



Federal Accounting Standards Advisory Board

June 7, 2005

TO: Members of FASAB
FROM: Richard Fontenrose, Assistant Director
THROUGH: Wendy Comes, Executive Director
SUBJECT: Social Insurance – Tab C

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

For the June FASAB meeting the staff is presenting revised paragraphs on eligibility intended to reflect the Board's position regarding eligibility and achieving eligibility developed at the May FASAB meeting.

The staff also explains in a second section of this memorandum why "attaining age 62" was rejected as a condition for eligibility. At the May FASAB meeting a member requested a discussion of the reasons for rejecting the possibility that attaining age 62 was a necessary condition for liability determination, and that the Board's analysis of the obligating event include an explanation of why some alternatives were rejected.

A third section of this memorandum contains a project plan for the Social Insurance Liability Project for the next several FASAB meetings – August, October, 2005, and January 2006.

Finally, a fourth section contains a pro forma statement of social insurance (SOSI) that illustrates what the SOSI might look like if a line item(s) was added linking it to a balance sheet accrued liability and providing other information.

1. Social Insurance Eligibility Characteristic

For the past several meetings the staff has been drafting paragraphs intended to capture the fundamental basis for concluding that Social Security and Medicare and other social insurance program characteristics cause the liability definition to be met before the due and payable event. Although it has considered many program characteristics, the Board is now focusing on eligibility and achieving eligibility as the key concept. The following paragraphs are intended to reflect the Board's position and represent a central concept to be conveyed in an eventual basis for conclusions for a social insurance standard.

The Board has concluded that eligibility is the key concept for a social insurance liability. Eligibility requires conditions to be met. Current law provides the conditions that qualify the participants to receive a specific benefit for a specific period of time. Benefits begin within a discernable range of dates and end upon occurrence of a specified event. The specificity of the law with respect to qualification for benefits, timing and amount of benefit payments, and provision of recourse if benefits are unlawfully withheld influenced the determination of what past obligating event creates a present obligation to make a future sacrifice consistent with the liability definition.

Current law links eligibility to participants' work in covered employment. The wages earned in covered employment and other factors (for example, indexing of wages for inflation) determine their future benefits when other conditions are met. This relationship of work in covered employment to future benefits means that a portion of future benefits are attributable to events occurring before or during the period being reported on. This relationship between future benefit payments and past events suggests that a present obligation to make a future sacrifice arises as certain past events occur and that conditions determining eligibility are met over time.

The Board evaluated the steps leading to being eligible to receive benefit payments and determined that the past event that creates a present obligation for Social Security and Medicare Hospital Insurance is work in covered employment combined with attaining fully insured status upon accumulating 40 quarters of work in covered employment. Further, the Board decided that the expense associated with future benefit payments also should be recognized when events creating the obligations occur.

The staff is also proposing that the basis for conclusions explain that the context in which the Social Security and Medicare Hospital Insurance programs operate is an important consideration, including certain program characteristics that are important to many observers. These characteristics include the "*permanence of funding*" and *direct communication* of benefit information. For example, although permanent funding is not required for a liability to exist, some believe the permanence of funding gives weight to the notion that an obligation exists, especially when the participants are providing that funding. Current law not only provides all the means to determine the entitlement, amount and timing of benefits but also provides a perpetual (but not unlimited) source of funding through the combination of the trust fund and payroll taxes. With respect to direct communication of benefit information, the basis for conclusions will note that it is reasonable to expect participants to make long-term savings and investment plans based on what they are told about their scheduled benefits.

2. Why the 40 Quarters Alternative Is Preferred

At the May FASAB meeting Mr. Patton requested a discussion in the next iteration of the staff's working memorandum of why "attaining age 62" was rejected as a condition for eligibility. He noted that the votes regarding the obligating event showed there was support for other obligating events than 40 quarters or work in covered employment (QC). He requested that the Board's analysis of obligating event alternatives explain why some were rejected.

The discussion of the rationale for choosing a past obligating event should begin with the notion that the social insurance liability will be consistent with the new FASAB liability definition. Ms. Wardlow's February 17, 2005 memorandum, paragraph L7, presented two

liability characteristics. First, the federal entity has a present obligation, including especially a past obligating event. Second, “under existing conditions, the federal entity is required to settle the obligation at a specified or determinable date, when a specific event occurs, or on demand.”

The Social Security and Medicare Hospital Insurance (HI) require 40 QC to qualify for benefits. (Eligibility with fewer than 40 quarters is possible in exceptional cases, e.g., disability and survivors.) After meeting the 40 QC condition, no additional conditions are required to be eligible to receive a payment or hospital benefits that are due at a specified time (attainment of the designated age). At 62 years of age (or 65 for Medicare) a participant with 40 QC will receive benefits without further payroll taxes. Although Medicare participants are eligible to purchase Supplemental Medical Insurance (SMI) after 40 QC, the SMI is similar to other insurance in that the policy holder is required to pay premiums, albeit heavily subsidized ones.

A majority of the Board concluded that the obligating event for Social Security and Medicare HI occurs when participants attain 40 QC. The Board tentatively concluded that the obligating event for SMI occurs when participants decide to purchase the insurance.

The first section of this memorandum (“**Social Insurance Eligibility Characteristic**”) provides the essential basis for the conclusion that obligating event for Social Security and Medicare HI occurs when participants attain 40 QC. In addition, staff notes that when participants attain 40 QC: (1) any remaining unmet conditions necessary for a benefit payment are beyond the control of the Government under current law, and (2) the likelihood that such conditions will remain unmet is remote. Conditions beyond the control of the Government include the passage of time, the aging of fully insured individuals, and continued work in covered employment. Each of these conditions is equally beyond the control of the entity especially when viewed for the population of participants instead of for individuals.

Ms. Wardlow’s December memorandum noted that FASB Statement 116, *Accounting for Contributions Received and Contributions Made*, (Issue Date 6/93) defines a conditional promise to give as one that depends “on the occurrence of a specified future and uncertain event to bind the promisor” (par. 22). Statement 116 states that such promises should be recognized when the conditions are substantially met (i.e., the promise becomes unconditional). Ms. Wardlow noted that Statement 116 also indicates “a conditional promise to give is considered unconditional if the possibility that the condition will not be met is remote” (par. 22). As an example, the FASB states that the possibility that a donee would fail to provide a required annual report to receive subsequent annual payments on a multiyear promise to give would be a remote condition. It would not preclude a liability encompassing amounts beyond the current year.

At that time Ms. Wardlow stated that the FASAB may wish to consider whether there is a parallel concept for multiyear programs that have certain eligibility requirements beyond those initially required. For some of those requirements, the possibility that they would not be met might be remote, so that an expense and a liability would be incurred upon satisfaction of the “initial eligibility requirements.” In contrast, satisfaction of other requirements to renew eligibility might be more problematic, suggesting that the expense and liability be limited to the first year of eligibility.

Some might favor attaining age 62 as the obligating event because the probability that Congress will change the Social Security law is less for those participants than for participants who meet have 40 QC. However, the Board has decided at prior meetings that the ability of the Government to change the eligibility conditions is not relevant for deciding when the liability definition is met. Presumably such uncertainty would be relevant for measuring the liability.

Similarly, some may view attaining age 62 as a preferable obligating event because the reliability of estimates of future flows is higher at that point than at 40 QC. Again, staff believes that the reliability of estimates is not relevant for a decision regarding the point at which a liability definition is met. However, it may be relevant to other decisions such as an assessment of relevance, reliability or understandability.

3. Social Insurance Near-Term Project Schedule

FASAB Meeting	Subject
August 2005	<p>Measurement and Display Staff will present measurement concepts and alternatives with emphasis on what is currently available from the SSA versus other possible approaches. Staff will also present a comprehensive illustration of the basic financial statements (including the Statement of Social Insurance) with some alternatives for presenting an accrued liability, actuarial gains and losses, and expenses for Social Security and Medicare. Alternatives presentations will be provided including ways to relate the articulated statements to the Statement of Social Insurance.</p>
October 2005	<p>Measurement and Display Staff will develop the measurement concepts and revise the illustrations consistent with Board decisions at the August meeting.</p>
January 2006	<p>First draft of an exposure document Staff will present the decisions made to date in the form of a request for comment. The Board will consider the issue of whether to first release a preliminary views document or a proposed standard in light of the progress on this project and the conceptual framework project.</p>

4. Pro Forma Statement of Social Insurance Illustrating a Line for an Accrued Liability.

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

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

	2004	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security)					
<i>Contributions and Earmarked Taxes from:</i>					
1. Participants who have attained age 62.....	411	359	348	309	266
2. Participants ages 15-61	14,388	13,576	13,048	12,349	11,335
3. Future participants (< age 15 + births + immigrants during the periods)	12,900	12,213	11,893	11,035	10,088
4. All Current and future participants (lines 1 + 2 + 3).....	<u>27,699</u>	<u>26,147</u>	<u>25,289</u>	<u>23,693</u>	<u>21,689</u>
<i>Expenditures for Scheduled Future Benefits for:</i>					
5. Participants who have attained age 62.....	4,933	4,662	4,401	4,256	4,020
6. Participants ages 15-61:	[22,418]	[21,015]	[20,210]	[18,944]	[17,217]
6a. Benefits accrued for those with 40 QC	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
6b. Liability on the balance sheet (lines 5 + 6a)	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
6c. Benefits accrued for those without 40 QC	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
6d. Accrued benefit obligation (lines 6b + 6c)	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
6e. Benefits to be accrued in future.....	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>	<u>XXX</u>
7. Future participants (< age 15 + births + immigrants during the periods)	5,578	5,398	5,240	4,700	4,297
8. All Current and future participants (lines 6d + 6e + 7).....	<u>32,928</u>	<u>31,075</u>	<u>29,851</u>	<u>27,900</u>	<u>25,534</u>
9. Present value of future expenditures less future revenue (lines 8 – 4).....	<u>5,229</u>	<u>4,927</u>	<u>4,562</u>	<u>4,207</u>	<u>3,845</u>

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

Federal Supplementary Medical Insurance (Medicare Part D:					
<i>Premiums:</i>					
30. Participants who have attained eligibility age	176				
31. Participants who have not attained eligibility age	1,857				
32. Future participants	<u>618</u>				
33. All Current and future participants (lines 30 + 31 + 32).....	<u>2,651</u>				
<i>Expenditures for Scheduled Future Benefits for:</i>					
34. Participants who are enrolled in SMI/Part D – balance sheet liability	XXX				
35. Participants who have attained eligibility age without enrolling.....	<u>XXX</u>				
36. Participants who have attained eligibility age.....	773				
37. Participants who have not attained eligibility age.....	7,566				
38. Future participants	<u>2,431</u>				
39. All Current and future participants (lines 36 + 37 + 38).....	<u>10,770</u>				
40. Present value of future expenditures less future revenue (lines 39 – 33)	<u>8,119</u>				