Statement of Social Insurance. *There are two illustrations, one for the CFR Illustrative CFR SOSI (Part I) and another for the component entity Illustrative SOSI for Component Entity (Part II).*]

33. As required in SFFAS 17, paragraph 27, the component entities administering the Social Security, Medicare, Railroad Retirement and Black Lung programs and the governmentwide entity should present a statement of social insurance as a basic financial statement. The SOSI would contain present values as described in SFFAS 17, paragraph 27, as amended by SFFAS 26, par. 5.

34. The component entity and governmentwide SOSI should conclude with a summary section displaying the closed group measure and open group measure (see Appendix D). The closed group measure line item should be the same as lines on the balance sheet (see above and Appendix C), and the beginning-of-year and end-of-year amounts on the SCSIA (see below and Appendix E).

35. The summary section of the component entity SOSI should include the assets held by the programs, if any, and totals for the **closed group unfunded obligation** and **open group unfunded obligation** (see Appendix D, Part II, summary section).

36. This standard should not be construed to preclude displaying subtotals by age cohort.

### Statement of Changes in Social Insurance Amounts

[See Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts.]

37. The governmentwide and component entities presenting a SOSI should present a statement of changes in social insurance amounts (SCSIA) (see pro forma example at Appendix D). The SCSIA will reconcile beginning and ending closed group measures and display the reasons for changes in the closed group measure from the end of the previous reporting period (see Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts).

38. The SCSIA should display the significant components of the change e.g., interest on the obligation due to present valuation; changes in demographic, economic, and healthcare assumptions; changes in law, regulation, and policy; and the amounts associated with each type of change (see Appendix D). The SCSIA should disclose in notes on the face of the statement and/or in notes to the financial statements the reasons for the changes. The reasons should be explained as briefly as possible without detracting from understanding. The most significant changes should be explained in the entity's MD&A as well as in disclosures associated directly with the SCSIA.

### Required Disclosure

39. The entity should disclose an **accrued benefit obligation** amount in the notes to the financial statements. The preparer should select and describe in the notes to the financial statements the method used for calculating the accrued benefit obligation. In addition, the preparer should explain that the disclosure provides a perspective on social insurance programs from the point of view of a deferred benefit or an insurance obligation for those users who value such information.

### Required Supplementary Information other than MD&A

40. As required in SFFAS 17, paragraph 27(1), actuarial projections of annual cashflow as a percentage of taxable payroll and Gross Domestic Product (GDP) are required for component entities and for the governmentwide entity. For the OASDI and HI programs, the actuarial projections should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in inflation-adjusted or constant dollars. The percentages or amounts should be reported for at least every fifth year in the projection period for total cash inflow excluding net interest on intragovernmental borrowing/lending and total cash outflow. Actuarial projections of annual cashflow in nominal dollars are no longer required of component and governmentwide entities.

### Valuation Date

41. All projections and estimates should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon as possible and no more than one year prior to the end of the reporting period. The estimate should include projections to the end of the fiscal year, if feasible, taking into account major factors that affect the results that are known at the time of the projection. If projections to the end of the fiscal year are not feasible, the entity should disclose an estimate of the magnitude of the effect of changes in major factors on the projection or, if not possible, disclose that it was not possible to reasonably estimate the effect. In any case, the nature of the change should be disclosed. This valuation date should be consistently followed from year to year.
42. If, after the valuation date, but prior to the end of the fiscal year, policy reforms are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy reforms had taken place as of the valuation date. If policy reforms are enacted after the end of the fiscal year, but prior to the issuance

of the financial statements, the financial statements should disclose the nature of the policy reform and, if known, the estimated effect on the projections.

43. The entity should provide a brief statement explaining that the SOSI amounts are estimates based on current conditions, that such conditions may change in the future, and that actual cost may vary, sometimes greatly, from the estimated cost. For example:

### APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. The financial statements include information to assist in understanding the effect of changes in assumptions to the related information.

### Sensitivity Analysis

44. The entity should provide sensitivity analysis of the closed and open group measures appropriate for their particular social insurance program.<sup>8</sup> The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change.
45. When determining the type of sensitivity analysis to provide, the entity should consider future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of **stochastic modeling** as an augment or alternative to sensitivity analysis.

### Governmentwide Entity Accounting and Reporting

46. The proposed standard for governmentwide accounting and reporting for social insurance programs is the same as that for component entities. However, the level of detail at the governmentwide level should be less than at the component level.

### Effect on SFFAS 17

47. The proposed Statement provides additional requirements for display, disclosure, and supplementary reporting for social insurance programs. SFFAS 17 is amended as follows:

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<sup>8</sup> See ASP 32, paragraph 3.5.

~~26. All projections and estimates required in these standards should be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon ("current year") as possible and no more than one year prior to the end of the current year. This valuation date should be consistently followed from year to year.~~

~~27~~

~~(1) Cashflow Projections – ...~~

~~(a) Actuarial projections of the annual cashflow, in nominal dollars, with amounts reported for at least every fifth year in the projection period. The cashflow information should show~~

~~i. total cash inflow from:~~

- ~~a. all sources and~~
- ~~b. excluding net interest on intragovernmental borrowing/lending, and~~

~~ii. total cash outflow.~~

~~b)The actuarial estimate provided in 27(1)(a)(i)2) and 27(1)(a)(ii) immediately above as a percentage of (i)taxable payroll<sup>7</sup> and (ii) **Gross Domestic Product** (GDP).<sup>8</sup>~~

For the OASDI and HI programs, the actuarial projections should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

~~<sup>7</sup> Certain social insurance programs (i. e., SMI , Black Lung benefits, and UI) are either not financed by earmarked payroll taxes or are financed by state-determined payroll taxes on employers that can vary by state and by employer; therefore these programs are not required to provide this estimate.~~

~~<sup>8</sup> This requirement does not apply to the RRB, Black Lung, and UI programs.~~

~~...~~

~~(4) Sensitivity Analysis –~~

~~(a) For aAll programs except UI, illustrate the sensitivity of the projections and present values required by paragraph 27(1) and 27(3) to change in the most significant individual assumptions. For~~

example, using the entity's "best estimates" cost assumptions as a baseline, show the effect of varying several significant assumptions one at a time to show the effect on the projection. At a minimum, the OASDI and Medicare programs should analyze assumptions regarding the birth and death rates, net immigration, the real wage differential, and the real interest rate. The real wage differential is the difference between the annual percentage increase in wages in covered employment and the inflation rate, as measured by the CPI. The Medicare program should also analyze the health care cost factors and their trend. should provide sensitivity analysis appropriate for their particular social insurance program. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The SSA, Medicare and Railroad Retirement programs should provide sensitivity analysis of the the closed and open group measures in the SOSI summary. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of stochastic modeling as an augment or alternative to sensitivity analysis. The entity should state that the amounts of the closed and open group measures depend on the assumptions used and that actual experience is likely to differ from the estimate.

- (b) For UI, illustrate the sensitivity of the projections required by paragraph 27(1) to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).

- 32. ... (4) Sensitivity Analysis – For all social insurance programs, indicate that relevant sensitivity analysis is available in the component entity's financial report. provide a summary of the sensitivity analysis required under the standard for component entities (see par. 27(4)). At a minimum, the summary should present the OASDI, HI, SMI, and UI separately.

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3

1 Effective Date

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41. This standard would be effective for periods beginning after September 30, 2009.

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The provisions of this statement need not be applied to immaterial items.

## Appendix A: Basis for Conclusions

### Appendix A: Basis for Conclusions

A1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this statement---not the material in this appendix---should govern the accounting for specific transactions, events or conditions.

### Background

A2. Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other non-exchange transactions and government-acknowledged events) has been a long-standing source of controversy. In its 18 years of operation the Board has issued several exposure drafts, a standard, and a preliminary views document related to social insurance reporting as follows:

- A 1995 exposure draft entitled *Accounting for Liabilities of the Federal Government*
- A 1998 exposure draft entitled *Accounting for Social Insurance*
- SFFAS 17, *Accounting for Social Insurance*, in August 1999
- A 2002 exposure draft entitled *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which resulted, in 2003, in SFFAS 25 of the same title
- A 2004 exposure draft entitled *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*, which resulted, in 2004, in SFFAS 26 of the same title
- A 2006 preliminary views document entitled *Accounting for Social Insurance, Revised*

A3. The issue of social insurance accounting was addressed in SFFAS 17 through compromise between strongly opposing views. The compromise featured:

- a. liability recognition at the point when social insurance benefit payments are due and payable and with revenue and expenses on a cash flow basis, plus or minus the change in the due and payable liability during the reporting period;
- b. a statement of social insurance ("SOSI") and accompanying disclosures; and
- c. other narrative and graphic information, e.g., graphs of long-term cash flows projections using nominal dollars and as percentages of taxable payroll and GDP, the "dependency ratio," and sensitivity analysis.

A4. In SFFAS 26, the Board re-classified the SOSI from "required supplementary

## Appendix A: Basis for Conclusions

stewardship information” to basic information, and the SOSI became subject to a full audit in fiscal year 2006; and required significant assumptions to be disclosed.

- A5. SFFAS 17 and 26 substantially improved the information presented in general purpose external financial reports of the U.S. Government and its component entities. However, in 2004 the Board decided to reconsider the question of liability and expense recognition. A majority of members serving at that time concluded that the compromise that produced SFFAS 17 did not recognize the accruing cost of social insurance programs in each reporting period and the accumulated liability for benefits payable at a determinable date under current law. Nor did it fully explain the change in the net present value of program-related cash flows. Hence, in 2004, the Board initiated a new social insurance project, and a *Preliminary Views* document was issued in October 2006.

### What the *Preliminary Views* Document Proposed

- A6. In the *Preliminary Views* document, the Board presented two views of proposed improvements in the information provided about the effect of social insurance programs. The Primary View proposed to change the SFFAS 17 requirements for:

- a. expense and liability recognition and measurement for Social Security, Medicare, and Railroad Retirement programs, and
- b. the statement of social insurance (“SOSI”).

Under the Primary View proposal, social insurance expense would have been recognized on the statement of net cost when participants become **fully insured** and thus substantially meet the eligibility conditions for future benefits and as scheduled benefits increase due to additional work in covered employment by fully insured individuals. For Social Security, Medicare, and Railroad Retirement programs, participants become fully insured when they complete sufficient work in covered employment, e.g., for Social Security and Medicare, 40 quarters of work in covered employment, or the equivalent thereof. The liability would have been the accumulated unpaid expense as of the reporting date. Those members who supported the Primary View believed that their proposed recognition and measurement standard conformed to the definition for liability and expense in FASAB’s new concepts statement SFFAC 5, *Definition of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*.

- A7. In addition to changing the expense and liability recognition points, the Primary View would have linked the SOSI amounts with amounts reported for social insurance on the balance sheet and statement of net cost. For the Primary View members, such linkage or “articulation” would have illustrated how the amounts reported on the basic financial statements relate to the present values of the cash inflow and outflow over the next 75-years that are presented in the SOSI.



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- 1  
2 A8. The Alternative View proposed to maintain the recognition and measurement of  
3 expense and liability for Social Security, Medicare, and Railroad Retirement  
4 programs currently required in SFFAS 17. That is, the entity would recognize a  
5 liability and a related expense for social insurance benefits when all eligibility criteria  
6 are met such that an individual beneficiary is entitled to receive a benefit (e.g., a  
7 cash payment, goods or services), which includes the point when benefit payments  
8 are “due and payable”.<sup>9</sup> Thus, under the Alternative View the amounts reported on  
9 the balance sheet, statement of net cost, and statement of social insurance  
10 presentation would not have changed from what is currently reported under SFFAS  
11 17.  
12
- 13 A9. Those members who supported the Alternative View also believed their proposed  
14 recognition and measurement standard would have conformed to the new definition  
15 for liability and expense in the recently issued SFFAC 5, *Elements*.  
16
- 17 A10. The Alternative View would have added a new basic financial statement entitled the  
18 “statement of changes in social insurance amounts,” that would show the reasons  
19 for all changes during the period in the amounts (net benefits less receipts)  
20 presented in the statement of social insurance. The Primary View members agreed  
21 in principle that such a statement should be required.  
22
- 23 A11. In addition, the Alternative View members proposed to break new ground. They  
24 proposed a new statement of “**fiscal sustainability**” for the consolidated *Financial*  
25 *Report of the United States Government (CFR)* that would provide sustainability  
26 information on the entire Government, including information necessary to assess the  
27 sustainability of social insurance programs and information on intergenerational  
28 equity, as required supplementary information. Members who supported the  
29 Alternative View believed that such reporting would reflect the unique nature of  
30 social insurance programs, the extent of the Government’s responsibilities for these  
31 and other programs, and the Government’s ability to adjust these responsibilities.  
32 The Alternative View pointed out that a statement of fiscal sustainability would  
33 present the fiscal sustainability of social insurance in the context of sustainability of  
34 the Government as a whole in the *CFR*.  
35
- 36 A12. The members supporting the Primary View welcomed and encouraged the  
37 development of additional supplementary sustainability information. However, they  
38 believed it should be the subject of a separate project because it has implications for  
39 a wide variety of issues.

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<sup>9</sup> SFFAS 17 established a “due and payable” liability standard for social insurance programs. Under that standard the expense recognized for the reporting period is the benefits paid during the period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability is the social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including claims IBNR.

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A13. The FASAB subsequently undertook a project on sustainability that resulted in the *ED Reporting Comprehensive Long-Term Fiscal Projections for the U. S. Government* (“*Projections ED*”). The *Projections ED* is currently out for comment.

A14. Further, members who supported the Alternative View believed that any analysis of scheduled future benefits must include a consideration of future earmarked revenues, as these programs are pay-as-you-go in nature.

A15. The Primary View did not consider future revenues in its liability calculation, other than premiums for Medicare-SMI. However, some note that the Social Security programs hold \$2 trillion of assets and, since the 1983 amendments, is intended to be partially advance funded.

A16. Both the Primary and Alternative Views would have retained the supplemental information now required in SFFAS 17, such as the “dependency ratio” of contributors to beneficiaries, and the sensitivity analysis.

### Different Views Regarding the Obligating Event

A17. Supporters of both the Primary and Alternative Views believed that financial statements resulting from Federal financial accounting standards are intended to be accrual-based. That is, the statements strive to recognize the financial effects of events and transactions as they occur rather than only when the cash transfers take place. The members differed as to the event or transaction that would trigger an expense and a liability for social insurance programs.

A18. The members supporting the Primary View believed the critical point at issue among Board members and generally among participants in the debate involved the timing of the event that creates a liability. The Primary View was that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities.

A19. The Primary View’s principal focus was on the economic cost being incurred for social insurance programs and the accumulation thereof. The Board members supporting the Primary View believed that a key objective of the basic financial statements should be to report the estimated economic costs incurred during the reporting period and the amount of those costs that will have to be financed in future periods. They believed the payroll tax contributions received during the reporting period should be matched against such costs rather than against the benefits paid out during the reporting period to truly evaluate the inter-period equity of the program. Supporters of the Primary View believed such present value of accumulated costs represent the accrued liability portion of long-term actuarial

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1           projections  
2

3           A20. The members who supported the Primary View believed that the distinction between  
4           exchange and nonexchange transactions that was among the points emphasized in  
5           the Alternative View is not determinative. For them, an expense may be incurred  
6           and a liability may arise equally for exchange, nonexchange, or quasi-exchange  
7           transactions so long as a present obligation exists. The Government has many  
8           programs for which it incurs large liabilities and yet receives nothing or little in  
9           exchange other than promotion of the general welfare. In addition, members  
10          supporting the Primary View noted the quasi-exchange features of social insurance  
11          programs such as the relationship between wages earned in covered employment  
12          and benefits accrued and payroll taxes paid, both of which are based on wages in  
13          covered employment. They noted also the way the programs are structured,  
14          including the use of “trust funds” and the “investment” of excess payroll taxes in  
15          special Treasury securities, arguably creates a constructive obligation at a point  
16          much earlier in time than when the payments are due and payable.  
17

18          A21. Members supporting the Alternative View saw a fundamental distinction in financial  
19          reporting of exchange transactions, which are voluntary market exchanges of goods  
20          and services for a price, and nonexchange transactions resulting from decisions  
21          made collectively by the Congress and the President to levy taxes and to authorize  
22          programs. They noted that this distinction is made in FASAB concepts, standards,  
23          and statements, e.g., the statement of net cost, as well as by other standard setters,  
24          including the Governmental Accounting Standards Board (GASB) and the  
25          International Public Sector Accounting Standards Board (IPSASB); and that it is also  
26          the difference between offsetting collections and governmental receipts in the  
27          Budget.  
28

29          A22. Members who supported the Alternative View believed that although the basis for  
30          recognition of a liability and cost for social insurance established in SFFAS 17 (e.g.,  
31          due and payable) remains appropriate, the set of information required by SFFAS 17  
32          was inadequate. They argued that SFFAS 17 does not (1) recognize important  
33          information concerning the fiscal sustainability of social insurance programs, or (2)  
34          fully explain the change in the net present value of program related cash flows. They  
35          believed that the fundamental nature of social insurance is richer and more complex  
36          than the Federal Government’s current accounting model could accommodate.  
37

38          A23. The Alternative View was that social insurance programs comprise two separate  
39          nonexchange transactions – the compulsory payment of taxes during an individual’s  
40          working life and the Government’s payment of benefits after the individual has  
41          satisfied all eligibility criteria. Hence, the Alternative View was that benefits beyond  
42          the due and payable amount are not present obligations of the Government and  
43          should not be recorded as current expenses or current liabilities. In addition, the  
44          Alternative View was that:  
45

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- a. recognition of such future social insurance benefits as current expenses and liabilities would result in a substantial mismatch of net costs for nonexchange programs in the current year and the services provided in that year;
- b. inclusion of such large amounts as proposed in the Primary View, which in the Alternative View were not current expenses or liabilities, on the financial statements would diminish significantly the relative size and importance of valid expense and liabilities shown on the financial statements, providing misleading information about the Government's true financial position and lessening the focus on non-social insurance programs; and
- c. given the ability of the Federal Government to change the laws relating to social insurance programs and the unsustainability of current benefit payments with current financing, about which beneficiaries are on notice, amounts are uncertain and not reliably estimable.

A24. In addition, the members who supported the Alternative View believed that characterizing future benefits as current expenses and liabilities may undermine needed efforts to reform these programs.

A25. The Board members who supported the Alternative View agreed that a key objective of the basic financial statements should be to report the costs incurred during the reporting period. However, they believed that the costs are incurred when all eligibility requirements are met and benefits are due and payable.

A26. In addition to the due and payable amount, members who supported the Alternative View believed that recognition of deferred revenue equal to the earmarked social insurance program revenues in excess of program costs should be considered. If this option were adopted, earmarked revenues collected for social insurance programs in excess of program liabilities (as defined above and in existing liability standards) incurred would be recorded as deferred revenues. The members supporting this view believed, however, that this concept should be considered by the Board as a separate project. It would have required revising portions of SFFAS 7 and the supporting arguments also may have applied to numerous other funds with earmarked receipts.

A27. It is extremely important to note that both the Primary View and the Alternative View called for sustainability reporting. Those members who supported the Primary View believed that the Board should consider additional sustainability reporting in a future project. As noted above, the FASAB subsequently undertook a project on the subject that resulted in the *Projections* ED. However, the members who supported the Primary View believed that reporting on sustainability is not a substitute for or alternative to their proposal to alter expense and liability recognition on the statement of net cost and balance sheet. They believed that the balance sheet and statement of net cost serve different objectives than a statement of fiscal

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sustainability.

A28. The members who supported the Alternative View believed that an appropriate understanding of the sustainability of social insurance requires a consideration of not only the social insurance programs, but also of the Government as a whole because of the significant interrelationship between the two and the need to consider tradeoffs.

### Respondents Comments

A29. The *Preliminary Views* document received 67 responses as follows:

	FEDERAL (Internal)	NONFEDERAL (External)
Users, academics, others	5	47
Auditors	5	3
Preparers and financial managers	7	0

### Question No. 1: Obligor Event Giving Rise to a Liability

A30. The *Preliminary Views* document asked respondents to consider six questions, as well as to submit any other comments they wished. Question 1 asked respondent which of four possible obligor events<sup>10</sup> they favored for creating a social insurance liability. A slight majority of respondents who commented on this question favored either the Primary View's attain-fully-insured-status obligor event (e.g., when participants complete 40 quarters or equivalent of work in covered employment) (22 respondents) or an even earlier event, "work in covered employment" (11 respondents). The Alternative View proposed continuation of the SFFAS 17 obligor event, and this position received the single most favorable responses among the four obligor event options (30 respondents).<sup>11</sup> No respondents commented on the fourth obligor event, "threshold eligibility."

A31. Those favoring the attain-fully-insured-status obligor event commented that:

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<sup>10</sup> (1) when participants become **fully insured** under the terms of the programs, (2) when the participant meets all eligibility requirements and payments become "due and payable," (3) when participants begin work in covered employment and continuing as long as such work continues, and (4) "threshold eligibility" at age 62 for Social Security and 65 for Medicare.

<sup>11</sup> These counts and the others below are approximate. Some responses were difficult to classify. For example, one stated that the respondent concurred with the Primary View but would not report the 40-QC liability on the balance sheet, suggesting limited disclosure instead. This response was counted as favoring the Primary View regarding Question 1 but not regarding Question 2.

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- a. Financial statements should display elements based on current law rather than possible changes in law, and current law requires that social insurance benefits be provided to those who attain fully insured status.<sup>12</sup>
- b. Some argue that social insurance is not a “legal liability” at the point when insured status is attained but, even if the question of the legal standing of the claim to future benefit payments at that point were clear cut, legal arguments are set aside when feasibility and likelihood of future payments are judged largely in economic terms.<sup>13</sup>
- c. The attain-fully-insured-status obligating event best meets the expectations of financial statement users.
- d. The attain-fully-insured-status obligating event is appropriate because Social Security is equivalent to a mandatory retirement savings plan.
- e. The attain-fully-insured-status obligating event promotes comprehensive accounting.
- f. *Social Security Statement* that the Social Security Administration sends to participants each year acknowledges a liability based on attaining fully insured status and the sum of these amounts is similar to the attain-fully-insured-status obligating event amount.
- g. Social insurance is based on a promise that contributions will be held in trust and will be paid out in retirement.
- h. Social insurance contributions and benefits are linked.
- i. Social insurance is a well-established social contract.
- j. Social insurance rights and obligations are established in law.
- k. The FASAB liability definition (either in SFFAS 5, *Liabilities* or SFFAC 5, *Elements*) is met when fully insured status is attained.

<sup>12</sup> In November 2004 GASB decided, relative to its net asset reporting ED (*Net Assets Restricted by Enabling Legislation*), that judicial or constitutional provisions indicating that one legislature cannot bind another does not preclude a government from determining it has legally enforceable enabling legislative restrictions on certain assets.

<sup>13</sup> The same uncertainty regarding the meaning of “legal enforceability” that is evident when discussing Social Security also exists at the state and local arena. The state of Texas recently enacted a law (May 2007) offering state and local governments in Texas an alternative to GASB 45 for reporting OPEB obligations in response to GASB 45. The position of some state officials is that retiree health benefits are not a contractual obligation but are budgeted during each biennial budget cycle. These officials argue that because the benefits are not a legal obligation, they should not be reported as a liability of the state or local governments. State and local governments in Texas may use GASB 45 or a statutory method. However, the Texas Comptroller of Public Accounts is required to use the latter, which requires reporting only OPEB expenditures during the current reporting period; and disclosure of future benefit obligations would be optional and would appear in the statistical section of an annual report. [*Business Wire*, July 17, 2007]

The Fitch rating service stated that the commitment to fund OPEB in Texas is similar to that in other states where Fitch expects widespread compliance with GASB 45. Non-compliance may result in qualified auditor opinions. Fitch considers non-compliance with GASB 45 a managerial weakness. It views positively governments that are forward-thinking: anticipating potential issues, and then taking action to deal with them. Fitch sees compliance with GASB 45 as a first step in a multi-year process of addressing what in many cases will be sizable liabilities. [*Business Wire*, July 17, 2007]

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- l. The attain-fully-insured-status obligating event is a reasonable balance between the events when a participant (a) begins work in covered employment and (b) a “threshold” event, e.g., becoming eligible for immediate benefits at 62 years of age.
- m. Some respondents favoring the work-in-covered-employment obligating event found the attain-fully-insured-status obligating event acceptable because it approximates a “work-in-covered-employment” obligating event.

A32. Those favoring the work-in-covered-employment obligating event commented that:

- a. The work-in-covered-employment obligating event is consistent with real world experience.
- b. The Federal Government recognizes as revenue the payroll tax contributions that participants are required to make in conjunction with their work in covered employment.
- c. The work-in-covered-employment obligating event results in a better match of benefits earned with the earning period.
- d. Social Security and Medicare are like pensions and other post-employment benefits and should follow accounting rules developed for such programs.
- e. Government action has created expectations and reliance beginning with work in covered employment.
- f. Financial statements should reflect accounting based on current law rather than possible changes in law, and the law provides benefits based on work in covered employment.
- g. According to SFFAC 5, *Elements*, power to change law does not preclude liability recognition and therefore possible changes in law should not preclude recognition of a liability based on work in covered employment.
- h. Social insurance is not like Medicaid and other annual programs because there is a past event.
- i. The obligating event should be wages earned subject to social insurance payroll taxes.
- j. Social insurance benefits are based on both time worked and wages received over a participant’s lifetime.
- k. The SFFAC 5, *Elements*, liability definition is met when participants work in covered employment.
- l. Payroll tax contributions, which are collected concurrently with work in covered employment, are exchanged for a promise of future benefits.

A33. Those opposed to the attain-fully-insured-status obligating event commented that:

- a. Financial statements would lack integrity if a liability were recognized when fully insured status is attained due to the uncertainty of the necessary estimates.
- b. Social insurance significantly differs from private sector retirement programs and an attain-fully-insured-status obligating event would negatively affect the decision usefulness of government financial statements.

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- c. Attaining fully-insured-status event has no economic relevance and is a mere legal formality.
- d. The attain-fully-insured-status obligating event, as proposed in the *Preliminary Views* document, does not consider future income as it should.
- e. Since accounting rules do not allow future taxes to be recognized as assets, recognizing future benefits as liabilities when participants attain fully insured status would be misleading.
- f. The Supreme Court has ruled that Social Security benefits are not property or a contractual right and Congress can change benefits.
- g. The attain-fully-insured-status obligating event is an insufficient obligating event because under certain circumstances a worker who attains fully insured status can subsequently lose it; and even the attaining of permanently insured status is an insufficient obligating event because future benefits are too uncertain and there is no binding contract or obligation until benefits are due and payable.
- h. Social insurance benefits are not guaranteed or contractual, or advance funded, or promised.
- i. Social insurance benefits are not part of an exchange but rather are a welfare program and/or an annual general fund program like Medicaid and defense – which are as likely as social insurance but for which early accrual is not proposed.
- j. The attain-fully-insured-status obligating event could diminish the likelihood of reform because, although recent proposals have promised not to alter benefits to retirees and near-retirees, the proposals could affect other benefits included in the “fully insured” group. Thus, the attain-fully-insured-status obligating event could create anti-reform political pressure.
- k. The attain-fully-insured-status obligating event is based on private sector pension accounting and is unsuitable for the Government, which has unique characteristics.
- l. The Government can and no doubt will change the social insurance obligation that would be displayed as “accrued” under the attain-fully-insured-status event substantially.
- m. The attain-fully-insured-status obligating event does not meet the SFFAS 5 liability definition.
- n. The current FASAB social insurance standards are accepted and workable and the attain-fully-insured-status obligating event does not make a compelling case for change.
- o. Those favoring the attain-fully-insured-status obligating event are wrongly changing the liability definition to accommodate preconceived preference.
- p. Social insurance and other nonexchange transactions are unique to the Government. They are fundamentally different from exchange transactions and should be accounted for differently.

A34. Those favoring the due-and-payable obligating event commented that:

- a. The due-and-payable obligating event is consistent with the liability definition in



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SFFAC 5, *Elements*, with FASAB's long-held views, and with the pay-as-you-go financing of social insurance.

- b. The due-and-payable obligating event is useful to lawmakers and the public.
- c. Social insurance benefits do not meet the criteria even for constructive liabilities and therefore recognizing a liability earlier than the due-and-payable event is inappropriate.
- d. The SFFAC 5, *Elements*, liability definition requires that the obligor not be able to change the liability unilaterally, which Congress can do until social insurance benefits are due and payable.
- e. Recognizing pension liabilities is appropriate in the private sector where advance funding is a concern, but the federal budget and most federal programs are not advance funded. Social Security is a pay-as-you-go program.
- f. Social insurance benefits are non-binding obligations.
- g. The due-and-payable obligating event maintains the accepted and workable SFFAS 17 standard and is consistent with SFFAC 5, *Elements*.
- h. Social insurance funds are similar to government funds in state and local governments.

A35. Those opposed to the due-and-payable obligating event commented that:

- a. The argument for due-and-payable obligating event that the collection of taxes and payment of benefits are two separate non-exchange transactions and that the Government is free to walk away from social insurance commitments is unsupportable from accounting, public administration, and political perspectives. Social insurance programs have citizens' support because they perceive an exchange and Congress and SSA have reinforced that perception.
- b. The argument for the due-and-payable obligating event that there is a mismatch of cost and service with the early-accrual obligating event approach is inappropriate because accrued expenses are economic events; they are current expenses even though cash outflow will occur in the future.
- c. The due-and-payable obligating event implies a "stay-alive" criterion that is a very narrow interpretation of liabilities.
- d. The large size of the social insurance liability under the attain-fully-insured-status obligating event should not deter reporting; it illustrates the importance of these programs.

### Question No. 2: Measurability

A36. The respondents' answers to Question 2, which asked whether respondents believe that the Social Security and Medicare obligations are measurable for the purposes of recording a liability when participants complete 40 quarters of work in covered employment and attain fully insured or equivalent status, generally reflected their position on Question 1. Those believing Social Security and Medicare obligations are measurable for the purposes of recording a liability commented that the attain-

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fully-ensured-status obligating event – or earlier event – would be measurable and auditable. The rationales included that the SOSI is basic information now and is audited; that actuarial practice currently accommodates large estimates; and that SFFAC 5, *Elements*, does not require certainty; that the SSA distributes *Social Security Statements* that are presumably accurate enough to send to participants for the purposes of long-range planning. Those not believing Social Security and Medicare obligations are measurable for the purposes of recording a liability and expense commented that the amount is too uncertain, that assumptions, law, and/or insured status change and such changes would cause great fluctuations. One respondent commented that the future cost of Medicare is unknown or unknowable.

### Question No. 3: Reporting Changes

A37. Part one of Question 3 asked respondents whether (1) the new SOSI line items that tied to the balance sheet and operating statement as proposed by the Primary View members should be adopted (Question 3.1) and (2) they favored reporting the components of the change in the SOSI present values and, if so, which approach for such reporting they favored – the Primary View approach featuring an expanded SOSI, or the Alternative View featuring a new statement (Question 3.2).

A38. Respondents favoring the new SOSI line items commented that adding such line items would illustrate relationship for unfamiliar users. Respondents not favoring new SOSI lines items commented that the current SOSI or SFFAS 17 approach is appropriate; that additional line items would make the SOSI more complex without increasing understandability; and that there should be a “bright line” distinction between primary financial statements and SOSI.

A39. Regarding Question 3.2, almost all respondents who commented on it favored reporting changes, although some preferred that it be RSI. The majority of respondents favored a separate statement rather than new SOSI line items. Some commented that a new statement would be concise and simple and therefore promote discussion of context.

### Question No. 4: Statement of Fiscal Sustainability

A40. Question 4 asked respondents whether they favored the statement of fiscal sustainability proposed by the Alternative View members (and not opposed in principle by the Primary View members). Those favoring a SOFS commented that:

- a. A SOFS would help explain long-term effects without compromising the financial statements.
- b. Sustainability information is vital for federal managers, elected officials, citizens, and holders of Treasury debt. And,
- c. Intergenerational information is of the highest importance.

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A41. Some who favored a SOFS preferred to develop it via a separate project. The FASAB subsequently undertook a project on the subject that resulted in the *Projections* ED.

A42. Respondents not favoring a SOFS commented that:

- a. A SOFS would be too costly to prepare and audit and of little practical use.
- b. Present value “point estimates” and per capita ratios and/or infinite horizons are inappropriate for sustainability reporting for pay-as-you-go programs like social insurance. Sustainability reporting for social insurance requires analysis of the timing and trends of future cash flow on an annual basis and as a percentage of GDP, taxable payroll, and possible other measures of the economy; and/or
- c. that the estimates would be too subjective or too uncertain or just would be just one more competing view.
- d. One respondent commented that the information that would be provided via the Primary View proposal is more appropriate than a SOFS for GAAP financial statement. However, this respondent did not oppose research and development of guidance for sustainability reporting, but not as a substitute for financial statements.

### Question No. 5: Deferred Revenue

A43. Question 5 asked respondents whether the Board should consider recognizing deferred revenue in excess of related program costs as a liability. Some of the respondents who did not believe the Board should consider recognizing deferred revenue commented that:

- a. The information provided under the Primary View proposal properly matches costs and revenues, and/or that current revenue recognition standards were appropriate.
- b. Some commented that earmarked taxes were the same as non-earmarked; or that payroll taxes were mandatory and not “deferred” for anything.
- c. One respondent noted that the concept of deferred revenue may be contradictory to the Alternative View that there are no present obligations until benefits are due and payable. Another respondent said that deferred revenue pertains to exchanges.

A44. Respondents favoring the Board’s consideration of recognizing deferred revenue did not provide specifics as to their rationale. Some said that, if the attain-fully-insured-status obligation event or other early accrual were not adopted, then the notion of deferred revenue should be considered.

A45. One respondent commented that the *Preliminary View* document did not provide

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sufficient information to respond to the question.

### The Board's Conclusions and the Proposed Standard

#### Fiscal Sustainability Reporting

A46. After the public hearing on social insurance on May 23, 2007 and initial discussions in the summer of 2007, the Board decided to develop fiscal sustainability reporting further before considering social insurance. The *Preliminary Views* document mentioned the Board's unanimous interest in fiscal sustainability reporting and the Alternative View presented examples of what it might look like. The members wanted to know if the fiscal sustainability project would address some of the objectives of the social insurance project.

A47. The Board developed and has now issued the exposure draft, *Projections ED*.<sup>14</sup> In the *Projections ED*, the Board is proposing to require that the *CFR* present information addressing the fundamental question of whether the Government can sustain public services and meet its obligations as they come due, including social insurance. The Board concluded that answering this question requires analyzing current and projected levels of all federal spending, federal receipts and federal debt in relation to the economy. Such an analysis is complex and the result is challenging to communicate.

A48. The fiscal sustainability standard would be comprehensive. It would consist of an analytical narrative that integrates a basic financial statement and illustrations. The standard includes what the Board notes is information that is consistently found in reports of U.S. entities and many other countries. For example,

- a. Information on the present value of receipts and spending to convey the magnitude of policy changes that would be required to sustain delivery of goods and services. Presenting this information in relation to a meaningful base such as GDP is required to assist readers in understanding large dollar amounts.
- b. Information on the trajectory of spending and receipts to show the timing of the Government's need for financing and allow for comparison to historic financing needs on an annual basis.
- c. Information on the trend in debt-to-GDP ratios in graphic form to facilitate an understanding of when the rising drain on financial markets might constrain borrowing.

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<sup>14</sup> Issued August 29, 2008, comments due January 5, 2009, and a public hearing scheduled for February 25, 2009.

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A49. The proposed fiscal sustainability standards in the *Projections* ED would require:

a. A basic financial statement presenting the present value of projected receipts and spending for all activities of the Federal Government, including social insurance; how those amounts relate to projected GDP; and the summary measure “**fiscal gap**.”

b. Disclosures explaining and illustrating the projected trends in:

1. The relationship between all Federal Government receipts and spending,
2. Deficits or surpluses, and
3. Treasury debt as a share of GDP.

c. Disclosures also explaining and illustrating:

1. The assumptions underlying the projections,
2. Factors influencing trends,
3. The range of possible results using alternative assumptions, and
4. The likely impact of delaying corrective action when a fiscal gap exists.

A50. The Board believes that these projections will provide meaningful information essential to assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, including SI obligations. However, this ED is proposing that the fiscal sustainability standard is not a substitute for presenting the amount of social insurance commitments on the balance sheet below assets, liabilities, and net position and not included in the totals of those classifications.

### Social Insurance Revisited

A51. Having developed the proposed fiscal sustainability standard, the Board returned to social insurance. On the fundamental question of liability and expense recognition for social insurance, the Board notes the division of opinions among respondents reflected the *Preliminary Views* document itself. Indeed, the difference of opinion has persisted since the Board’s initial consideration of the social insurance liability question during the development of SFFAS 5 and especially during the development of SFFAS 17.

A52. SFFAS 17 presented a compromise between two strongly held views regarding liability and expense recognition for social insurance programs. For SFFAS 17, the Board concluded that the best approach was to recognize the annual cash flow effects of the social insurance programs in the basic financial statements; that is, revenue is the cash inflow during the reporting period from payroll tax contributions

## Appendix A: Basis for Conclusions

and income tax on social insurance benefits and expenses are the cash outflow during the year plus or minus the change in a “due and payable” liability. However, the Board also required a package of information that it characterized as “required supplementary stewardship information” (“RSSI”).

A53. For the RSSI section, the Board required an array of present values by age cohort in what became the statement of social insurance (“SOSI”). The SOSI is required to have five years of data and thereby provide an historical perspective. In addition, the Board required other narrative and graphic information, e.g., graphs of cash flows over long-term projection periods using nominal dollars and as percentages of taxable payroll and GDP. The graphs show the timing of future cash flows that present values cannot do and thereby provide a future perspective. The information is to include the point when benefit payments begin to exceed social insurance income, which is sometimes called the “cross-over point.” The RSSI was also to include the ratio of beneficiaries to workers also known as the “dependency ratio,” as well as extensive explanatory material.

A54. The Board decided that the “bottom line” of the SOSI should be an open group measure. That bottom line represents the total excess of actuarial present values of future benefit payments over future contributions and tax income for current and future participants over a period sufficient to illustrate long-term sustainability. There had been much debate during the development of the standard over whether to display the open group measure or the closed group measure.

### *The Closed Group Measure*

A55. The term “group” simply refers to the participants included in a measure. The “closed group” includes current participants only, e.g., for Social Security, current retirees and covered workers. It does not include future participants; those projected to become participants during the projection period but after the valuation date. It contrasts with what is known as the “open group” that does include those who are currently participating and those who will participate in the future during the projection period. The open and closed group measures include all future flows related to the specified group. These measures contrast with an accrued benefit obligation measure which includes only future benefits attributed to past work in covered employment by current participants as of the reporting date.

A56. The closed group measure has been an option for Federal financial reporting for a long time. From 1985 through 1994, the closed group measure was disclosed in a footnote in the “prototype” *Consolidated Financial Statements of the United States* (“prototype CFS”). Before that, from 1976 to 1985, a liability had been recognized for Social Security in the prototype CFS, using a calculation similar to that called for by private sector accounting standards.

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- 1 A57. The original exposure draft leading to SFFAS 17 had required disclosure of the  
2 closed group measure as part of a package of RSSI. The Board noted that the  
3 closed group measure is sometimes referred to as the actuarial liability for certain  
4 social insurance programs related to the closed group of current participants. The  
5 Board noted that some believe it is analogous to the liability that would be  
6 recognized on the face of the balance sheet if social insurance programs were  
7 accounted for like federal pensions and retiree health care benefits. Others dispute  
8 this, pointing to different financing arrangements, legal status, and the nature of  
9 social insurance and pensions.
- 10
- 11 A58. At that time the Board noted that some people believe that the closed group  
12 measure gives a rough idea of the implicit intergenerational transfer taking place in  
13 social insurance programs. Others disagree because they believe there has been  
14 no intent for individuals or cohorts of individuals to make contributions  
15 commensurate with the benefits they receive.
- 16
- 17 A59. The Board had also noted that some believe the closed group measure is  
18 analogous to the measure of “risk assumed” that would be reported as  
19 supplementary information if social insurance programs were accounted for like  
20 other federal insurance programs. SFFAS 5, *Accounting for Liabilities of the*  
21 *Federal Government*, defines “risk assumed” as the present value of unpaid  
22 expected losses net of associated premiums, based on the risk inherent in the  
23 insurance or guarantee coverage in force (i.e., the expected loss on the “current  
24 book of business”). The Board noted that, in the context of social insurance, one  
25 would use the term “closed group” instead of “current book of business.”<sup>15</sup>
- 26
- 27 A60. SFFAS 5 requires insurance programs, other than social insurance programs, to  
28 report risk assumed amounts if they differ from the amount recognized as a liability.  
29 The Board noted that some people believe that it is useful to report this information,  
30 for the same reason that it is useful to report amounts of a similar nature for other  
31 kinds of government programs: that as a general principle, decision-making is best  
32 informed if the government recognizes the costs of its commitments at the time it  
33 makes them. The Board noted government analysts had argued in a similar vein for  
34 recognition of the economic costs of federal insurance in the budget, as is done for  
35 federal credit programs. Accrual-based information offers the potential to overcome  
36 a number of the deficiencies of cash-basis information. In concept, risk assumed  
37 information would permit policymakers to consider these costs in relation to other  
38 priorities and improve the measurement of a program’s impact on private economic  
39 behavior. In most cases, the Board agreed that the risk-assumed approach to  
40 accrual would be analogous to a premium rate-setting process in that it looks at the  
41 long-term expected cost of an insurance commitment at the time the insurance

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<sup>15</sup> In insurance accounting, the term “book of business” refers to the total amount of insurance in force on an insurance entity’s books at a particular date. AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*, Glossary.

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commitment is extended.

A61. Ultimately, for SFFAS 17, the Board decided, as part of a compromise solution, to develop the SOSI that provided actuarial present values of future contributions and benefits for the open group of participants but not the closed group per se. The Board concluded that the SOSI so constituted would be useful for analysis of sustainability and financial position of social insurance programs.

A62. The vote for SFFAS 17 was not unanimous. Three members dissented. They focused primarily on the switch from the closed to the open group bottom line. One of the dissenting members said the closed group deficit was a very important measure in evaluating alternative proposals for social insurance financing. Even though SFFAS 17 required instructions in a footnote on how to calculate the closed group measure, the member felt that, if the Board truly wished to establish standards that meet the information needs of citizens, elected officials and program managers, the standard should require the prominent display and explanation of the closed group measure rather than a footnote explaining how to calculate the closed group deficit. The member did not see how that could possibly be interpreted as satisfying the mission of the Board.

A63. Another member dissented because he felt SFFAS 17 did not require a clear unambiguous disclosure of a reasonable estimate of the Government's social insurance liability/obligation. That member argued that the due and payable liability would result in a reported financial position that will appear to many as significantly misleading, at best, and clearly not commensurate with the significant financial implications of this critical national issue. The member noted that SFFAS 17 required the NPV of future benefits related to the open group but not the closed group; and that the absence of the specified closed group measure is significant because some suggest that the closed group measure represents an appropriate estimate of the social insurance liability.

A64. Lastly, a third dissenter argued that the removal of the closed group number from the published financial statements removed any forthright indication of the existence of any obligations to participants. He asked what the Government's repeated promises meant if there is no obligation to the participating public. He argued that the closed group number is an important indicator of financial stress to be faced by the next generation of Americans, and is a proxy for an economic liability or an "implicit" liability. He mentioned that proposals to add social insurance benefits or increase social insurance taxes or to make other changes in the program should be evaluated by Congress and the public against these absolute numbers and the strength of the Government's commitment to honor the indicated obligations. Finally, he argued that the SOSI should be a basic financial statement, which it became with SFFAS 25 and SFFAS 26.

A65. Some current Board members believe that the closed group measure is the best



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measure of the social insurance obligation.<sup>16</sup> However, they do not believe it is appropriate for the balance sheet or that the change in this measure during the reporting period is appropriate for the statement of net cost. They view future revenues that are included in the measure as contingent revenues, and they believe all other future inflows and/or revenues included in balance sheet and statement of net cost relate to earned revenues.

A66. Others counter that insurance accounting and fair value measures currently incorporate future inflows and outflows in the measure of liability and expense. Some argue that the basis for including future revenue in current year cost and liability measures depends on the obligating event to which they relate. If they related to a past event, e.g., an insured event, then they are appropriate measures of cost. If they relate solely to a future event, e.g., future insurance policies in the program, then they should be excluded from current costs and from liability measurement. The key is the event not the fact that the cash flow is in the future. They cite current FASAB insurance standards in SFFAS 5<sup>17</sup> that include future revenue when calculating the net liability.

A67. Some Board members argued against including the closed group measure for social insurance on the balance sheet. They said that the balance sheet displays accumulated assets and liabilities that are primarily accrual-based and impact the entity's net results of operations and net position. They believe that the use of the actuarially derived present values for the balance sheet for social insurance would put both accrual-based and actuarial-based estimates on the balance sheet, which they feel would be confusing. They point to GASB Statement 34 as an example of a standard that moves away from such commingling because it separates current financial resources from economic data. Other members believe that the actuarial assumptions and estimates are commonly used in measuring long-term liabilities such as for pension obligations and veteran's benefits.

### *The Current Proposal*

A68. Since the two views regarding liability and expense recognition persist and the likelihood of achieving a satisfactory majority one way or the other is remote, and since the Board wishes to further improve social insurance reporting, the Board concluded that a compromise was in order. The Board believes that a fair

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<sup>16</sup> The current group of participants is also known as the closed group of participants.

<sup>17</sup> SFFAS 5, par. 113: The liability for life insurance includes both the liability for unpaid claims ... and a liability for net future policy benefit outflows.... The [latter] represents the expected present value of future outflows to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders. The liability is estimated using appropriate financial or actuarial methods that include assumptions ... applicable at the time the insurance contracts are made and in accordance with existing law and related policy .... Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in

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1 presentation of the financial position, condition, and results of operations requires  
2 that the closed group measure be provided as part of a balanced package of  
3 information. The closed group measure represents a reasonably good estimate of  
4 the net responsibility of future taxpayers, under current laws, to pay benefits to  
5 current participants. Although this amount is subject to change due to changing  
6 long-range demographics, it is not as volatile as the computation under the open  
7 group measure that includes all current and future participants over a projection  
8 period, e.g., the next 75 years. It relates only to individuals who already are  
9 participating in the program.

10  
11 A69. The open group measure represents the net present value of all expenditures to or  
12 on behalf of the open group population and all contributions or other income from or  
13 on behalf of the open group population over a given projection period, e.g., 75  
14 years. It is used to estimate the future financing shortfall in social insurance  
15 programs. The closed group measure involves only those participating in the social  
16 insurance program at the reporting date. It represents the same measurement  
17 approach as for the open group; that is, it is the net present value of all  
18 expenditures to or on behalf of the current participants and all contributions or other  
19 income from or on behalf of the current participants over a given projection period.

20  
21 A70. The open group measure is inherently more sensitive to assumptions about the  
22 distant future than the closed group measure. The greater sensitivity is inevitably  
23 true, despite the best efforts of actuaries, economists, and other professionals  
24 involved in making these projections. It is mainly caused by the fact that a closed  
25 group dwindles over time, so that uncertainty about what will happen in the distant  
26 future has less impact than is the case for an open group that grows larger during  
27 the projection period.

28  
29 A71. Federal accounting and financial reporting attempts to address the needs of users  
30 and to inform their decisions, and particularly decisions on highly important and  
31 topical issues. The Board believes that the closed group measure is one way to  
32 quantify the financing challenges relating to social insurance programs. It is  
33 relevant to the concerns of users who are assessing options for dealing with those  
34 challenges. The measure not only draws attention to the challenge but also  
35 quantifies it in a way that can support further analysis and decision-making.

36  
37 A72. For example, the closed group measure represents one way to consider the cost of  
38 transition from a current program to a new program. The transition cost is also used  
39 to evaluate the actuarial status of an existing plan when continuing the program in a  
40 different form. The closed group measure represents net benefits scheduled to be  
41 paid to current retirees and to workers.

42  
which the changes occur. ...

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A73. The Board is proposing to require:

- a. a discussion and analysis by management of the closed group measure of social insurance along with other critical measures in the MD&A;
- b. a separate line presenting the closed group measure that would be displayed on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications;
- c. new displays on the SOSI for closed and open group measures;
- d. a new statement of changes in social insurance using the closed group measure;
- e. note disclosure of an accrued benefit obligation; and
- f. continuing to require the projections and other supplementary reporting currently required by SFFAS 17, with the sensitivity analysis amended by this standard.

### *Management's Discussion and Analysis*

A74. The Board provided MD&A standards and guidance in SFFAS 15 and SFFAC 3, *Concepts for Management's Discussion and Analysis* ("SFFAC 3, MD&A"). SFFAS 15 requires the entity's financial report to include a MD&A, which it categorizes as required supplementary information. SFFAS 15 requires the entity's MD&A to address the entity's:

1. mission and organization structure;
2. performance goals and results;
3. financial statements; and
4. systems, controls, and legal compliance.<sup>18</sup>

A75. Very importantly, the MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known as well as anticipated demands, risks, uncertainties, events, conditions, and trends.<sup>19</sup> MD&A should deal with the "vital few" matters, i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the financial report, including the most important problems that need to be addressed and the actions taken or planned. SFFAC 3 provides examples of items that might be relevant.<sup>20</sup>

A76. The MD&A should discuss significant amounts that affect the financial statements, the major changes during the reporting period, and the causes thereof. The entity should not report amounts merely because they are large, for example, the fund

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<sup>18</sup> SFFAS 15, par. 2.

<sup>19</sup> SFFAS 15, par. 3.

<sup>20</sup> SFFAC 3, pars. 31-39.

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balance with Treasury, if the affects of such amounts and changes in amounts were insignificant with respect to the entity's operations during the period. The entity should explain why the changes occurred, not merely that change did occur.

A77. SFFAC 3 explains the conceptual basis for the role and importance of MD&A, the general content of the financial report, and the elements of MD&A. The concepts provide a foundation for the standards presented in SFFAS 15 as well as suggestions for the contents of the MD&A.

A78. This standard requires the governmentwide and component entities that present a SOSI to include certain information in their discussion of financial statements in the MD&A. (see paragraph 26). The discussion will relate costs, asset and liabilities, social insurance commitments, the budget, and, for the governmentwide entity, the fiscal gap.

A79. The closed group measure is important for analysis of programmatic changes. Since it will be presented on the balance sheet, below assets, liabilities, and net position and not included in the totals for these classifications, it should be addressed in the governmentwide and component entities' MD&A discussion of social insurance.

### *The Balance Sheet*

A80. With respect to the balance sheet, the Board proposes to display new information on the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications rather than to change the due and payable measure of the social insurance liability or change the basis for social insurance expense recognition. Again, under SFFAS 17, social insurance revenue is the payroll tax contributed and expense is the cash outflow during the period plus or minus the change in the due and payable liability. This would not change under the new standards. Instead, the Board is proposing to add to the reporting model to require the closed group measure to be displayed on the balance sheet but not included in the amounts in the totals for assets, liabilities, and net position (see Appendix C).

A81. The closed group measure represents a point estimate of the program's shortfall over a projection period sufficient to illustrate long-term sustainability (e.g., traditionally a period of 75 years has been the primary period used by the Social Security Administration for long-term projections). It is the amount that will not be covered by payroll tax contributions from the current participants over that period. The closed group measure is a concise and familiar depiction. It is a "stock" number, rather than a "flow" number, and captures much information about the future. Many point estimates are used for reporting under general accepted accounting principles. However, the closed group measure does not address the timing of the shortfall. Timing is the subject of the social insurance RSI, which displays the cash flow projections graphically, in nominal dollars and as a percentage of taxable payroll and

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the GDP.

A82. The Board believes that the concept of a liability-commitment-expectation continuum is useful. The Government's recognized liabilities include Treasury debt, pensions and medical benefits owed to Federal employees and veterans, environmental cleanup liabilities, and other liabilities. Employee liabilities are a form of deferred compensation. Liabilities also include accrued obligations for Government insurance policies and the estimated present value of failed loan guarantees and deposit insurance claims. However, liabilities are only a subset of the Government's overall commitments.

A83. The full extent of the Government's commitments dwarfs the outstanding total of all acknowledged Federal liabilities. Farther along the continuum the Government has a broad range of programs that dispense cash and other benefits to individual recipients. The Government also provides a wide range of public services that must be financed through the tax system. Some commitments relate to past events and transactions but are too uncertain as to their occurrence or are insufficiently measurable to be recognized as liabilities. Some of these uncertain or insufficiently measurable commitments are disclosed in notes to the financial statements or required supplementary information in accordance with relevant accounting standards. Other commitments are too remote for disclosure or relate entirely to future events. Pursuant to SFFAC 5, *Elements*, liabilities require the existence of a present obligation with a related past transaction or event, and, to be recognized as a liability, must be reasonably measurable.

A84. Some components on the continuum are generally accepted as limited. These may be characterized as commitments. Commitments relating solely to future events represent a claim on budgetary resources in the foreseeable future unless the law is changed. All of the Government's existing programs are reflected in the long-run budget projections for which reporting is proposed in the *Projections ED*. These future claims need to be discussed in the MD&A or RSI. Leaving these programmatic commitments out of projections of future claims on the Government or in calculating the Government's long-run fiscal imbalance would be misleading. However, they do not belong among liabilities on the balance sheet because they do not meet the definition and/or the recognition criteria for liabilities.

A85. Others items are even further along the continuum and may be characterized as expectations. They involve general assistance and Government service programs.

A86. The Board is proposing to add social insurance commitments to the balance sheet below assets, liabilities, and net position and not included in the totals for those classifications, as illustrated in Appendix C. In addition, the Board is proposing that the SOSI display the closed group measure as well as the open group measure, and to create a new statement to display the changes in the closed group measure during the reporting period. Finally, the Board is proposing note disclosure of the

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1 accrued benefit obligation because users have asked for this measure and because  
2 it is needed for analysis.

3  
4 A87. Some members ask why social insurance should be treated differently than other  
5 programs that provide annual government services, and why social insurance should  
6 be selected for the balance sheet but not other programs, e.g., food stamps, school  
7 lunches. They note that some commentators say one area of difference is the  
8 dedicated taxes in social insurance programs, but these members note that a large  
9 part of Medicare is funded by general revenue. They do not believe that a strong  
10 basis has been established for saying social insurance programs are the ones to  
11 highlight and others can be excluded. In this regard some members believe one of  
12 the drawbacks of the SOSI is that it does not provide a comprehensive view of the  
13 continuum of Government liabilities-commitments-expectations. They note that the  
14 fiscal sustainability project will provide that view.

15  
16 A88. Some assert that social insurance programs are indistinguishable from other federal  
17 programs for which no one argues that accrued liability treatment or unique displays  
18 should be developed. Thus, social insurance programs should not be afforded  
19 unique accounting treatment.

20  
21 A89. For SFFAS 17 the Board identified five programs as social insurance programs.

- 22  
23 • Old-Age, Survivors, and Disability Insurance ("OASDI" or "Social  
24 Security");  
25 • Hospital Insurance ("HI") and Supplementary Medical Insurance ("SMI"),  
26 known collectively as "Medicare;"  
27 • Railroad Retirement benefits;  
28 • Black Lung benefits; and  
29 • Unemployment Insurance ("UI").  
30

31 A90. The Board noted that although they generally share certain characteristics, "social  
32 insurance" programs are too diverse to allow definitive criteria to be applied to  
33 include some and exclude others from the category. SFFAS 17 identifies the  
34 following five characteristics common among social insurance programs:

- 35  
36 (1) Financing is from participants' and/or their employers' payroll tax  
37 contributions and fees.  
38 (2) Eligibility is from payroll tax contributions/fees paid and time worked in  
39 covered employment.  
40 (3) Benefits not directly related to pay tax contributions/fees paid.  
41 (4) Benefits prescribed in law.  
42 (5) Programs intended for the general public and most citizens are eligible.  
43

44 A91. After weighing these arguments carefully, the Board continues to believe that

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definitive criteria would be unworkable. Although these programs do generally share certain characteristics, they are complex. Each program has unique benefits, different eligibility requirements, and different financing arrangements. Because definitive criteria would be subject to interpretation, questions would arise about individuals programs that would require a response from the Board. The Board has decided to continue to identify social insurance programs that now exist and consider the classification of other programs as they may arise in the future.

A92. The Board is now proposing to amend SFFAS 17. In order to offer improvements in a timely manner, the Board will leave open certain questions regarding the reporting model and the elements of Federal financial reporting, as explained elsewhere in this basis for conclusion. However, the Board will indicate here areas where additional conceptual work will be undertaken.

A93. Some members argue that financial reporting geography matters. They argue that a SOSI and even a new SCSIA and note disclosure is no substitute for reporting the economic cost as an expense of the period and the accrued obligation as a liability.

A94. Others argue that the value and credibility of current financial reporting is negatively impacted by having three bottom lines: (1) the budget deficit, (2) the “GAAP” deficit, and (3) the government’s change in financial position taking into account social insurance programs. Even though the last of these three is not currently reflected in the financial statements, it is most important and the one on which the Board encourages others to focus their analysis.

A95. The social insurance programs are a challenge for the current model. The obligations and assets associated with these programs do not fit well within the existing model. Currently the model is outlined in FASAB Concepts Statements and calls for an MD&A; certain basic financial statements, especially a balance sheet, an operating statement (“statement of net cost”), a statement of changes in net position, a statement of social insurance, and other statements; and supplementary information.

A96. Members believe that the current financial statements need to do a better job of explaining the implications as to why the power to tax is not an asset but nonetheless relevant to assessing the sustainability or the financial condition of the Federal Government. For example, one can argue that current deficits are indeed bad but that the problem is actually long-range rather than short-range. Thus, the current financial statements need to explain the timing of the problem as well as providing point estimates like the closed group measure. The financial statements need to explain why the point estimates on the balance sheet have limitations for assessing financial condition. They believe that the fiscal sustainability reporting proposed in the *Projections* ED is moving in that direction.

A97. The Board’s current Financial Report Phase of the Concepts Project also will

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consider this issue. The Financial Report Phase will be conducted in four segments:

- a. determine user needs within certain cost/benefit constraints;
- b. determine the inventory of user needs and how they relate to the reporting objective;
- c. determine methods for meeting user needs; and
- d. determine presentation.

Ultimately, completing the phases could lead to conceptual guidance, standards, and/or educational material on the federal reporting model.

A98. For now, the Board is expanding the reporting without comprehensively addressing the model. The Board is identifying a “commitment” for special display and reporting but is not characterizing the new balance sheet information as an “element” of financial statements within the context of SFFAC 5, *Elements*, definitions.

A99. Some argue that there is a further, significant issue regarding the concept of articulation of the elements of the required financial statements. Articulation refers to the linkage of an item in one financial statement to an item reported on a different financial statement. Articulation demonstrates the interrelationships of the various financial statements. That linkage is demonstrated in Appendix 1- A thru 1- F of SFFAC 2, *Entity and Display*. The concept of linkage (described therein as “the order and flow of data in the financial statements”) is also very clearly depicted in a chart on page 43 of the 2007 *Financial Report of the United States Government*. Since the other statements outlined in SFFAC 2 are prepared on an accrual basis, there is no linkage (articulation), as traditionally understood, between the basic financial statements described in SFFAC 2 and the SOSI. Some argue that that condition is technically unsound in basic financial statements. This was acceptable in SFFAS 25 and 26 and is proposed here as a compromise standard that requires disclosure and RSI. Being concerned that the lack of linkage to the other basic statements will not be easily understood by users willing to study the information with reasonable diligence, others might not believe the users of the SSA and CFR financial reports, particularly citizens and citizen intermediaries, will be well served by this proposal. Elevating the SOSI to become a basic financial statement without accruing a liability or recognizing an expense based on that information might increase confusion of users of Government reports.

A100. As with the current reporting model, changes in the closed group measure for social insurance programs will not impact financial position. Thus, the impact of changes in social insurance – and other programs – is not comprehensively captured in the financial statements of the period the changes are made. The Board has on-going projects on its agenda addressing both the reporting model and recognition and measurement, and the Board will consider the issues in due course.



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### *The Statement of Net Cost*

A101. The proposed standard does not affect the statement of net cost of social insurance entities and the governmentwide entity. Some argue that the change in the social insurance closed group measure or other net present value during the reporting period is an economic cost. The economic cost of social insurance programs has been debated by the Board over the years. Some current Board members are concerned that this cost is not highlighted in this compromise proposal. These members note the effect of changes in the closed group measure is not displayed on the statement of net cost.

A102. They note that SFFAC 5, *Elements*, defines expense as an outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the Government's net position during the reporting period.<sup>21</sup> SFFAC 5, *Elements*, defines liabilities as a present obligation of the Federal Government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.<sup>22</sup> A present obligation requires a past transaction or other event.<sup>23</sup> These members believe that there is an economic cost being incurred as workers participate in social insurance programs.

A103. Some members note that accrual accounting has a universal definition: expenses are recognized when incurred. They believe that only through accrual accounting can cost or financial position of an entity be measured, which is why generally accepted accounting principles primarily require accrual accounting.

A104. As is discussed above and in the *Preliminary Views* document, Board members, respondents to the *Preliminary Views* document, and, historically, all groups who considered the question have disagreed over the past transaction or event that creates a liability and expense for social insurance programs.

A105. Those FASAB members who are concerned that the economic cost of social insurance is not being highlighted reference the FASAB Objectives when attempting to decide what should be recognized as social insurance expense. These members note that FASAB expectations regarding objectives of federal financial reporting in general and social insurance in particular are most clearly set forth in SFFAC 1, *Objectives*. The FASAB's *Strategic Directions* report, issued November 2006, focused on the objectives in SFFAC 1, *Objectives*, and established Objective 2, "Operating Performance," and Objective 3, "Stewardship," as FASAB's most important focus. With respect to social insurance, these members note especially objectives 2A, 2B, and 3A regarding the need for information about costs:

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<sup>21</sup> SFFAC, par. 53.

<sup>22</sup> SFFAC, par. 39.

<sup>23</sup> SFFAC, par. 42.

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2A. The cost of providing specific programs and activities and the composition of, and change in, these costs.

2B. The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.

3A. Whether the government's financial position improved or deteriorated over the period.

A106. These three sub-objectives speak most clearly about financial statements showing costs associated with a specific period and the impact these costs have on an entity's financial position.

A107. Other FASAB Objectives speak about financial statements showing other elements of financial position. These members believe that SOSI and the new SCSIA will do a very good job of meeting SFFAC 1, *Objectives*, Objective 3B, "Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due." These statements will also contribute to meeting Objective 3C, "Whether government operations have contributed to the nation's current and future well being."

A108. In addition, information from the SOSI, if combined with other financial statement information, could help meet Objective 3A, which relates to changes in the Government's financial position. Moreover, the proposed SCSIA, which all members support, will help meet Objective 3A.

A109. However, these members note that the proposed standard can be criticized for failing to address Objective 2A and 2B, noted above, unless something is reported on the operating statement. They suggest adding a line item to the Statement of Net Cost to show the change in the social insurance commitment during the period in close proximity to other costs, an approach similar to the new line item that is proposed for the balance sheet.

A110. Other members disagree that the change in the social insurance commitment should be on the statement of net cost. They believe that cost should represent the goods and services provided during the period, and the change in social insurance, although meaningful, is not a good or service so provided, and should not be associated with such costs. They believe that displaying the change in the social insurance commitment on the statement of net cost would be misleading. They argue that the SOSI amounts are purporting to represent something entirely different from what is on the balance sheet and statement of net cost. They believe people expect customary elements on the operating statement, and that SOSI amounts are too uncertain for that purpose.

A111. They note that the Board made the SOSI a basic statement and proposes that the

## Appendix A: Basis for Conclusions

SCSIA be a basic statement, and that the SOSI and SCSIA are to be presented in close proximity to the balance sheet and operating statement. They believe that that approach is appropriate. For them, the change in the social insurance commitment during the reporting period should be presented apart from the costs of the period and clearly labeled as, for example, “social insurance exposures.” They conclude that associating the change with period costs is inappropriate because it does not represent the complete change in the Government’s financial condition, and that the fiscal sustainability reporting proposed in the *Projections* ED provides context and is more a measure of the Government’s financial condition.

A112. This proposed standard does not require that the change in the closed group measure be recognized as an operating cost of the Government on the statement of net cost and the statement of changes in net position. The Board decided to continue the SFAS 17 approach.

A113. The Board’s proposal is an attempt to secure all board members’ support for a position that meets FASAB reporting Objectives while still being sensitive to the objectives of the Primary View, the Alternative View, and points made by respondents and testifiers that were somewhat different from both Board positions. The Board is asking respondents to comment on the question of how and where to display the effect of the change in the social insurance commitment, be it the closed group measure or another measure, on the Government’s financial condition (see Question Q6).

### *The Statement of Social Insurance and the Statement of Changes in Social Insurance Amounts*

A114. Regarding the statement of social insurance, the Board has said that it believes the SOSI should be treated as a basic financial statement because it is essential to fair presentation and is important to achieve the objectives of federal financial reporting.<sup>24</sup> The Board is proposing a display of the closed and open group measures on the *CFR* SOSI in a summary section. The FY 2007 *CFR* provides this summary section for the first time, although SFFAS 17 does not require it. Again, the titles and amounts of these line items would match identical lines in the highlights section, the balance sheet, and the statement of changes in SOSI amounts. This summary section will provide present value information for all age cohorts, with sub-totals for the closed and open group measures.

A115. Under the proposal, the component entity’s SOSI would display the closed group and open group measures, as shown in the pro forma illustration at Attachment D, which is consistent with what is proposed for the *CFR* SOSI.

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<sup>24</sup> SFFAS 25, par. 26-30.

## Appendix A: Basis for Conclusions

A116. The Board is also proposing a new basic statement, the statement of changes in social insurance amounts. This Statement presents the changes during the reporting period for the closed group measure (Attachment E). The Board considered requiring such a Statement for both the closed group measure and the open group measure, but decided that two statements and two primary measures would be somewhat overwhelming and perhaps confusing. The line items/components of the SCSIA are consistent with the Social Security Trustees' Report (see, for example, the 2007 Trustees' Report, Table IV.B9, page 66). Thus, there are line items for:

- a. changes in the valuation period;
- b. interest on the obligation;
- c. changes in demographic, economic, and other assumptions;
- d. changes in law and policy,
- e. changes in methods, and
- f. other changes.

The format in Attachment E also includes beginning of the year and end of year present values, which would agree with the balances for the current year and immediate past year displayed in the SOSI for the closed group. This will illustrate the link between current and prior years.

### *Note Disclosure*

A117. The proposal also requires note disclosure of an accrued benefit obligation. The objective is to provide information for the many users who are interested in knowing what such an amount would be and in evaluating the obligation in this way. An accrued benefit obligation is a measure of the present value of future benefits scheduled to be paid to or on behalf of current participants based on past events (e.g., for Social Security and Medicare Hospital Insurance (Part A), work in covered employment; or, Medicare Supplementary Medical Insurance (Parts B and D), insurance coverage in effect) as of the **valuation date**. Because it is based on past events, the accrued benefit obligation applies only to **current participants** in the programs as of the valuation date.

A118. There are several acceptable methods for calculating an accrued benefit obligation.<sup>25</sup> For example, the Social Security Administration provides, through its Office of the Actuary, an accrued benefit obligation for Social Security in a periodically updated Actuarial Note.<sup>26</sup> The Actuary Note discusses two liability-number candidates: the accrued benefit obligation and the **maximum transition cost** ("MTC"). The accrued benefit obligation is a measure of the future benefit obligation based on past earnings and past work in covered employment as of the

<sup>25</sup> See <http://www.ssa.gov/OACT/NOTES/actnote.html>.

<sup>26</sup> Actuarial Note: Unfunded Obligation and Transition Cost for OASDI.

## Appendix A: Basis for Conclusions

valuation date. Only current participants are included.<sup>27</sup> Future payroll taxes to be paid by the current participants and benefits attributable to earnings and work in covered employment in the future are excluded. However, any income taxes to be paid by current participants on their future benefits under the current plan are subtracted. Assets in the form of Treasury securities held by the program at beginning of the projection period are not subtracted.

A119. The other measure in the Actuary Note is the MTC. The only difference between the accrued benefit obligation and the MTC is that assets held by the Social Security program are subtracted in calculating the MTC.

A120. The Board notes two other numbers used in pension accounting: the accumulated benefit obligation and the projected benefit obligation. The accumulated benefit obligation, for which the abbreviation “ABO” is frequently used, is the actuarial present value of benefits (whether vested or non-vested) attributed by the pension benefit formula to employee service rendered before a specified date and based on employee service and compensation prior to that date. The projected benefit obligation, for which the abbreviation “PBO” is frequently used, differs from the accumulated benefit obligation merely in that it includes assumptions about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.<sup>28</sup>

A121. Conceptually, there is some similarity between the SSA’s accrued benefit obligation and the PBO. SSA projects future wage levels via the “average wage index” and the PBO is measured using assumptions as to future compensation levels.

A122. Other approaches for calculating an accrued benefit obligation are acceptable. For example, the Primary View in the FASAB’s *Preliminary View: Accounting for Social Insurance, Revised*, provided methodology for calculating a liability amount for social insurance programs. Following that approach, the liability would be the present value of future expenditures for benefit payments to or on behalf of current participants, both those who have attained (1) fully insured status by completing sufficient work in covered employment as of the end of the reporting period and (2) retirement age or disability status; as well as current participants who have attained (1) fully insured status but (2) have not yet attained retirement age or disability status. The present value amount would include the future benefits attributed to past work completed in

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<sup>27</sup> SSA Actuarial Note 2006-1, Definitions, page 3.

<sup>28</sup> SFAS 87, *Employers’ Accounting for Pensions*, Glossary, “Accumulated Benefit Obligation.” Users of federal financial reports have asked whether a given measure of the **SOSI NPV** is like the ABO or the PBO. They understandably want to know how **SOSI NPV** relate to private sector pension accounting standards. Although care is needed when comparing pension accounting methods with methods used for the national SI program, it may be helpful to stipulate – since the question persists – that SSA’s **accrued benefit obligation** is more like the PBO than the ABO. Both the **accrued benefit obligation** and the PBO attempt to project future wage levels, albeit for different orders of magnitude.

## Appendix A: Basis for Conclusions

covered employment. Past work is work completed prior to the end of the reporting period. The present value amount would exclude any additional benefits attributable to future work in covered employment. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.<sup>29</sup> Also, SFFAS 5 provides a methodology for calculating pensions, disability, and post-employment healthcare and insurance liabilities. All of these approaches are acceptable. Finally, the Board proposes to require the entity to provide a description of the approach used.

A123. The accrued benefit obligation will give interested users a traditional frame of reference. The accrued benefit obligation is intended to provide a perspective on social insurance programs from the point of view of a deferred benefit or an insurance obligation for those users who value such information. It is equivalent to the measure that the Board members who held the Primary View believe should be recognized as a liability. The amount thus provided can be compared to the other measures and provide a full array of information. Finally, this number is not currently available in Federal financial reports.

### *Required Supplementary Information*

A124. The proposal would continue the RSI currently required by SFFAS 17 except for the sensitivity analysis. The RSI calls for graphs of cash flow over long-term projection periods sufficient to illustrate long-term sustainability. The requirement calls for projections of annual cash flow in nominal dollars and as percentages of taxable payroll and GDP. This is critical because the graphs show the timing of future cash flows, which present value point estimates cannot do, and thereby provide a future perspective. Projections of future flows together the SOSI's historical flows provide a robust picture of the program cash flows. In addition, the RSI call for the ratio of beneficiaries to workers, also known as the "dependency ratio."

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<sup>29</sup> The prior note is applicable here as well: A projection period for future participants would cover their working and retirement years. The entity would make an assumption about the length of this period. For example, the OASDI program uses a projection period of 75 years. A projection period for current participants (i.e., for the people actually participating in the program) would theoretically cover all of their working and retirement years, a projection period that could be greater than 75 years in a few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years usually would not be material, and a 75 year projection period would include virtually all the future contributions, tax income, and benefit payments for current as well as future participants.

## Appendix A: Basis for Conclusions

### Sensitivity Analysis

A125. The proposal would amend the sensitivity analysis. The Board notes that it is adopting a new approach to illustrating uncertainty from that in SFFAS 17. The objective of sensitivity analysis is to illustrate how much an estimate or projection would change if the assumptions, data, methodologies, or other inputs change. The Board believes the requirements in SFFAS 17 resulted in voluminous narrative and graphs but was somewhat daunting to use. The Board believes that preparer-developed sensitivity analysis will be more informative and concise and therefore communicate better with users.

A126. According to SFFAC 1, *Objectives*, financial information has certain qualities, including reliability. In SFFAC 1 the FASAB stated that

[R]eliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.<sup>30</sup>

A127. Another equally important characteristic of financial information is relevance. SFFAC 1 states the familiar principle that a characteristic of relevant information is its capacity to make a difference in users' assessment of and decisions about a problem, condition, or event.<sup>31</sup>

A128. Relevant information frequently involves estimates, which necessitate some tolerance of uncertainty. Uncertainty can be tolerated if it is clearly explained and illustrated in the entity's financial statements, and there are many ways to do this. Uncertainty can be discussed and illustrated in the notes to the financial statements, in supplemental information, or even in the measurement of the liability and expense.

A129. SFFAS 17 focused sensitivity analysis on the long-term projections. SFFAS 17 required all component entities except Unemployment Insurance to illustrate the sensitivity of projections and present values to changes in the most significant assumptions.<sup>32</sup> The result had been a daunting array of narrative, charts, and graphs.

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<sup>30</sup> SFFAC 1, par. 160

<sup>31</sup> SFFAC 1, par. 161

<sup>32</sup> See SFFAS 17, par. 27(4)(a).

## Appendix A: Basis for Conclusions

- 1  
2 A130. The objective of the proposed standard is to make the sensitivity analysis more  
3 concise and more meaningful. The focus of the analysis will now be on the basic  
4 financial statements; specifically, on the balance sheet, where the closed group  
5 measure will now be displayed; on the SOSI, where both the closed and open group  
6 measures will be displayed; and on the proposed SCSIA.  
7
- 8 A131. This proposal would eliminate much of the sensitivity analysis requirement in SFFAS  
9 17 and allow preparers to develop their own sensitivity analysis. The Board is  
10 proposing a very general approach for illustrating uncertainty. The Board anticipates  
11 that the preparers will streamline the presentation while at the same time making it  
12 more useful. Conciseness itself should make it more useful and less daunting.  
13
- 14 A132. Entities would decide what is appropriate based on trends, the utility of the  
15 information to the users and policy-makers, and the relative burden of producing it.  
16 The entities are encouraged to explore areas of analysis. This will afford flexibility  
17 and allow best practices to develop. Entities may continue to vary key assumptions,  
18 as required by SFFAS 17, or pursue other methods. For example, this standard  
19 encourages stochastic modeling. The Board believes that a graph like figure “VI.E2”  
20 from the Trustees’ Annual Report shown below is a promising method for illustrating  
21 uncertainty. The Board believes that a stochastic presentation of the ranges of  
22 possible outcomes with respect to the present value estimates in the basic financial  
23 statements will provide useful information for users to consider.  
24
- 25 A133. Each year the Social Security Trustees report on the financial condition of the  
26 system. The principal results from their report are generated by a **deterministic**  
27 **model** of the annual income and expenses of the system over the projection period.  
28 The Social Security Trustees carefully review and update assumptions used for  
29 projections on an annual basis. This helps ensure that they represent the Trustees’  
30 best estimate of future possibilities.  
31
- 32 A134. The Social Security Trustees illustrate uncertainty throughout their Annual Report.  
33 The results of their intermediate cost assumptions are contrasted in narratives,  
34 tables, and charts with estimates based on low- and high-cost assumptions. The  
35 latter vary all assumptions either low or high. This approach is characterized as  
36 “deterministic.”<sup>33</sup>  
37
- 38 A135. The Trustees also present sensitivity analysis. Key assumptions are varied from the  
39 intermediate cost assumptions to illustrate how changes therein affect the estimates.  
40
- 41 A136. In addition to this sensitivity analysis, starting in 2003 the Social Security Trustees’  
42 Report began to illustrate uncertainty via a stochastic model that attempts to capture

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<sup>33</sup> The 2008 Trustees’ Annual Report, p. 166.



## Appendix A: Basis for Conclusions

1 uncertainty by displaying ranges rather than point estimates.<sup>34</sup> The report of the  
2 1999 Technical Panel<sup>35</sup> included the following observations under the heading,  
3 “Illustrating Uncertainty”:  
4

5 The current system of presenting low- and high-cost alternatives to the intermediate  
6 assumptions is inadequate. The alternatives are useful in demonstrating the sensitivity of  
7 the forecast to the underlying parameters ... . However, without any model of the  
8 probabilities of the underlying parameters taking on the alternative values, there is no  
9 way to use the alternatives to form a distribution of possible outcomes. It is inadequate to  
10 show any forecast without an indication of the uncertainty that surrounds it. We follow  
11 previous panels in strongly recommending efforts toward stochastic modeling or similar  
12 techniques that are better able to capture the interrelationship among assumptions. We  
13 are not dogmatic in the recommendation, as we recognize that even stochastic modeling  
14 requires some set of assumptions about the variance in future outcomes—for example in  
15 fertility rates—that are hard to estimate. However, the assumptions are in some way  
16 embedded in current methods of projection in any case.  
17

18 Some modeling techniques allow for graphical presentations that are better at displaying  
19 the range of uncertainty. What we seek is a method of displaying to policy makers and  
20 the public just how uncertain is some average cost outcome or date of exhaustion of the  
21 Trust Funds, and what are the probabilities that events will be close to or far from that  
22 result. That the system might have a very high probability of being out of balance by 2 or  
23 more percent of taxable payroll, for instance, may be worth knowing regardless of  
24 whether it has attained actuarial balance under some set of intermediate assumptions.  
25

26 A137. Stochastic modeling represents a probability distribution of possible future outcomes  
27 centered on the Trustees’ intermediate assumptions. For example, the following  
28 figure (VI.E2) shows the probability distribution of the year-by-year Social Security  
29 cost rates (i.e., cost as a percentage of taxable payroll). The range of the cost rates  
30 widens as the projections move further into the future reflecting increasing  
31 uncertainty. The lines in the figure display different confidence intervals expected for  
32 future annual cost rates. For each given year, these lines represent the percentile  
33 distribution of cost rates based on all stochastic simulations for that year. The two  
34 extreme lines indicate, for example, the range within which future annual costs rates,  
35 as a percentage of taxable payroll, are expected to occur 95 percent of the time. In  
36 other words, actual future annual cost rates in a given year would be expected to  
37 exceed the upper bound only 2.5 percent of the time or to fall below the lower bound  
38 2.5 percent of the time. Other lines in the figure display additional confidence  
39 intervals (80-percent, 60-percent, 40-percent, and 20-percent) around future annual  
40 cost rates. The 50-percent confidence level for each year indicates the annual cost  
41 rates which are projected by this model to fall exactly in the middle of possible  
42 outcomes for that year. The 50 percent confidence level aligns closely with the  
43 Trustees’ intermediate cost assumptions.<sup>36</sup>  
44

<sup>34</sup> 2008 Trustees’ Annual Report, pp. 166-171.

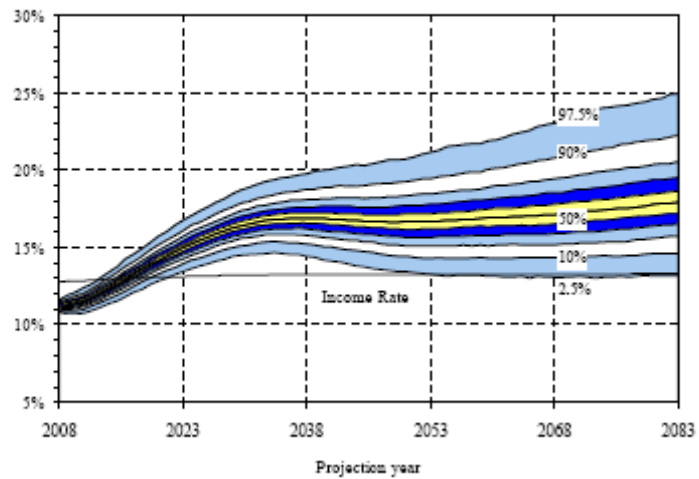
<sup>35</sup> Available at [http://www.ssab.gov/Rpt99\\_III.html#pgflid-1005309](http://www.ssab.gov/Rpt99_III.html#pgflid-1005309).

<sup>36</sup> 2008 Social Security Trustees’ Report, p. 168-70.

## Appendix A: Basis for Conclusions

1

Figure VLE2.—Annual Cost Rates



2

## Appendix B: Highlights Table

## Appendix B: Highlights Table

Highlights Statement			
	billions of dollars		
	2005	2006	2007
Costs			
Net costs	(\$2,945)	(\$2,890)	(\$2,903)
Total taxes and other revenues	2,186	2,441	2,627
Net operating cost	(760)	(450)	(276)
Net Position			
Assets	\$1,448	\$1,497	\$1,581
Less: Liabilities, comprising			
Federal debt held by the public	4,624	4,868	5,078
Federal employee & veterans benefits	4,492	4,679	4,769
Other liabilities	799	866	940
Total liabilities	9,915	10,413	10,787
Net position (assets net of liabilities)	(\$8,467)	(\$8,916)	(\$9,206)
Social Insurance Commitments			
Net present value (NPV) of future cash flows for current participants (closed group), end of fiscal year	(\$40,038)	(\$44,147)	(\$45,062)
NPV of future cash flow for current participants (closed group), beginning of fiscal year	(37,278)	(\$40,038)	(\$44,147)
Change in NPV	(2,760)	(4,109)	(915)
Budget Results			
Unified Budget Deficit	(\$319)	(\$248)	(\$163)
Fiscal Gap			
Fiscal Gap as of January 1	\$ XX,XXX	\$ XX,XXX	\$ 41,900

## Appendix C: Pro Forma Balance Sheet

## Appendix C: Pro Forma Balance Sheet

<b>United States Government</b> <b>Pro Forma Balance Sheet</b> <b>as of September 30, 2007, and September 30, 2006</b> (billions)			2007	2006
<b>Assets:</b>				
Cash and other monetary assets (Note 2)			\$128	\$98
Accounts and taxes receivable, net (Note 3)			88	69
Loans receivable, net (Note 4)			2,319	221
	***		***	***
Total assets			<u>\$ 1,581</u>	<u>\$ 1,497</u>
Stewardship property, plant, and equipment				
Stewardship Land (Note 24) and Heritage Assets (Note 25)				
<b>Liabilities:</b>				
Accounts payable (Note 9)			\$ 66	\$ 58
Federal debt securities held by the public and accrued interest			5,078	4,868
Federal employee and veteran benefits payable (Note 11)			4,769	4,679
Environmental and disposal liabilities (Note 12)			342	305
Benefits due and payable (Note 13)			134	129
Insurance program liabilities (Note 14)			71	73
Loan guarantee liabilities (Note 4)			69	66
Other liabilities (Note 15)			258	234
Total liabilities			<u>10,787</u>	<u>10,413</u>
Contingencies (Note 18) and Commitments (Note 19)				
Net position:				
Earmarked funds (Note 20)			614	419
Non-earmarked funds			(9,820)	(9,336)
Total net position			<u>(9,206)</u>	<u>(8,916)</u>
Total liabilities and net position			<u>\$1,581</u>	<u>\$1,497</u>
<b>Social Insurance Commitments:</b>				
Net present value of future cash flow for current participants			<u>(\$45,062)</u>	<u>(\$44,147)</u>

## Appendix D: Pro Forma Statement of Social Insurance

### Appendix D: Pro Forma Statement of Social Insurance, Part I, Governmentwide SOSI

United States Government					
Statements of Social Insurance					
*****UNAUDITED*****					
(In billions of dollars)	2007	2006	2005	2004	2003
<b>Federal Old-Age, Survivors and Disability Insurance (Social Security):</b>					
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained age 62	\$ 477	\$ 533	\$ 464	\$ 411	\$ 359
Participants ages 15-61	17,515	16,568	15,290	14,388	13,576
Future participants (under age 15 and births during period)	16,121	15,006	13,696	12,900	12,213
All current and future participants	34,113	32,107	29,450	27,699	26,148
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained age 62	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Participants ages 15-61	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Future participants (under age 15 and births during period)	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
All current and future participants	(40,876)	(38,557)	(35,153)	(32,929)	(31,075)
<i>Net present value (NPV) of future expenditures less future revenue (open group measure)</i>	\$ (6,763)	\$ (6,450)	\$ (5,703)	\$ (5,230)	\$ (4,927)

## Appendix D: Pro Forma Statement of Social Insurance

<b>Federal Hospital Insurance (Medicare Part A):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 178	\$ 192	\$ 162	\$ 148	\$ 128
Participants who have not attained eligibility age	5,975	5,685	5,064	4,820	4,510
Future participants	4,870	4,767	4,209	4,009	3,773
All current and future participants	11,023	10,644	9,435	8,977	8,411
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(2,558)	(2,397)	(2,179)	(2,168)	(1,897)
Participants who have not attained eligibility age	(15,639)	(15,633)	(12,668)	(12,054)	(10,028)
Future participants	(5,118)	(3,904)	(3,417)	(3,246)	(2,653)
All current and future participants	(23,315)	(21,934)	(18,264)	(17,468)	(14,578)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<u>\$(12,292)</u>	<u>\$(11,290)</u>	<u>\$ (8,829)</u>	<u>\$ (8,491)</u>	<u>\$ (6,167)</u>

### Illustrative CFR SOSI

<b>Federal Hospital Insurance (Medicare Part B):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 433	\$ 409	\$ 363	\$ 332	\$ 283
Participants who have not attained eligibility age	3,184	3,167	2,900	2,665	2,148
Future participants	1,172	906	924	891	688
All current and future participants	4,789	4,482	4,187	3,888	3,119
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(1,834)	(1,773)	(1,622)	(1,475)	(1,306)
Participants who have not attained eligibility age	(12,130)	(12,433)	(11,541)	(10,577)	(8,845)
Future participants	(4,257)	(3,407)	(3,408)	(3,277)	(2,622)
All current and future participants	(18,221)	(17,613)	(16,571)	(15,329)	(12,773)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<u>\$(13,432)</u>	<u>\$(13,131)</u>	<u>\$ (12,384)</u>	<u>\$ (11,441)</u>	<u>\$ (9,654)</u>

## Appendix D: Pro Forma Statement of Social Insurance

<b>Federal Hospital Insurance (Medicare Part D):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 167	\$ 173	\$ 185	\$ 176	
Participants who have not attained eligibility age	1,627	1,700	1,790	1,857	
Future participants	611	492	572	618	
All current and future participants	2,405	2,365	2,547	2,651	0
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(794)	(792)	(880)	(773)	
Participants who have not attained eligibility age	(7,273)	(7,338)	(7,913)	(7,566)	
Future participants	(2,699)	(2,121)	(2,440)	(2,431)	
All current and future participants	\$(10,766)	\$(10,251)	\$(11,233)	\$(10,770)	\$ -
<i>NPV of future expenditures less future revenue (open group measure)</i>	<i>\$ (8,361)</i>	<i>\$ (7,886)</i>	<i>\$ (8,686)</i>	<i>\$ (8,119)</i>	<i>\$ -</i>
<b>Railroad Retirement</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Contributions and Earmarked Taxes from:</i>					
Participants who have attained eligibility age	\$ 5	\$ 5	\$ 4	\$ 4	\$ 4
Participants who have not attained eligibility age	41	40	37	37	40
Future participants	54	56	41	39	41
All current and future participants	100	101	82	80	85
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age	(93)	(92)	(84)	(81)	(80)
Participants who have not attained eligibility age	(86)	(84)	(73)	(72)	(73)
Future participants	(26)	(25)	(16)	(14)	(14)
All current and future participants	(205)	(201)	(173)	(167)	(167)
<i>NPV of future expenditures less future revenue (open group measure)</i>	<i>\$ (105)</i>	<i>\$ (100)</i>	<i>\$ (91)</i>	<i>\$ (87)</i>	<i>\$ (82)</i>
<b>Black Lung (Part C):</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>NPV of future revenue over future expenditures (open group measure)</i>	<i>\$ 5</i>	<i>\$ 4</i>	<i>\$ 5</i>	<i>\$ 4</i>	<i>\$ 4</i>
<b>Total NPV of future expenditures in excess of future revenue (open group measure)</b>	<b>\$(40,948)</b>	<b>\$(38,853)</b>	<b>\$(35,688)</b>	<b>\$(33,364)</b>	<b>\$(20,826)</b>

## Appendix D: Pro Forma Statement of Social Insurance

<b>Social Insurance Summary</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<i>Participants who have attained eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes)	\$ 1,260	\$ 1,312	\$ 1,178	\$ 1,071	\$ 774
Expenditures for scheduled future benefits	(11,608)	(10,920)	(10,160)	(9,430)	(7,945)
Present value of future expenditures in excess of future revenue	(10,348)	(9,608)	(8,982)	(8,359)	(7,171)
<i>Participants who have attained age 15 up to eligibility age:</i>					
Revenue (e.g., Contributions and earmarked taxes)	28,342	27,160	25,081	23,767	20,274
Expenditures for scheduled future benefits	(63,056)	(61,699)	(56,137)	(52,687)	(39,961)
Present value of future expenditures in excess of future revenue	(34,714)	(34,539)	(31,056)	(28,920)	(19,687)
<b>Closed group -- Total present value of future expenditures in excess of future revenue for current participants</b>	<b>(45,062)</b>	<b>(44,147)</b>	<b>(40,038)</b>	<b>(37,279)</b>	<b>(26,858)</b>
<i>Future participants (under age 15 and births during period):</i>					
Revenue (e.g., Contributions and earmarked taxes)	22,828	21,227	19,442	18,457	16,715
Expenditures for scheduled future benefits	(18,714)	(15,933)	(15,092)	(14,542)	(10,683)
Present value of future expenditures in excess of future revenue	4,114	5,294	4,350	3,915	6,032
<b>Open group -- Total present value of future expenditures in excess of future revenue for current and future participants</b>	<b>\$ (40,948)</b>	<b>\$ (38,853)</b>	<b>\$ (35,688)</b>	<b>\$(33,364)</b>	<b>\$(20,826)</b>



## Appendix D: Pro Forma Statement of Social Insurance

Illustrative SOSI for Component Entity

<b>Social Security Administration</b>					
<b>Pro Forma Statements of Social Insurance</b>					
*****UNAUDITED*****					
(In billions of dollars)	2007	2006	2005	2004	2003
<b>Federal Old-Age, Survivors and Disability Insurance (Social Security):</b>					
<i>Participants who have attained eligibility age:</i>					
Contributions and earmarked taxes	\$ 477	\$ 533	\$ 464	\$ 411	\$ 359
Expenditures for scheduled future benefits	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Present value of future expenditures in excess of future revenue	(5,852)	(5,333)	(4,931)	(4,522)	(4,303)
<i>Participants who have attained age 15 up to eligibility age:</i>					
Contributions and earmarked taxes	17,515	16,568	15,290	14,388	13,576
Expenditures for scheduled future benefits	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Present value of future expenditures in excess of future revenue	(10,413)	(9,643)	(8,652)	(8,030)	(7,439)
<b>Net present value of future expenditures in excess of future revenue for current participants (closed group measure)</b>	<b>(16,265)</b>	<b>(14,976)</b>	<b>(13,583)</b>	<b>(12,552)</b>	<b>(11,742)</b>
<b>Plus: Treasury securities and assets held by the programs*</b>	<b>2,048</b>	<b>1,859</b>	<b>1,687</b>	<b>1,531</b>	<b>1,378</b>
<b>Closed group unfunded obligation</b>	<b>(\$14,217)</b>	<b>(\$13,117)</b>	<b>(\$11,896)</b>	<b>(\$11,021)</b>	<b>(\$10,364)</b>
<i>Future participants (under age 15 and births during period):</i>					
Contributions and earmarked taxes	\$ 16,121	\$ 15,006	\$ 13,696	\$ 12,900	\$ 12,213
Expenditures for scheduled future benefits	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
Present value of future expenditures in excess of future revenue	9,502	8,526	7,880	7,322	6,815
<b>Net present value of future expenditures in excess of future revenue for current and future participants (open group measure)</b>	<b>(6,763)</b>	<b>(6,450)</b>	<b>(5,703)</b>	<b>(5,230)</b>	<b>(4,927)</b>
<b>Plus: Treasury securities and assets held by the programs</b>	<b>2,048</b>	<b>1,859</b>	<b>1,687</b>	<b>1,531</b>	<b>1,378</b>
<b>Open group unfunded obligation</b>	<b>(\$4,715)</b>	<b>(\$4,591)</b>	<b>(\$4,016)</b>	<b>(\$3,699)</b>	<b>(\$3,549)</b>

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

### Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

The following table contains a pro forma illustration of a statement of changes in social insurance amounts.

Illustrative Statement of Changes in Social Insurance Amounts  
Closed Group Measure  
For the Year Ended September 30, 2007  
(in billions of dollars)

	Social Insurance, Closed Group Measure				
	Social Security	Medicare HI	Medicare SMI	Other (e.g., Railroad Retirement)	Total
Closed group measure, beginning of year	\$(14,976)	\$(12,153)	\$(16,887)	\$ (131)	\$(44,147)
Changes in demographic data and assumptions <sup>1</sup>	XXX	XXX	XXX	XXX	XXX
Changes in economic data and assumptions <sup>2</sup>	XXX	XXX	XXX	XXX	XXX
Legislative changes <sup>3</sup>	XXX	XXX	XXX	XXX	XXX
Methodological changes <sup>4</sup>	XXX	XXX	XXX	XXX	XXX
Changes in Medicare healthcare trend assumptions	XXX	XXX	XXX	XXX	XXX
Other changes	XXX	XXX	XXX	XXX	XXX
Net change in closed group measure	(1,289)	109	267	(2)	(915)
Closed group measure, end of year	\$(16,265)	\$(12,044)	\$(16,620)	\$(133)	\$(45,062)

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

1. *[The following examples are adapted from the Social Security Trustees' Report. The explanations of the changes obviously will depend on the social insurance program in question.]* Changes in the demographic starting values and the transition to ultimate assumptions and changes in the ultimate mortality and legal immigration assumptions have largely offsetting effects. They combine to have little net effect on the closed group measure. Final mortality data for 2004 result in slightly lower starting death rates and faster near-term declines in death rates than in last year's report. Also, slightly faster rates of decline in death rates are assumed ultimately for ages 15-64 in this year's report. These changes in ultimate rates are based on the continuing strong declines in mortality recently experienced by men at these ages and a belief that the lower rates of decline experienced by women since 1982 will not continue in the future. All of the mortality changes result in a decrease (worsening) in the closed group measure of about \$106 billion. Partially offsetting the effect of the mortality changes is an increase in the assumed ultimate level of net legal immigration in this year's report. Based on data since 2000, the ultimate level of net legal immigration is assumed to increase from 600,000 to 750,000 persons per year. This change results in an increase (improvement) in the closed group measure of about \$103 billion. Other demographic changes are made to the starting values of birth rates and numbers of people in the Social Security area. Birth rates for the first 25 years of the projection period are higher than in last year's report, based on preliminary birth data for 2005 and 2006 which indicate higher than expected numbers of births. These changes in birth rates and the starting population result in an increase (improvement) in the closed group measure of about \$102 billion.
2. Ultimate economic assumptions are unchanged from last year's report. Changes in starting values for the economic assumptions and in the near-term transition to the ultimate economic assumptions have a negligible effect on the social insurance closed group measure.
3. There were no legislative changes since the last report that are projected to have a significant effect on the long-range OASDI actuarial balance.
4. Several methodological improvements and updates of program-specific data are included in the 2007 measures. These changes to programmatic data and methods result in a combined increase (improvement) in the closed group measure of about \$171 billion. The most significant of these changes is a major revision in the methods used for projecting the other-immigrant (other than legal permanent resident) population. In previous reports, the other-immigrant population was projected using assumed annual numbers of net other immigrants with a static age-sex distribution. For this year's report, the annual numbers of net other immigrants are projected by explicitly modeling other immigrants and other emigrants separately. Under this approach, a large number of other immigrants is assumed to enter the Social Security area at relatively young working ages, with the total annual number of other immigrants entering the area assumed to be about 1.5 million. Most of these immigrants are assumed to either: (1) leave the

## Appendix E: Pro Forma Statement of Changes in Social Insurance Amounts

Social Security area (i.e., to depart from the area without having attained the legal status or work credits needed to become eligible for retired-worker benefits); or (2) attain legal permanent resident (LPR) status after several years of being in the other-immigrant population. Thus, this year's report results in a much larger other-immigrant population projected at working ages and a smaller number remaining in the Social Security area into old age. This change, along with the additional births due to the larger other-immigrant population at younger ages, results in a substantial increase in the number of working-age individuals contributing payroll taxes, but a relatively smaller increase in the number of retirement-age individuals receiving benefits in the latter half of the long-range period. This revision results in an increase (improvement) in the closed group measure of about \$163 billion. Another area of methodological improvement is related to the projection of average benefit levels for workers who will become eligible in the future. The historical sample of new beneficiaries, which serves as the basis for the projection of average benefit levels, was updated from a 2003 sample to a 2004 sample. Also, additional records of beneficiaries who began receiving benefits after the year for which they were first found to be entitled are now included in the sample of newly entitled retired-worker beneficiaries. These changes in projecting average benefits, along with several other smaller changes, result in an increase (improvement) in the closed group measure of about \$101 billion.

The combined effects of changes made in data, assumptions, and methods for this report more than offset the decrease in the OASDI long-range actuarial balance due to the new valuation period. This effect is indicated by the total \$140 billion increase in the closed group measure, which, after rounding, changes the closed group measure from \$XX<sub>1</sub> trillion in last year's report to \$XX<sub>2</sub> trillion in this report.

### Appendix F: Glossary

#### Eligibility under Social Security

Eligibility for benefits under the Social Security program requires some minimal level of work in covered employment. This requirement is established by a worker's accumulation of quarters of coverage (QCs). A worker must be fully insured to be eligible for a primary retirement benefit, and for his or her spouse or children to be eligible for auxiliary benefits. A deceased worker must have been either currently insured or fully insured at the time of death for his or her children (and their mother or father) to be eligible for benefits. If there are no eligible surviving children, the deceased worker must have been fully insured at the time of death for his or her surviving spouse to be eligible.

#### Fiscal Gap

The fiscal gap is the change in spending and/or revenue that would be necessary to maintain public debt at or below a target percentage of GDP. The fiscal gap is the net present value of projected spending minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at the target level for the stated projection period. The fiscal gap may be expressed as: (a) a summary amount in present value dollars, (b) a share of the present value of the GDP for the projection period, and/or (c) a share of the present value of projected receipts or projected spending.

#### Fiscal Sustainability

The terms "sustainability" or "sustainable solvency" are used frequently with respect to social insurance programs. The dictionary definition of "sustain" that is closest to the financial accounting usage is "to keep up;" and "solvent" means to be able to pay all legal debts. The Government Accountability Office has defined "solvency" and "sustainable solvency" for Social Security as essentially being able to pay full benefits as they come due, permanently.

#### Fiscal Sustainability Reporting

In federal financial reporting, "Fiscal Sustainability Reporting" is the short term for "Comprehensive Long-Term Fiscal Projections and Accompanying Graphics and Narrative in the Financial Report of the U.S. Government."

### Fully Insured

“Fully insured” status means that a social insurance participant is eligible for benefits. Social insurance benefits include pensions and health care for retirees and the disabled. For example, Social Security and Medicare participants become permanently fully insured when they attain at 40 quarters of work in covered employment (QC). Social Security and Medicare participants may be fully insured without being permanently fully insured. This is important with respect to disability benefits, which include subsistence payments and medical care. Disability benefits may be needed well before the participants attained retirement age. A participant who receives disability benefits for 24 consecutive months is eligible for Medicare and, when if he or she continues receiving disability benefits until attaining retirement age, he or she is converted to Social Security pension benefits. To be fully insured, participants generally need a minimum of 6 QC. Once a worker has accumulated 40 QCs, he or she remains permanently fully insured, that is, no further QCs are required.<sup>37</sup>

The table below illustrates the numbers of QC needed to qualify for disability benefits:

Age	QCs Needed
24 and younger	6
25	8
26	10
27	12
28	14
29	16
30	18
31	20
32	22
33	24
34	26
35	28
36	30
37	32
38	34
39	36
40	38
41	40
42 and over	40

### Intergenerational Equity

Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain Federal responsibilities. It is a concept involving

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<sup>37</sup> 2003 OASDI Trustees' Report, page 111.

## Appendix F: Glossary

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relative contributions of current and future citizens. This concept focuses on fiscal obligations and responsibilities being accumulated by the current generation, however one defines it, that are passed on to future generations.

### Maximum transition cost

As defined by the Office of the Actuary, Social Security Administration, this measure represents the cost of meeting the **accrued benefit obligations** (see above) 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 maximum transition cost 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. For Social Security, 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.

### Present value

Present value represents the amount of money that if invested today would grow to a specified amount in the future. Present value is an adjusted amount that takes the “time value of money” into consideration. The “time value of money” is illustrated by a question such as: “At ten percent annual interest, how much do I need to put into the bank to have \$100 one year from today?” Clearly, the amount you would need today would be less than \$100.

### Projections

A projection is the calculation of future data based upon the application of trends to present data. Projections of deficits, or surpluses, and debt are a central feature of Fiscal Sustainability Reporting. Projections are not forecasts or predictions; they are designed to depict results that may occur under various conditions—for example, what if current policy without change regarding Federal Government public services and taxation are continued in the future? Projections are useful in order to display alternative future scenarios, but it is important to clearly explain the nature of the information being presented.

### Sensitivity Analysis

An analysis of the sensitivity of the program’s closed group measure under reasonable, alternative scenarios that are different from expected experience. When the data used in setting assumptions is particularly sensitive to the assumptions, greater sensitivity testing is indicated.

### Stochastic Model

The Social Security Trustees’ Annual Report (“Trustees’ Report”) explains that its primary analysis utilizes estimates of the financial status of Social Security using a “deterministic” model. For Social Security’s deterministic model, certain assumptions are made regarding

1 levels of fertility, changes in mortality, legal and other immigration levels, legal and other  
2 emigration levels, the Consumer Price Index, average real wages, unemployment rates, trust  
3 fund real yield rates, and disability incidence and recovery rates. Each of these variables will  
4 reach an assumed ultimate value at a specific point during the long-range period and will  
5 maintain that value throughout the remainder of the period.  
6

7 However, the Trustees' Report also provides supplementary analysis using stochastic  
8 modeling. In contrast to deterministic models, stochastic modeling involves the results of  
9 many independent simulations. The Trustees' Report uses 5,000 each of which is  
10 determined by allowing the variables to vary throughout the long-range period. The  
11 fluctuation in each variable is projected by using standard time-series modeling, a method  
12 designed to help make inferences based on historical data. The Trustees' Report explains  
13 that, generally, each variable is modeled by an equation that captures a relationship between  
14 current and prior years' values of the variable and introduces year-by-year random variation,  
15 as reflected in the historical period. For some variables, the equations additionally reflect  
16 relationships with other variables. Parameters for the equations are estimated using  
17 historical data for periods between 20 years and 110 years depending on the nature and  
18 quality of data available. Each time-series equation is designed such that, in the absence of  
19 random variation, the value of the variable would equal the value assumed under Social  
20 Security's intermediate set of assumptions.  
21

22 For each simulation of the model, the values are determined for most of the variables via  
23 Monte Carlo techniques to randomly assign the year-by-year variations. Each simulation  
24 produces an estimate of the financial status of the combined Social Security program.  
25

26 The Trustees' Report urges caution when interpreting the results from stochastic simulations,  
27 which have inherent limitations. The Trustees' Report explains that the results are very  
28 sensitive to equation specifications, degrees of interdependence among variables, and the  
29 historical periods used for the estimates. For some variables, using the variations exhibited in  
30 a relatively recent historical period may not provide a realistic representation of the potential  
31 variation for the future. In addition, results would differ if random variations had been applied  
32 to additional variables. Furthermore, additional variability could result from incorporating  
33 statistical approaches that would more fully model change in the long-range central  
34 tendencies of the variables. The historical period available for most variables is relatively  
35 homogeneous and does not reflect many substantial shifts. The time-series modeling reflects  
36 what occurred in the historical period. As a result, the variation indicated in any given result  
37 should be viewed as the minimum plausible variation for the future. Substantial shifts, as  
38 predicted by many experts and as seen in prior centuries, are not fully reflected in the current  
39 model.<sup>38</sup>  
40

### 41 **Valuation date**

42  
43 Beginning of the projection period or January 1 of the starting projection year. This date  
44 defines the point in time for determining present values.  
45

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<sup>38</sup> 2008 Trustees' Annual Report, pp. 166-7.



### Appendix G: List of Abbreviations

ANPV	Actuarial net present value
APB	Accounting Principles Board
CFS	Consolidated financial statements
COLA	Cost of living adjustment
CPI	Consumer Price Index
DI	Disability Insurance (Social Security)
DOL	U.S. Department of Labor
ED	Exposure draft
ESAA	Employment Security Administration Account
EUCA	Extended Unemployment Compensation Account
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FECA	Federal Employees Compensation Account
FUA	Federal Unemployment Account
FUTA	Federal Unemployment Tax Act
GAO	Government Accountability Office
GDP	Gross Domestic Product
IBNR	Incurred but not reported
Medicare HI	Hospital Insurance (Medicare)
Medicare SMI	Supplementary Medical Insurance (Medicare)
OASDI	Old-Age, Survivors, and Disability Insurance (Social Security)
OASI	Old-Age and Survivors Insurance (Social Security)
OMB	Office of Management and Budget
PV	Preliminary Views
RSI	Required supplementary information
SCNP	Statement of Changes in Net Position
SFAS	Statements of Financial Accounting Standards
SFFAC	Statements of Federal Financial Accounting Concepts
SFFAS	Statements of Federal Financial Accounting Standards
SNC	Statement of Net Change
SCSIA	Statement of Changes in Social Insurance Amounts
SOSI	Statement of Social Insurance
SSA	Social Security Administration
UI	Unemployment Insurance
UTF	Unemployment Trust Fund

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**Federal Accounting Standards Advisory Board**

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Date: October 22, 2008

To: Members of the Board

From: Wendy Payne, Executive Director

Subject: **Ballot for Exposure Draft, Accounting for Social Insurance, Revised**

The following is a ballot for the Exposure Draft on the standard, *Accounting for Social Insurance, Revised*. Please enter your name in the space provided below and indicate your approval or disapproval.

If possible, please submit the ballot to us at the October 2008 FASAB meeting. If for some reason doing so is not convenient, please fax it to us subsequently at 202 512-7366. If you wish to submit your ballot via e-mail, please e-mail to me at [paynew@fasab.gov](mailto:paynew@fasab.gov).

Ballots are “officially” due by November 5, which is 10 working days after October 22. If you wish to express an alternative view, please notify staff immediately and provide your alternative view as soon as possible but no later than November 10. **When staff receives six affirmative votes, we will publish the exposure draft unless a member has notified us that he or she is preparing an alternative view.**

Board Member: \_\_\_\_\_ Date \_\_\_\_\_

\_\_\_\_\_ I approve the subject Exposure Draft

\_\_\_\_\_ I do not approve the subject Exposure Draft