Statement of Federal Financial Accounting Standards 17: Accounting for Social Insurance

Status

Issued	November 19, 1999
Effective Date	For fiscal periods beginning after September 30, 1999
Interpretations and Technical Releases	
Affects	None.
Affected by	• SFFAS 26, par. 5, affects SFFAS 17, paragraphs 24, 27(3), 31, and 32(3) by changing the classification of information required by SFFAS 17. • SFFAS 33, par. 39-41, affects SFFAS 17, par. 25, 27(2), and 27(4)(a). • SFFAS 37 affects SFFAS 17, par. 26, 26A, 27, and 32.

Summary

This statement presents accounting standards for federal social insurance programs. The standards cover the following programs: Social Security (Old-Age, Survivors, and Disability Insurance), Medicare (Hospital Insurance [Part A] and Supplementary Medical Insurance [Part B]), Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. The standards do not cover any other programs at this time.

Social insurance programs have complex characteristics and thus require specialized accounting standards. These programs blend elements of exchange and nonexchange transactions and therefore do not completely fit traditional accounting notions of either annual governmental assistance programs (nonexchange transactions) or long-term pension programs (exchange transactions).

Because taxpayers rely on social insurance programs in their long-term planning, fundamental questions about social insurance programs include (1) whether they are sustainable as currently constructed and (2) what their effect on the government's financial condition will be. The requirements of this standard reflect the complexity of these programs. In its entirety, the information required will help users assess the government's financial condition and the sufficiency of future budgetary resources for these programs. No single element of the information required is sufficient to meet all the users' needs.

The standards require that a liability be recognized when payments are due and payable to beneficiaries or service providers. Supplementary stewardship information is to be reported to facilitate assessing the program's long-term sustainability and the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.

The information is required in the financial reports of both the individual agency and the governmentwide entity. The information is tailored for specific programs but generally includes narrative and/or graphic presentation of the following:

(1) long-range cashflow projections in nominal dollars and as a percentage of (a) the payroll that is subject to the tax earmarked for the program and (b) the Gross Domestic Product;

(2) long-range projection of the ratio of contributors to beneficiaries (commonly called the "dependency ratio"); and

(3) a statement presenting the actuarial present values of (i) future benefits and (ii) contributions and tax income for social insurance programs; the Statement of Social Insurance.

The Board is issuing this statement after years of debate. Taken as a whole, the package is a major step forward in meeting the objectives of federal financial reporting. Nonetheless, federal financial reporting is in a period of great change and the Board expects that further research regarding presentation of a federal balance sheet is needed. In Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, the Board acknowledged that an evolutionary approach would be taken:

> The FASAB recognizes that developing and implementing standards that will contribute to achieving certain objectives may take considerable time. Time will be needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches. [par. 35]
>
> The FASAB expects that some of these objectives may best be accomplished through means of reporting outside general purpose financial reports. Indeed, the FASAB recognizes that information sources other than financial reporting, sources over which the FASAB may have little of no influence, also are important to achieving the goals implied by these objectives. [par. 36]

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Purpose

1. The purpose of this statement is to establish standards for reporting information on social insurance programs that will assist users in evaluating operations and aid in assessing the government's financial condition and the sufficiency of future budgetary resources to sustain program services and meet program obligations as they come due. Social insurance programs were studied and analyzed during the Board's work on Statements of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, and No. 8, *Supplementary Stewardship Reporting*. However, the Board decided to address the subject in a separate project.

Scope

2. This statement establishes accounting standards to be used by component entities and by the governmentwide entity for the following federal programs: Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security"), **Medicare**[1] Hospital Insurance (HI), Medicare Supplementary Medical Insurance (SMI), **Railroad Retirement** benefits, **Black Lung** benefits, and **Unemployment Insurance** (UI) for the general public. Accounting standards for UI for federal employees are provided in Statement of Federal Financial Accounting Standards No. 5 and are not within the scope of this statement. This statement should be applied only to programs listed in paragraph 14.

Background

3. As noted in FASAB's Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting* (*Objectives*), the Federal Government is unique when compared with any other entity in the country. It is the vehicle that citizens of the United States use to exercise their sovereign power. It has continuing responsibility for the general welfare. It also has unique access to financial resources in that it has the power to tax, to borrow, and to create money.

4. As a result of these responsibilities, the Federal Government engages in many activities that have no counterpart or that are a relatively small part of the activities in the private sector.

[1]See the [Consolidated] glossary (Appendix E) for definitions of terms used in the statement. Terms defined in the glossary are in **boldface** the first time they appear in the text.

The government is concerned, for example, with macroeconomic policies to maintain incomes during recessions and therefore provides unemployment compensation and other benefits. It is concerned with the distribution of income and therefore (1) provides a wide variety of welfare payments in cash and in kind to low-income households and (2) makes taxes and many kinds of benefits "progressive." It is concerned about conditions and services in certain regions and communities, urban and rural, and therefore provides grants to state and local governments for various purposes. The fiscal year 2000 Budget of the United States reports that Social Security, Medicare, and other health and income security payments for individuals constituted more than 50 percent of the federal budget; grants to state and local governments comprised 15 percent.

5. In *Objectives*, the Board established four major reporting objectives around which accounting standards should be organized. Taken together, they provide a framework for assessing the existing accountability and financial reporting systems of the Federal Government and for considering how new accounting standards might enhance those systems.[2] The four objectives are

    1. Budgetary Integrity,
    2. Operating Performance,
    3. Stewardship, and
    4. Systems and Controls.

6. Although all the objectives are important, Nos. 2 and 3 directly impact the social insurance standards. Objective No. 2 provides,

    > 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.[3]

    As noted in *Objectives*, because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure "net income." Moreover, directly measuring the value added to society's welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relation to a variety of measures of the achievement of results. Information about social insurance that is relevant to this objective includes the cost of the program as well as long-range estimates (and ranges

[2]SFFAC No. 1, par. 109.

[3]SFFAC No. 1, par. 122.

of estimates) of future costs and other obligations. Estimates of future costs highlight the cost impact of changes in benefit levels as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

7. Meeting Objective No. 3 is the other focus for this statement. It says,

> Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.[4]

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. Thus, federal financial reporting should provide information that helps the reader to determine

- whether the government's financial position improved or deteriorated over the period,
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- whether government operations have contributed to the nation's current and future well-being.

8. In light of Objective Nos. 2 and 3, fundamental questions about social insurance programs that can be addressed by accounting standards include whether the 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 the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information required by this standard, taken as a whole, will help users make this assessment while acknowledging the complexity of the programs and the uncertainty of long-term projections.

9. To meet the objectives of federal financial reporting, the standards require that:

(1) a liability be **recognized**[5] when payments are due and payable to beneficiaries or service providers and

(2) supplementary stewardship information be reported to facilitate the assessment of:

[4]SFFAC No. 1, par. 134.

(i) the long-term sustainability of the program from both an entity and a governmentwide perspective and

(ii) the ability of the program and the nation to raise resources from future program participants to pay for benefits proposed to present participants.

10. The RSSI includes:

- long-range cashflow projections,
- long-range projections of the ratio between the number of those paying taxes earmarked for the program and the number of program beneficiaries, and
- actuarial present values of (i) future benefits for and (ii) contributions and tax income from or on behalf of current and future program participants.

> SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

11. The specification of RSSI by the Board should not be construed as precluding management from voluntarily providing any additional information pertaining to the financial condition of its program that it believes useful and appropriate.

Materiality

12. The provisions of the accounting standards in this statement need not be applied to immaterial items.

[5]The terms "recognition," "disclosure," and "required supplementary stewardship information" (RSSI) have specific, technical application in accounting. As explained further in the glossary to this statement, "recognition" (or "recognize") means formally recording or incorporating an item into the financial statements of an entity as an asset, liability, revenue, expense, etc. "Disclosure" (or "disclose") means reporting information in notes or narrative regarded as an integral part of the basic financial statements. RSSI is information reported outside the principal financial statements that the Board considers essential to an entity's financial reporting and therefore recommends authoritative guidelines for its measurement and presentation.

Effective Date

13. The provisions of this statement would be effective for reporting periods that begin after September 30, 1999.

Accounting Standards For Social Insurance

14. The following programs are designated as social insurance and subject to these standards:

- 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).

No other programs are subject to these standards, and the characteristics presented below should not be used to include other programs.

Characteristics Of Social Insurance Programs

15. These programs were developed to carry out the responsibilities of the government and generally have characteristics that make them unique. 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. This statement identifies the following five characteristics common among social insurance programs:

(1) Financing from participants or their employers,
(2) Eligibility from taxes/fees paid and time worked in **covered employment**,
(3) Benefits not directly related to taxes/fees paid,
(4) Benefits prescribed in law, and
(5) Programs intended for the general public.

These characteristics are briefly described below.

Financing From Participants

16. Some of the resources needed to run these programs are raised through explicit taxes and fees collected from the program participant or from the participant's employer. Taxes paid are usually a fixed percentage of the participant's wage income.

17. Federal social insurance programs utilize "trust funds" to account for dedicated collections held for later use to accomplish the program's purpose. Federal **trust funds** are accounts designated by law as such for receipts earmarked for specific purposes and the associated expenditure of those receipts. Trust funds serve useful purposes in allocating federal spending authority and accounting for earmarked taxes.

Eligibility from Taxes/Fees Paid and Time Worked in Covered Employment

18. Eligibility for benefits under social insurance programs usually rests, in part, on current or previous taxes and/or fees paid by the individual, the individual's employer, or both, and the time worked in covered employment. Frequently an individual's taxes and/or fees paid and time worked in covered employment also make family members eligible.

Benefits Not Directly Related to Taxes/Fees Paid

19. Social insurance programs sometimes intentionally redistribute toward lower-wage workers. Lower-wage workers tend to receive proportionately more in benefits relative to taxes paid than the higher-wage workers, sometimes much more. Many social insurance plans also subsidize benefits for nonworking members of workers' families and others.

Benefits Prescribed in Law

20. Social insurance programs normally have uniform sets of entitling events; and schedules of benefits are developed, announced, and applied to all participants. Administrators of such programs have little discretion in determining who should get benefits or how much they should get.

Intended for the General Public

21. These programs are intended for the general public and not solely for present or former federal employees.

Component Entity Accounting & Reporting Standard

Expense & Liability Recognition

22. The expense recognized for the reporting period should be the benefits paid during the reporting 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 should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (IBNR).

23. For Unemployment Insurance (UI), the liability to be recognized includes (1) amounts due to states and territories for benefits they have paid to beneficiaries but for which they 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.

Required Supplementary Stewardship Information

> SFFAS 26 reclassified most RSSI as RSI. See SFFAS 26 for detailed guidance.

24. The entity responsible for the social insurance program should include in its financial report, as **required supplementary stewardship information** (RSSI), a clear and concise description of the program, how it is financed, how benefits are calculated, and its financial and actuarial status. The description should include a discussion of the long-term sustainability and financial condition of the program. A display should illustrate and the discussion should explain the trends revealed in the data. The entity should consider both narrative and graphic presentations. Statutory or other material changes affecting the program after the current fiscal year, including those enacted between the fiscal year end and the date of the report, should be described, along with the implications thereof. [See SFFAS 26.]

25. The projections and estimates used should be based on the entity's reasonable estimates of demographic and economic **assumptions**, taking each factor individually and incorporating future changes mandated by current law. Significant assumptions should be disclosed.

26. All projections and estimates required by this Statement 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. If, after the valuation date, but prior to the end of the fiscal year, policy changes are enacted that could materially affect the basic statement, the projections should be adjusted, if feasible, as if the policy changes took place as of the valuation date. If not feasible, the entity should disclose an estimate of the magnitude of the effect of the policy change 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 policy change should be disclosed. If policy changes 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 change and, if known, the estimated effect on the projections.

26.A. 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 estimated cost. The entity should state that the amounts of the open (and closed) group measures depend on the assumptions used and that actual experience is likely to differ from the estimate. 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.

27. The information on financial and actuarial status should include the following measures and data:

(1) *Cashflow Projections* - Projections of cashflow for those persons who are participating or eventually will participate in the program as contributors or beneficiaries during a projection period sufficient to illustrate long-term sustainability (e.g., traditionally the "Social Security," or OASDI, program has used a projection period of 10 years for relatively short-term and 75 years for long-term projections, and the UI program has used a projection period of 10 years for its projections). The projection should include current workers, retirees, survivors, disabled persons, and new participants entering

the workforce or becoming beneficiaries, including those who will be born or immigrate to the United States during the projection period. The information should include the following:

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

(i) total cash inflow from:

1) all sources and

2) excluding net interest on intragovernmental borrowing/lending,[6] and

(ii) total cash outflow.

The narrative accompanying the cashflow data should include identification of any year or years during the projection period when cash outflow exceeds inflow, both in total and excluding interest on intragovernmental borrowing/lending (the "cross-over points"), and an explanation of the significance of the "cross-over points.

For the OASDI and HI programs, the actuarial projections of the annual cash-flows 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 Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars.

(2) *Ratio of Contributors to Beneficiaries* - With respect to the OASDI and HI programs, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio") during the same projection period as for cashflow projections

[6]"Interest on intragovernmental borrowing" refers to interest earned by the social insurance program on obligations of the U.S. Government.

(e.g., 75 years), using the program managers' estimate.[7] At a minimum, the ratio should be reported for the beginning and end of the projection period.

> SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

(3) *Actuarial Present Values* - For all programs except UI, a statement presenting the actuarial present value of each of the following:

All future expenditures during the projection period related to benefit payments:

(a) to or on behalf of current participants who have not yet attained retirement age (e.g., the Social Security Administration has assumed an age of 15 years for new participants and an age of 62 years for retirement),

(b) to or on behalf of current participants who have attained retirement age,

(c) to or on behalf of those who are expected to become plan participants (i.e., new entrants) during a projection period encompassing substantially all the present value attributed to (a) and (b) immediately above;[8]

All future contributions and tax income (from taxation of benefits) during the projection period:

(d) from or on behalf of current participants who have not yet attained retirement age (same group as in (a) above),

[7]SMI, Black Lung benefits, and UI programs are financed by, respectively, premiums paid by covered participants and general fund contributions (SMI); direct payments from employers, excise taxes per ton of coal, and general fund contributions (Black Lung); and state/employer-specific payroll taxes (UI). Therefore, these programs are not required to provide the ratio of contributors to beneficiaries. The OASDI trustees refer to the ratio of beneficiaries to contributors as the "dependency ratio."

[8]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 (that is, 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 a in 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.

(e) from or on behalf of current participants who have attained retirement age (same group as in (b) above),

(f) from or on behalf of those who are expected to become plan participants (same group as in (c) above) during a projection period encompassing substantially all the present value attributed to (d) and (e) immediately above.

Net present value of cashflow during the projection period:

(g) the actuarial present value of future contributions and tax income during the projection period [(d)+(e)+(f)] should be subtracted from the actuarial present value of future expenditures for the projection period related to benefit payments [(a)+(b)+(c)] to derive a total excess of future benefit payments over future contributions and tax income (or contributions and tax income over benefits).

Notes to the statement should present:

(h) the accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date, and

(i) a statement that the actuarial net present value of the excess of future expenditures related to benefit payments to or on behalf of current participants, that is, of the "closed group" of participants (see (a) and (b) above), over future contributions and tax income from them or paid on their behalf (see (d) and (e) above) is calculated by subtracting the actuarial present value of future contributions and tax income paid by and for current participants [(d)+(e)] from the actuarial present value of the future benefit payments to them or on their behalf [(a)+(b)].

(j) information required in subparagraphs 27(3)(a)-(h) for the current year and separate estimates for each of the four preceding years.

(4) *Sensitivity Analysis* -

All programs should provide sensitivity analysis appropriate for their particular circumstances. The objective of sensitivity analysis is to illustrate how an estimate or projection would change if assumptions, data, methodologies or other inputs change. The OASDI, Medicare and Railroad Retirement programs should provide sensitivity analysis of the open group measure presented 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. The entity should state that the amounts of the closed and open group measure depend on the assumptions used and that actual experience is likely to differ from the estimate.

(5) *State-by-State Analysis* - For the UI program provide a state-by-state analysis illustrating the relative solvency of individual state programs. The analysis should provide the ratio of each state's current accumulated fund balance to a year's projected benefit payments based on the highest level of annual benefit payments experienced by that state over the last 20 years.

Transition

28. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

Consolidated Governmentwide Entity Accounting & Reporting Standard

29. The standard for consolidated governmentwide accounting and reporting for social insurance programs is the same as that for component entities except as provided below. Thus, except for the specific modifications listed below, the governmentwide entity should refer to the relevant paragraphs of the standard for component entities in the preceding section for a description of the information to be provided.

Expense & Liability Recognition

30. Expense and liability recognition for the consolidated governmentwide entity are the same as for the component entities (see pars. 22-23).

Required Supplementary Stewardship Information

SFFAS 26 reclassified most RSSI as RSI. See SFFAS 26 for detailed guidance.

31. The consolidated governmentwide financial report should include, as required supplementary stewardship information (RSSI), a summary of the entities' descriptions of their social insurance programs (see paragraph 24). The description should include a discussion of the long-term sustainability and financial conditions of the programs, illustrate and explain the trends revealed in the data, and explain the relationship of the social insurance program(s) to governmentwide financing, especially regarding the intra-governmental nature of trust fund assets and government debt.

32. The information on financial and actuarial status should include the following measures and data:

(1) *Cashflow Projections* -

(a) Cashflow projections should be made for all social insurance programs as described under the component entity standard (see par. 27), except that only cash inflow from the public (that is, excluding interest on intragovernmental borrowing/lending) and total cash outflow are required. At a minimum the OASDI, HI, and SMI programs should be separately identified. The projection period of the display should be based on those used by the component entities, which may require summarization or presentation techniques such as using more than one graph (e.g., a 10-year graph and a 30-year graph). The presentation should include an explanation of material crossover points, if any, where cash outflow exceeds cash inflow and the possible reasons therefore.

(b) For the programs indicated immediately below, estimated future cash inflow (excluding net interest on intergovernmental borrowing/lending) and outflow for the projection period described in paragraph 27 as a percent of

(i) taxable payroll for OASDI and HI, presenting each program separately, and

(ii) GDP for OASDI, HI, and SMI, presenting each program separately.

(2) *Ratio of Contributors to Beneficiaries* - For OASDI and HI, the ratio of the number of contributors to the number of beneficiaries (commonly called the "dependency ratio")

during the projection period as described under the standard for component entities (see par. 27(2)).

> SFFAS 26, par. 5 requires that the actuarial present values and significant assumptions be presented as a basic financial statement and as disclosures, respectively.

(3) *Actuarial Present Values* - For all programs except UI provide a statement combining the entity statements required in paragraph 27(3)(a)-(i). The presentation should include data for the current year and separate estimates for each of the four preceding years. At a minimum OASDI, HI, and SMI should be separately identified.

(4) *Sensitivity Analysis* - For all social insurance programs provide a summary of the sensitivity analyses required for component entities.

(5) *State-by-State Analysis* - Provide a summary of the state-by-state analysis required for the UI program (see par. 27(5)).

Transition

33. In instances where data are not available to calculate the actuarial estimates for one or more prior years, as required in paragraph 27(3)(j) the entity may apply the standard prospectively.

Appendix A—Basis For Conclusions

Section 1 — Response To Comments Received

34. This appendix does not constitute authoritative guidance for those who prepare and audit general purpose federal financial reports. It summarizes important matters that the FASAB members considered as they deliberated on this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

35. FASAB published the exposure draft *Accounting for Social Insurance* in February 1998. The exposure draft included five questions and invited comments on the usefulness of the proposal for accounting and reporting for social insurance. Twenty-nine letters were received from the following sources:

	Federal (internal)	**Nonfederal (external)**	**Total**
General Public	2 [retired employees]	8	**10**
Auditors	3	4	**7**
Preparers and Financial Managers	12	0	**12**
Total	**17**	**12**	**29**

36. FASAB also held a public hearing on the exposure draft on October 5-6, 1998. Testimony was received from representatives of accounting, auditing, and actuarial organizations; from a public service organization; and from the Social Security and Medicare programs. Appendix C, Historical Background, provides a history of past accounting for these programs.

37. Section 1 of this basis for conclusions addresses certain responses to the exposure draft and the comments received at the public hearing.

38. The responses to the exposure draft illustrate what was described in the basis for conclusions for the exposure draft as two polarized views regarding recognizing or even disclosing a liability measure beyond the due and payable amount called for in this standard. Some respondents restated their views on the propriety of the accounting proposed in the ED, and/or they said they favored one or the other of the two opposing views described in the basis for conclusions. Some respondents argued once again that social insurance programs are pay-as-you-go, income transfer programs for which an estimate of accrued and future benefits and contributions and tax income is inappropriate. Other respondents

reiterated the contrary argument. They said that such programs are commitments for which a long-range accrual is not only appropriate but also essential for the balance sheet, if the information presented therein is not to be misleading.

39. The Board continues to believe that the original basis for conclusions in the exposure draft describes and explains the Board's conclusions adequately. Therefore, except for those issues specifically discussed immediately below, the Board is presenting the original basis for conclusions from the exposure draft in Section 2. Changes were made where necessary to reflect the requirement for a statement of social insurance in the final standard.

Expanded Presentation and Visibility of Actuarial Present Values

40. In response to comments received on the exposure draft and subsequent public hearing, the Board is adding a requirement for a statement presenting the actuarial present values (APV) of future benefits for and future contributions and tax income from or on behalf of all current and future participants during the projection period normally used by the programs. For example, the OASDI program uses a 75-year projection period. The net total of the statement will present the total excess of benefits over contributions and tax income.

41. The Board believes that this information will be useful in analyzing the sustainability and financial position of SI programs. The added detail on individual components of the actuarial net present value will provide analysts interested in different facts with useful detail. In addition, the statement presentation will increase the prominence of important data otherwise obscured in a long narrative.

42. The Board has considered whether the changes made regarding the presentation of actuarial present values requires re-exposure. The original exposure draft focused on one net actuarial present value, for the "closed group," while the final standard presents the components of that value as well as data on future participants. Also, the exposure draft proposed subtracting the fund balance at the valuation date from the actuarial present value of the net cash outflow over the projection period, while the standard now calls for fund balance information to be presented in a note to the statement.

43. The Board decided that the new presentation and data did not require re-exposure. The information added to the standard results from adding more detail and modifying the display to increase visibility. These modifications are responsive to the views expressed by many during the comment period. The Board believes that the difference in the presentation does not warrant delaying the issuance of the standard.

Specific Identification of Social Insurance Programs

44. A few of the respondents disagreed with the approach in the exposure draft whereby programs are specifically identified. One respondent reasoned that an accounting standard would be more useful if it established definitive criteria for current and future programs to meet rather than designating only specific programs. Conversely, another respondent said the standard should be even more specific and deal with the individual programs separately because some have characteristics of defined benefit plans while others are similar to welfare programs.

45. After weighing these arguments carefully, the Board continues to believe that 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 identify social insurance programs that now exist and consider the classification of other programs as they may arise in the future.

Consistency of Assumptions

46. Several respondents to the exposure draft expressed concern that projections of cashflow and GDP would not be consistent between entities and within an entity due to the use of different assumptions by separate programs. One respondent believed that cashflow estimates as a percentage of GDP would not be meaningful without a tremendous amount of effort and cost expended in coordinating assumptions and methodologies to achieve consistency.

47. The Board considered these arguments and decided not to require uniform assumptions. The assumptions used by Social Security and Medicare, the two predominant programs, will be consistent. These programs use the same principal assumptions and have the same **trustees**. On the other hand, the Board concluded that the GDP projection should not be required of smaller programs and therefore explicitly exempts them from that requirement.

Sensitivity Analysis

48. Some respondents disagreed with the approach in the exposure draft regarding sensitivity analysis, which calls for showing the effect of changing one major assumption at a time. One respondent favored a general requirement that entities provide sensitivity analysis rather than telling them how to do it. This respondent favored the high-, low-, and intermediate sets of cost assumptions that are featured in the trustees' annual reports for Social Security and Medicare. Another respondent suggested that the standard

not require sensitivity analysis because most users would not understand it and the potential for misuse would be great. Another respondent said that the requirement in the standard was useful because it gives an idea about the uncertainty associated with the estimate. However, this respondent said sensitivity analysis was inadequate without a further discussion of the nature of uncertainty itself and recommended mandating such a discussion.

49. The Board continues to believe that the analysis required by the standard is a clear, easily understood illustration of the sensitivity of projections to changes in assumptions. The Board recognizes the difficulty in illustrating the uncertainty inherent in all projections, especially very long-range projections. However, the requirement in the standard would not preclude the entity from presenting additional discussions of uncertainty and the Board expects that agencies would do so voluntarily.

State and Local Government Pension Accounting

50. Some respondents urged the Board to consider whether the approach used by state and local governments to account for employee pensions would be suitable, at least for some social insurance programs that are most analogous to pensions, such as the retirement benefit portion of Social Security. Those respondents focus on similarities, such as defined benefit formulas tied to earnings.

51. The Board concluded that there are important differences in the programs and environments involved. For example, state and local pension plans typically do not have extensive income transfer features. They are much like federal employee pension programs, which are not considered to be social insurance. On balance the Board concluded that such an approach would be inappropriate.

Vote of Approval

52. This recommended statement was approved by the Board with a vote of 6 members in favor of its issuance and 3 member(s) opposing its issuance. Two members submitted written dissents, which are available for public inspection at the FASAB's offices.

Section 2 — Basis For Conclusions From The Exposure Draft

[Note: The Board's recommendation differs from the proposal made in the exposure draft. Certain sections from the basis for conclusion in the exposure draft were deleted since they are no longer relevant to the final recommendation. Paragraphs 40-51 explain the differences and reasons therefore.]

53. The following paragraphs address the basis for the Board's proposals on

- defining social insurance,
- recognition of liabilities and expense for social insurance, and
- required supplementary stewardship information (RSSI).

Characteristics of Social Insurance Programs

54. As stated in the introductory sections, the Board has analyzed certain programs that are generally considered social insurance. These programs have certain characteristics that set them apart from general assistance programs on the one hand and insurance programs on the other hand. Accounting standards for liabilities associated with general assistance and insurance programs are provided in SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.

55. After analyzing specific programs, the Board determined that, although these programs generally shared certain characteristics, their operational features were too diverse for establishing definitive criteria that would include all the subject programs and exclude all other federal programs for which accounting standards have already been provided. Thus, the Board has outlined the general characteristics that social insurance programs usually—but not always—possess and has listed the specific programs to which the standards apply. This does not preclude the Board from considering an additional program(s) in the future and, given the individual circumstances pertaining to that program, including it within this statement. However, no entity on its own volition should apply this statement to any program not listed in this statement.

56. Accounting for UI for federal employees is provided in SFFAS No. 5 and is not within the scope of this standard. SFFAS No. 5 provides that the unemployment program for federal employees should be accounted for like other postemployment benefits (e.g., severance benefits and workers' compensation) because the nature of the liability is similar. Federal employer entities must reimburse the Labor Department for the full cost of unemployment benefits received by former federal employees rather than paying a payroll tax each period.

Nature of Social Insurance

57. In determining how social insurance program transactions should be recognized in the financial statements and the supplementary information that should be provided about them, the Board considered the nature of the Federal Government, the nature of those programs, and the needs of users of federal financial reports. Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, *Objectives of Federal Financial Reporting*, notes the Federal Government's unique responsibilities for the common defense and general welfare and its unique access to financial resources and financing, including the power to tax and

create money. The government undertakes many programs despite potentially unfavorable effects on its financial condition, and transactions between citizens and the government generally are not individual exchanges between willing buyers and sellers.[9]

58. Consideration of guidance for the recognition, measurement, and display of obligations for social insurance programs has continued to present the Board with significant, vexing theoretical and practical problems. The programs are complex, reach a unique order of magnitude, and involve projections that are extremely sensitive to assumptions whose range of possibilities is large.

Expense & Liability Recognition

59. The Board believes that the annual expenses of such programs should be the benefits paid during the accounting 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, including claims incurred but not reported. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, and supplementary stewardship information should be provided as described in the standards.

Exchange and Nonexchange Transactions

60. During its consideration of social insurance and, before that, of liability accounting, the Board considered whether social insurance programs result in **exchange** or **non-exchange transactions** or whether they contained features of both. As described in Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, nonexchange transactions give rise to a different kind of obligation than exchange transactions under federal accounting principles.

61. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future. However, for a nonexchange transaction, a liability is recognized for any unpaid amounts due and payable as of the reporting date, including estimates of claims incurred but not yet reported.

62. As defined in SFFAS No. 5, obligations become liabilities against the Federal Government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing the liability recognition point among various

[9]SFFAC No. 1, *Objectives of Federal Financial Reporting*, pars. 52, 53, 55, and 60.

federal programs is whether a nonexchange transaction is involved. Although a high probability may exist that a grant, a subsidy, or an income transfer will be made or will continue to be made in future years, the recipients do not have as high an equitable claim to receive grants, subsidies, or transfers in the future as do those who exchange service for promises of future payments. The latter have a greater probability of being paid than the former. At the same time, many people feel that some social insurance benefits, Social Security in particular, also have similar "exchange" or "equitable" claims. They also believe that social insurance benefits have as great a probability of being paid as any other payments.

63. Whether on the balance sheet or elsewhere in the financial report, estimates of the future amounts required to continue present policies regarding such programs are relevant to certain decisions and should be disclosed or otherwise reported. In the context of the Board's definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute a liability.[10]

Polarization

64. With regard to social insurance, the Board notes the strength of feelings on this issue. The Board has been faced with two polarized views. On the one hand there are those who believe a liability should be recognized for the net benefits expected to be paid in future periods to current participants. On the other hand, there are those who believe that the long-term obligation (i.e., beyond amounts due and payable at the end of an accounting period) associated with these programs is not a liability and should not be recognized as such. Some people also believe such amounts should not be reported as RSSI.

Arguments against Recognition, Disclosure, or Supplementary Reporting

65. The latter group would argue that social insurance programs do not result in exchange transactions, that social insurance programs are income transfers financed primarily by compulsory earmarked taxes and also, in certain cases, general revenues of the government. For them, the political nature of the commitment is critical, for its terms can be and are changed by the Congress to maintain **actuarial balance**. In this regard, they point to *Flemming*, *Secretary of HEW v. Nestor*, *Part I* (363 U.S. 608-611) wherein Mr. Justice Harlan, delivering the opinion of the Court, said,

[10]SFFAS No. 5, pars. 129-131.

> [T]he entire [Social Security System] rests on the legislative judgment that those who in their productive years were functioning members of the economy may justly call upon that economy, in their later years, for protection from the 'rigors of the poor house'...

He continued,

> It is apparent that the noncontractual interest of an employee covered by the Act cannot be soundly analogized to that of the holder of an annuity, whose right to benefits are bottomed on his contractual premium payments.... *To engraft upon the Social Security System a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands.* (Emphasis added.)

66. Those who believe that only the due and payable amount should be recognized as the liability would argue that, under social insurance, the government uses its sovereign power to require payment of taxes that it dedicates to finance benefits. The individual beneficiaries of these programs are receiving payments that may be indirect and disproportionate to the taxes paid by them or on their behalf. In the case of Social Security, the oldest social insurance program, those who retired in the first years after enactment in 1935 received benefits that were many times their taxes. This was possible because the system transfers resources across generations. The system transfers resources within a generation as well, from those working and paying taxes to the disabled, the surviving spouse, and dependent children.

67. They would argue that benefits have also been very different by family type, wage level, and sex. One-earner couples receive benefits that are far larger than taxes paid, followed by two-earner couples. Single females have still lower benefit/tax ratios, followed by single males. Low-wage earners have a higher benefit ratio than those with average or high wages. For each type of recipient, benefit/tax ratios have been trending down. High- and average-earning single males retiring now cannot expect to get their money back, with interest; and this will soon also be true for high-earning single females.[11]

Uncertainty

68. Some of those who do not believe that social insurance obligations constitute a liability argue that the level of future benefit payments is too uncertain for accrual as a liability. They point out that not only did Congress expressly include (and retain) the right to alter, amend, or repeal any provision in the **Social Security Act** itself, it has made such changes frequently. In the early years, the changes generally expanded benefits—for example, to

[11]See Steuele, C. Eugene, and Jon M. Bakija, *Retooling Social Security for the 21st Century: Right and Wrong Approaches to Reform*, (The Urban Institute Press, Washington, DC).

dependents, the disabled, and early retirees; to a broader coverage of workers; to protect retirees against inflation—and increased tax rates. But as the system has matured, the changes have increased the tax rate further, taxed an increasing proportion of benefits, reduced cost of living adjustments and various benefit provisions, and prospectively raised the retirement age.

69. They argue further that the benefit payments that might be made in the future are dependent on economic and demographic variables including the growth of real wages, interest rates, births, immigration, and labor force participation. The aggregate benefits under the **high cost Social Security assumptions** in 2070 are estimated by the Social Security Trustees to be 2.5 times those under the **low cost assumptions**. And the estimates change over time. The legislative changes in 1983 were expected to maintain a positive fund balance until 2063; however, by current **intermediate cost assumptions** the fund will run out three decades sooner.

Period Costs

70. Some argue that the critical issue is the period to which a particular cost or expense relates. They emphasize that a significant determination in accounting is to decide in which period a transaction should be recognized as an expense. They believe that social insurance benefits, like other non-exchange transactions, should be recognized as expenses in the time period when they are paid or are due and payable and not earlier when a participant has covered wages. Future social insurance benefits constitute program costs of future periods, notwithstanding that they may be for the purpose of carrying out responsibilities that the government has already assumed.

71. They would argue further that, given the nature of the Federal Government and of social insurance, liability-type measures of the social insurance obligation (e.g., the closed group measure...) are meaningless or even potentially misleading. In particular, they argue that this information would not be useful to assess sustainability. It ignores the pay-as-you-go financing, excludes future earmarked taxes from future participants, and results in such an enormous **actuarial present value** that it may needlessly scare those unfamiliar with the debate. Such measures do not reflect the way the program is financed under current law and could, if taken out of context, imply that the current participants have a right to benefits superior to future participants.

72. They argue that other supplementary information would provide useful sustainability information. For example, the Social Security Trustees' annual report provides "open group" projections of cashflow—in dollars, as a percentage of the tax base earmarked for the program, of the GDP, etc.—and the "dependency ratio." The open group measure reflects the way the program is financed; and the dependency ratio—the ratio of contributors to beneficiaries—indicates whether the program could potentially encounter stress in the

future. Both of these were proposed in the exposure draft on social insurance as part of the supplementary information. They argue that these and other measures provide meaningful sustainability information.

Arguments for Recognition, Disclosure, or Supplementary Reporting

73. Those who hold a contrary view believe either that the distinction between exchange and non-exchange transactions is not relevant to the liability recognition or supplementary reporting issue or that the programs possess characteristics that make the transactions predominantly exchanges. They argue that social insurance programs possess certain characteristics that, taken together, cause the criteria for recognizing a liability to be met long before payments are due and payable. Those characteristics are

    1. the contributory nature of the program (i.e., benefits are predicated to some extent on prior payments),
    2. time in covered employment,
    3. government sponsorship,
    4. benefits prescribed in law, and
    5. specific accounting entity (e.g., the trust fund) and long-range financing.

74. These characteristics, in conjunction with the historical experience and political climate affecting the programs, create obligations and societal expectations that make the outflow of resources highly probable — far more than 50 percent. Therefore, an accounting liability should be recognized at an earlier point than when payments are due and payable; and the liability should be based on long-term or actuarial estimates of future payments.

75. Supporters of this view note that social insurance programs, as distinguished from general assistance programs, require the payment of taxes in order to establish an "insured status" before an individual is eligible for benefits. This is often referred to as an "earned right to benefits." In addition, most such programs have an element of individual equity in their benefit formulas whereby greater levels of taxes result in greater levels of benefits — although Medicare HI is a notable exception. Moreover, both the participant and the employer sacrifice value in anticipation of future benefit. Not only do the participants anticipate retirement benefits as a result of these sacrifices, many employers, including the Federal Government, build in the value of Social Security benefits when designing retirement plans. Those holding this view would argue that these factors make social insurance programs predominantly exchanges.

76. Some of those arguing for recognition or **disclosure** believe that social insurance programs are constructive liabilities and that users of financial statements are accustomed to seeing commitments as firm as these quantified in financial statements or in notes to the statements. Some say that there is little conceptual difference between the liability that is

recognized for federal pensions and the closed group obligation for social insurance. They would say that the failure at least to disclose a liability-type measure of the obligation therefore would potentially be misleading to those who relied on the financial statements and would raise questions about the credibility of the statements.

77. In addition, they believe that the closed group number is a measure of the intergenerational transfer implicit in the program under its current terms and that this number should be reported. They would argue that the failure to disclose this number makes these programs look healthier than they are and thus may lead to poor decisions about consumption and saving by Congress and by citizens. Those who hold this view would argue that a closed group measure that treats social insurance benefits as earned annually would help users to understand the extent to which social insurance programs have committed future-year taxpayers to finance amounts earned by participants as of a given point in time.

78. Some of those who argue that a liability should be recognized on the balance sheet maintain that most of the financial reporting community in the United States have adopted a different standard than exchange or nonexchange. The Financial Accounting Standards Board (FASB) concept statements adopt an "asset/liability" perspective in which what matters is whether a promise has been made, not whether something has been received for it or how it will be funded—in other words, what matters is whether a future sacrifice of resources is probable, regardless of whether it arises from an exchange of consideration. From this perspective, the only reason for not recognizing a liability for the amount promised by the social insurance program would be the assumption that it may not be paid.

79. Because most users are familiar with FASB's definition, or at least are accustomed to seeing financial reports based on it, those who favor recognition or disclosure of a liability-type measure argue it is inherently misleading to fail to quantify the size of the promise that is continually being made and on which people are told they can rely. While many who support liability-type disclosure agree the open group data are desirable to aid in assessing the sustainability of social insurance programs, they also believe that an assessment of the financial condition of the program — and more importantly, of the Federal Government — is not possible absent liability or closed group data. If a reader seeks to answer the question — Have we burdened future generations of citizens with the cost of the current and past years? and, if so, to what extent? — the very large obligations for social insurance must be considered.

The Board's Conclusion Regarding Recognition, Disclosure, or Supplementary Reporting

80. The Board acknowledges that it is faced with two polarized views without much hope of one side convincing the other side of the correctness of its position. On the one side are those who believe that social insurance programs — especially Social Security and Medicare — constitute a liability of the Federal Government that should be recognized on the

consolidated balance sheet and that the closed group is the best measure of it. They agree that other measures such as a long-range projection of a program's cash inflow from all sources and outflow for all purposes are also useful, and note that all measures of sustainability and financial condition must be taken in context to be meaningful. At the opposite pole are those who firmly believe that the closed group measure is meaningless or even potentially misleading and should not be disclosed at all in the financial report.

81. The Board recognizes that both approaches have limitations and that the data are best understood when used together. An "earned right" measure, for example, produces a relatively large dollar amount that could confuse the reader who is unaware of the way in which the program was intended to be funded. Although both sides make strong arguments, no empirical evidence has been offered that would prove one side right and the other wrong. The Board believes the best approach to resolve this issue is for the closed group data to be reported off the balance sheet as part of a balanced RSSI package of disclosures about the Social Security and other social insurance programs. *[The Board subsequently affirmed that the data necessary to calculate the closed group measure should be reported. See paragraphs 40-43 for a discussion of the Board's final recommendation.]*

82. The Board believes such disclosure will provide useful information and also serve the interests of users who are concerned primarily with federal accounting in its entirety. The Board has heard much from the two opposing sides, within the Federal Government, with the keenest interest in this issue. It does not forget, however, a larger third group of constituents, both within and outside the Federal Government, who are concerned with federal accounting in its entirety.

83. The Board believes that these users would consider social insurance accounting in general and Social Security accounting in particular to be important but only as one element of the complex of problems in federal accounting that led to the establishment of the FASAB. A closed group measure of some type undoubtedly will be provided to this group of users from some source if it is not provided based on government standards. These users will be better served if the Federal Government defines a credible measure, calculating it by using assumptions consistent with other Social Security and other social insurance program estimates, and disclosing it with explanatory materials and in a governmentwide and national context.

Measurement of Social Insurance Obligations

84. Considering the polarity of these positions, the Board is persuaded that the requirements incorporated in this statement best serve the users of federal financial information. The Board continues to believe that, given the strength of these differing views concerning the nature of social insurance transactions, an overriding concern exists that no single measurement on the balance sheet or elsewhere could adequately convey the financial

sustainability of social insurance programs or the impact on the financial condition of the administrative entities or the government as a whole. Using Social Security as an example, one could approach measurement from the perspective of an obligation to participants based on earned rights to future benefits; or one could approach measurement from a pay-as-you-go funding perspective, giving consideration to both future inflows and outflows. Projections based on a pay-as-you-go approach would acknowledge the way in which Social Security is funded and provide data on long-range sustainability based on the current benefit structure. An "earned rights" approach would acknowledge that, at any given point in time, Social Security has $X of accumulated obligation to current participants that would need to be provided by future generations under current law.

85. The Board believes that a more complete picture of the financial condition of the government can be provided by a forward-looking assessment of whether it can "sustain public services and meet obligations as they come due." The users of federal financial information need to know a great deal about the future of social insurance programs, a large and growing proportion of federal spending with financing that is under demographic and other strains. Understanding the financial condition of these programs is important to understanding the condition of the Federal Government as a whole. In addition, many citizens depend on these programs for their own financial security. The Board therefore believes that useful information about the future prospects of these programs should be fully and impartially presented in the financial reports of entities operating these programs and in the consolidated financial report of the United States government. The social insurance standards set forth the minimum information that the Board believes necessary for that purpose.

Required Supplementary Stewardship Information

86. The Board believes that the required information is relevant for assessing the sustainability of social insurance programs and also bears on the government's financial condition. The following paragraphs discuss each of the RSSI elements.

Cashflow

87. An estimate based on the amount and timing of future cash inflows and outflows will help users understand the long-range sustainability of the social insurance programs based on current revenue and benefit structure. The Board believes that the yearly inflows and outflows under the open group method should be disclosed over a sufficient number of years (e.g., 10 years, 75 years) to display "crossover" points where outflows begin exceeding inflows. Crossover points provide an early warning as to the need to adjust either the revenue stream or the expenditure stream to ensure that the program is sustainable under current law.

88. The Board considered specifying the length of the projection (e.g., 10-20 years). However, it decided that allowing the entity to use its traditional timeframe was preferable, if the period presented is long enough to reveal anticipated critical points as mentioned in the preceding paragraph.

Percentage of Taxable Payroll & GDP

89. Cashflow should also be put in relation to the taxable payroll or other tax base earmarked for the program, the GDP, or other benchmark that would be meaningful to users. The sustainability of a social insurance program cannot be determined solely on the basis of the financial position of the Federal Government. Rather, the size of the total fiscal burden shifted by government to future taxpayers—in relation to their ability to bear it—is critical to that determination. Thus, sustainability from the governmentwide perspective is better measured in terms of a healthy relationship between social insurance programs—and, indeed, the entire budget—and the national economy, as measured by the GDP or taxable wages.

Dependency Ratio

90. The ratio of contributors to beneficiaries, also commonly called the "dependency ratio" shows the estimated number of contributors (e.g., **covered workers**) per program beneficiary. The Board believes that a projection of the trend in the relationship between contributors and beneficiaries should be displayed. This ratio helps readers assess whether the program is under potential stress and whether it is sustainable as currently constructed. A deteriorating dependency ratio would illustrate the effect of demographic trends on relationships between contributors and beneficiaries that may affect the sustainability of the program as currently constructed.

The "Closed Group" Measure

[The social insurance exposure draft proposed that the net APV for the closed group of participants be reported as RSSI. As explained in paragraphs 40-43, the final standard requires information about the closed group APV, within the structure of the new statement of actuarial values, and an explanation of how to calculate it. See note No. 3 of the illustrated statement of social insurance, page 46. The closed group measure proposed in the exposure draft represented the actuarial net present value of (a) the future benefit payments to current participants, (b) future contributions to be made be them and their employers, and (c) the accumulated excess of cash receipts over cash disbursements within the social insurance program represented by fund balance at the valuation date. The Board continues to believe that the closed group measure is useful, and that the following paragraphs from the exposure draft retain their cogency.]

91. The closed group measure is sometimes referred to as an actuarial liability[12] for certain social insurance programs relating to the closed group of current participants. 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 pension and retiree health care benefits. Others dispute this, pointing to different financing arrangements, legal status, and the nature of social insurance and pensions.

92. Until 1985, the "prototype" *Consolidated Financial Statements of the United States* recognized a liability for Social Security, using a calculation similar to that called for by Opinion No. 8 of the Accounting Principles Board, *Accounting for the Cost of Pension Plans*, (APB 8). This liability was calculated by amortizing the "closed group" obligation and recognizing as a liability the unfunded portion that was amortized each year. APB 8 defined a variety of acceptable methods for measuring pension expense and required that any unfunded pension expense be recognized as a liability. APB 8 was superseded by Statement 87 of the Financial Accounting Standards Board (FASB), published in December 1985. FASB published Statement 87 to make accounting for pensions more independent of the financing arrangements, to provide more standardization in measurement of the pension expense and liability, and to require that at least a "minimum liability" be recognized in employers' Statements of Financial Position (balance sheets). From 1985 through 1994, the closed group amount was disclosed in a footnote in the *CFS*.

93. Some people believe that the closed group measure is analogous to the measure of "risk assumed" that would be reported as supplementary stewardship information if social insurance programs were accounted for like other federal insurance programs. SFFAS No. 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"). In the context of social insurance, one would use the term "closed group" instead of "current book of business."

94. SFFAS No. 5 requires insurance programs, other than social insurance programs, to report the risk assumed amount if it differs from the amount recognized as a liability. (SFFAS No. 5 exempts federal life insurance and loan guarantee programs from this disclosure requirement because the relevant accounting standards already incorporate a similar concept in determining the amount to be recognized in the financial statements.) Some people believe that it is useful to report this information, for the same reason that it is useful to report it for other kinds of government programs. This reason was summarized in a report

[12][A variety of actuarial methods exist which can be used to calculate an actuarial liability. The "closed group" measure is not identical to the methods that would be used in pension accounting. See paragraph 97]

on budgeting for federal insurance programs other than social insurance. Although FASAB is concerned with financial reporting, not budgeting, the underlying rationale is similar:

> As a general principle, decision-making is best informed if the government recognizes the costs of its commitments at the time it makes them. For most programs, cash-based budgeting accomplishes this. However, for insurance programs, accrual-based budgeting, which would recognize the expected long-term cost of the insurance commitment at the time the insurance is extended, offers the potential to overcome a number of the deficiencies of cash-based budgeting by improving cost recognition. In concept, recognition in the budget of the risk assumed by the government would permit policymakers to consider these costs in relation to other funding demands and would improve the measurement of a program's impact on private economic behavior. In most cases, the risk-assumed approach to 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. The risk assumed by the government is essentially that portion of a full risk-based premium not charged to the insured.[13]

95. Other people believe that, because there has been no intent for individuals or cohorts of individuals (generations) to make contributions commensurate with the benefits they receive (as would be the case in other kinds of insurance programs), it would be misleading to report the amount of this intergenerational transfer implicit in social insurance.

96. The Board believes that ... the closed group measure represents a reasonably good estimate of the net responsibility of future participants, 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" method that includes all current and future participants over the next 75 years since it relates only to individuals who already are participating in the program.

Transition Costs

97. Some people note that the closed group measure, in addition to being an important factor in assessing the financial position and condition of the program and of the government, also represents a rough estimate of the maximum "transition cost" of the program if it were to move from the present pay-as-you-go system to one that, like most pension plans, sets aside

[13]Budget issues: Budgeting for Federal Insurance Programs, General Accounting Office, GAO/AIMD-97-16, Sept. 30, 1997, p. 5.

resources during workers' careers to finance the benefits they will receive after they retire.[14] The primary reason for reporting the size of this implicit liability in general purpose federal financial reports is to ensure that the financial report fairly presents the financial position, condition, and results of operations of the reporting entities involved. It is also true, however, that this number is one way of quantifying the financing challenges relating to changing social insurance programs and is relevant to the concerns of users who are assessing options for dealing with those challenges. The number not only draws attention to the challenge but also quantifies it in a way that can support further analysis and decision-making. Federal accounting and financial reporting attempt to address the needs of users and to inform them for their decisions, including decisions on these highly important and topical issues.

98. For example, the 1994-96 Advisory Council on Social Security expressed interest in three different approaches to restoring financial solvency and improving the rate of return on individual's contributions to the Social Security System. The three plans were entitled "Maintenance of Benefits," "Individual Accounts," and "Personal Security Accounts (PSA)." The PSA plan involved transition costs that the plan's advocates explained as follows:

> Transition costs arise because, under the present system, there are large unfunded accrued obligations—that is, benefits scheduled to be paid to current retirees and to workers who have already paid taxes in excess of assets on hand. Under the plan, these obligations would be met as they mature. At the same time, the new fully-funded component of the system would be implemented. During the phase-in of the new system, the cost of meeting obligations under the existing system is sometimes referred to as the "transition cost."
>
> Transition costs would be met with a combination of added taxes and added Federal borrowing. The SSA [Social Security Administration] actuaries project that a 1.52 percent supplement to the payroll tax would cover average long-range transition costs over the next 72 years.[15] However, because the unfunded accrued obligations under the existing system are highest in the next couple of decades and taper off in later decades,

[14]Several ways exist for measuring transition costs depending on, among other things, whether one assumes the current program will continue for current participants alongside a new program for new participants (similar to federal employees continuing with the Civil Service Retirement System after the creation of the Federal Employee Retirement System in 1983). In such a transition, the older program would be closed to new entrants. Another type of transition would be where the current participants will move on to the new system, with the transition cost being the amount owed them under the former program. The discussion of different methodologies for calculating transition cost is beyond the scope of this accounting standard; but see the Stephen Goss, "Measuring Solvency in the Social Security System," *Prospects for Social Security Reform*, ed. Olivia S. Mitchell, Robert J. Myers, and Howard Young (Philadelphia: University of Pennsylvania Press, 1999), 16-36.

[15]Note that this rate differs from the 2.17 percent increase in the payroll tax that has been estimated to be necessary to maintain benefits under current law; see p. 25 of the 1994-96 Advisory Council report, vol. 1.

there is a shortfall of revenues between about 2000 and 2034 and an excess of revenues thereafter. It is assumed that the shortfall would be met by issuing bonds to the public for the next 40 years (totaling an estimated $1.9 trillion in 2034, in 1995 dollars), and that these bonds would be fully repaid by the excess of tax revenues in the later period. [vol. 1, p. 32]

99. Similarly, Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, has discussed the challenge confronting the Social Security system and the relevance of the transition amount:

> ... It has become conventional wisdom that the social security system, as currently constructed, will not be fully viable after the baby boom generation starts to retire.... This imbalance in social security stems primarily from the fact that, until very recently, payments into the social security trust accounts by the average employee, plus employer contributions and interest earned, were inadequate to fund the total of retirement benefits. This has started to change. Under the most recent revisions to the law and presumably conservative economic and demographic assumptions, today's younger workers will pay social security taxes over their working years that appear sufficient, on average, to fund their benefits during retirement. However, the huge liability for current retirees, as well as for much of the work force closer to retirement, leaves the system as a whole badly underfunded.[16]

100. In the course of discussing a variety of economic issues and policy options (including "privatization") that transcend accounting, Mr. Greenspan continues:

> Any move toward privatization will confront the problem of how to finance previously promised benefits. That would presumably involve making the implicit accrued unfunded liability of the current social security system to beneficiaries explicit.... If markets perceive that this liability has the same status as explicit federal debt, then one must presume that interest rates have already fully adjusted to the implicit contingent liability. However, if markets have not fully accounted for this implicit liability, then making it explicit could lead to higher interest rates for U.S. government debt.... There is reason to suspect, however, that if such a liability is made explicit in a manner similar to the transition procedure in Chile, each dollar of new liability will weigh far less on financial markets than a dollar of current public debt.[17]

[16]Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System, before the Task Force on Social Security, Committee on the Budget, United States Senate, Nov. 20, 1997, p. 1.

[17]Greenspan, p. 4-5.

101. Mr. Greenspan mentioned some reasons why the capital market's reaction—though possibly substantial—might be muted if the government made this implicit liability more explicit. The Federal Reserve has estimated that, using a 2 percent real rate of discount and other assumptions, the value of all currently accrued legislated future Social Security retirement benefits would be roughly $9.5 trillion.

102. The assumptions, benefits, population, and actuarial approach covered by this estimate differ somewhat from those used by the Social Security Trustees in the past to produce the closed group estimate comparable to the one called for by this statement. The calculation used for Mr. Greenspan's testimony is an estimate of the actuarial present value of future benefits arising from individuals' covered employment to the date of calculation, without considering their expected future employment until they retire. The estimate for the closed group in this standard considers both benefits to be earned and contributions to be made for current participants, in addition to benefits already earned or credited. Also, Mr. Greenspan's estimate is for Old-Age and Survivors Insurance only while this standard proposes that the closed group estimate for Social Security also include Disability Insurance. However, the numbers are roughly comparable.

103. The Chairman concluded by saying

> We owe it to those who will retire after the turn of the century to be given sufficient advance notice to make what alterations in retirement planning may be required. If we procrastinate too long, the adjustments could be truly wrenching. Our senior citizens, both current and future, deserve better.[18]

. . .

Money's Worth

104. The Board considered requiring a "money's worth" measure. Such a measure would show all contributions paid and benefits received by different age groups (e.g., those born in 1920 compared with 1940). The 1994-96 Advisory Council on Social Security recommended that Social Security meet a test of providing a reasonable money's worth return on the contributions of younger workers and future generations, while taking into account the redistributive nature of the system. The Council said that, although money's worth return was only one measure among many, it was important to the long-range sustainability of the program for younger generations to believe that they were getting a reasonable return on their taxes. The Council said,

[18]Greenspan, p. 9.

Social Security should provide benefits to each generation of workers that bear a reasonable relationship to total taxes paid, plus interest.

Many important values served by a Social Security system are not fully captured by looking solely at money's worth or rates of return. Nevertheless, the Council believes that it is important that young workers perceive that the system is fair. This perception suggests that the younger generation should be well treated in terms of the issue of money's worth, taking into account the fact that within each generation there will be a redistribution toward the lower paid. [vol. 1, p. 17]

105. Some argue that the money's worth measure may be viewed as a good measure of potential future stress caused by the disparity between taxes and anticipated benefits. However, others argue that this measure is of questionable relevance given the basic design and breadth of the benefits available under some social insurance programs. For example, the Social Security benefit formula is designed to provide relatively higher benefits for workers with lower earnings. This feature of the program is inconsistent with a pure focus on money's worth. Finally, as commonly reported, this measure does not reflect some social insurance programs and program features such as benefits to the disabled or dependents in the event of the participant's death.

106. The Board considered the money's worth measure and believes that it presents a useful perspective. However, the Board decided not to require it because it fails to capture the complexity of social insurance programs and could be calculated from too many perspectives. The Board recognizes the usefulness of the measure for policy analysis (and management may wish to report it voluntarily) but it goes beyond what the Board regards as essential to present fairly the financial position, condition, and results of operations of the reporting entities involved (including the governmentwide entity). Accordingly, the Board decided not to require RSSI about money's worth.

Trust Fund Ratio

107. The Board also considered the "trust fund ratio" which is defined as the fund balance at the beginning of the year expressed as a percentage of the outgo during the year; or, in other words, the proportion of a year's outgo that could be paid with the funds available at the beginning of the year.[19] The trust fund ratio is one of several measures the Social Security trustees use to evaluate the short-term financial status of the trust funds. Also, the 1994-96 Social Security Advisory Council advocated using the trust fund ratio as a gauge of long-term sustainability. The Council recommended that, in addition to the actuarial balance over 75

[19]The 1997 Annual Report of The Board of Trustees, Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, p. 221.

years, the program should have a stable trust fund ratio over the final years of the 75-year forecast horizon.[20] The Council believed that the trend of trust fund ratio would indicate whether there would be cause for concern about the years beyond the 75-year horizon. The Council was concerned that all factors known at the time of the 75-year projection be considered and reported, including whether there were problems beyond the 75-year projection period. For example, even as the trustees are reporting that the system is in actuarial balance over 75 years, demographic trends could make the next 10 years beyond the 75-year horizon more expensive.

108. The Board decided not to recommend the trust fund ratio as RSSI for a number of reasons. In particular, to be useful, the ratio would have to be used in conjunction with a projection that was in actuarial balance or nearly so. Under the current "best estimate" projection, where fund balance is expected to be exhausted well before 75 years, the trust fund ratio would not be usable. Although the Board acknowledges that the ratio may be useful as an indicator of short-term financial condition, it believes the projections and estimates in this standard will be more informative for accounting purposes.

. . .

Component & Governmentwide Perspectives

109. In developing these standards, the Board attempted to address the component entity as well as governmentwide reporting. From the perspective of the component federal entity, the accounting and reporting includes assets in the form of Treasury securities as well as interest thereon. These are not claims on third parties. The assets of the funds are offset by an identical liability of the U.S. Treasury. Like other intragovernmental assets and liabilities, they do not represent assets (or liabilities) of the Federal Government as a whole and are eliminated for governmentwide reporting. The nonmarketable Treasury debt securities are evidence of the accumulation of excess cash receipts over cash disbursements within the social insurance program.

[20]See *Findings and Recommendations*, vol. 1, p. 17 (Jan. 1997).

Appendix B - Sample Reporting For Illustration Only

NOTE

The sample report sections in Appendix B provide nonauthoritative illustrations of possible RSSI that would comply with this standard. The narrative, charts, tables, and other information shown there are intended to be one approach among others to provide a full description of the programs and to supply the required information. The standard does not require any particular format or graph. Most, but not all, of the data presented in Appendix B would be required by pars. 27 and 32 of the standard (e.g., the year the fund balance is exhausted [see par. 117] and the open group actuarial deficit as a percentage of taxable payroll [see par. 120] would not be required). This is done to illustrate that management may provide more supplementary information than is required by the standard.

Most data are taken from various reports for FY 1996 and are "actual data." Certain data are hypothetical. Although the data are realistic, readers should not rely on the validity of the data in the sample reports.

OMB provides specific form and content guidance on financial reports.

Social Security - Required Supplementary Stewardship Information

Statement of Social Insurance - Old-Age, Survivors and Disability Insurance - 75-Year Projection[a] as of September 30, 1996 [HYPOTHETICAL DATA]

Dollars in Trillions

		Prior Years			
	1996	**1995**	**1994**	**1993**	**1992**
Actuarial present value of future benefit payments[b] during the 75-year period to or on behalf of:					
Current participants not yet having attained retirement age[c]	$X	$X	$X	$X	$X
Current participants who have attained retirement age[c]	X	X	X	X	X
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
Subtotal—benefit payments for the 75-year period	**19**	**X**	**X**	**X**	**X**
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:					
Current participants not yet having attained retirement age	Y	Y	Y	Y	Y
Current participants who have attained retirement age[c]	Y	Y	Y	Y	Y
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y
Subtotal—contributions and tax income for the 75-year period	16	Y	Y	Y	Y
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period [d]	**$3**	**$X**	**$X**	**$X**	**$Y**

Notes to the Statement:

[a]The projection period for new entrants covers the next 75 years. The projection period for current participants (or "closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years a in few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

[b]"Benefit payments" include administrative expenses.

[c]To calculate the actuarial net present value of the excess of future benefit payments to current participants (that is, to the "closed group" of participants) over future contributions and tax income from them or on their behalf, subtract the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

[d]The calculation of the "close actuarial balance" used for analysis by the Social Security trustees differs from the calculation of the amount presented on this line. The trustees' close actuarial balance calculation includes the fund balance at the beginning of the period as an item of cash inflow and the cost of about one year's expenditure, as a target fund balance at the end of the period, as a cash outflow. The fund balance—which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over cash outflow within the social insurance program—for 1996 for the OASDI program is $ .6 trillion (OASI, $ .5 trillion, and DI $ .1 trillion). The fund balances for 1995-2, in trillions, were $.6, .5, .5, .4, respectively. The fund balance consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

Program Description

110. The Old-Age, Survivors, and Disability Insurance (OASDI) program, collectively referred to as "Social Security" or OASDI, provides cash benefits for eligible U.S. citizens and residents. During calendar year 1996, OASDI provided benefits to approximately 44 million beneficiaries. Eligibility and benefit amounts are determined under the laws applicable for the period. Current law provides that the amount of the monthly benefit payments for individuals, or dependent spouses and children, is based on the individuals' taxable earnings up to the date when payments commence.

111. The amount of the effective monthly OASDI benefits may be altered by changes in laws governing the program. In 1983 for example, up to one-half of OASDI benefits became taxable; cost-of-living-adjustments (COLAs) were permanently delayed six months; and the age for full retirement benefits was gradually increased from 65 to 67 over a 24-year period.

112. OASDI has been described as an income transfer program—that is, a program designed to reduce economic disparity by redistributing income between households. OASDI transfers income in at least two ways. First, its benefit structure is progressive in the sense that benefits during retirement for lower-income workers replace a larger proportion of income earned during their working years than is the case for higher-income workers. This results in an income transfer among workers of the same age group but in different income groups. Second, OASDI is financed largely on a pay-as-you-go basis. The payroll taxes paid to OASDI each year by current workers are primarily used to pay the benefits provided during that year to current beneficiaries. This results in income transfers between current workers and current beneficiaries and therefore between younger workers and older retirees, the disabled, and surviving family members.

Program Finances and Sustainability

113. As discussed in Note X to the consolidated financial statements, a liability of $34 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of OASDI benefits due to recipients for periods ended on or before September 30, 1996 ($33 billion in FY 1995). Virtually all of this amount was paid in October 1996. Also, an asset is recognized for the "investments in Treasury securities" as of September 30, 1996, of $550 billion ($483 billion in FY 1995). This investment represents trust fund assets accumulated from the excess of payroll taxes over benefits in prior periods. This fund balance is available for OASDI's use in future periods when a deficit occurs in the program. These investments are referred to as "trust fund assets" throughout the remainder of this disclosure.

114. No liability has been recognized on the balance sheet for future payments to be made to present and future program participants, beyond the unpaid amounts as of September 30, 1996. This is because the OASDI is accounted for as a social insurance program rather than a

pension program. Accounting for a social insurance program recognizes the expense of benefits when they are actually paid or are due to be paid because benefit payments are primarily nonexchange transactions and are not considered deferred compensation as would employer-sponsored, employee's pension benefits. Accrual accounting for a pension program, by contrast, would recognize the retirement benefit expenses as they are earned during a worker's career so that the full actuarial present value of the expected retirement benefits has been recognized by the time the worker retires.

115. ***Supplementary Stewardship Information*** - While no liability has been recognized on the balance sheet for future payments beyond those due at period end, actuarial estimates of future program activities are made annually to assess the financial condition and prospects for OASDI and are presented here as supplementary stewardship information. The statement presented above and the displays below represent the best estimate of future cash inflow and outflow based on the assumptions shown at the end of this section and considering future changes previously mandated by law. However, estimates extending so far into the future are inherently uncertain, and the uncertainty is greater for the later years in the period. This stewardship information includes:

    (1) actuarial present values of future benefits for and contributions and tax income from or on behalf of current and future program participants;

    (2) cashflow in **nominal dollars** and as percentages of taxable payroll and the GDP;

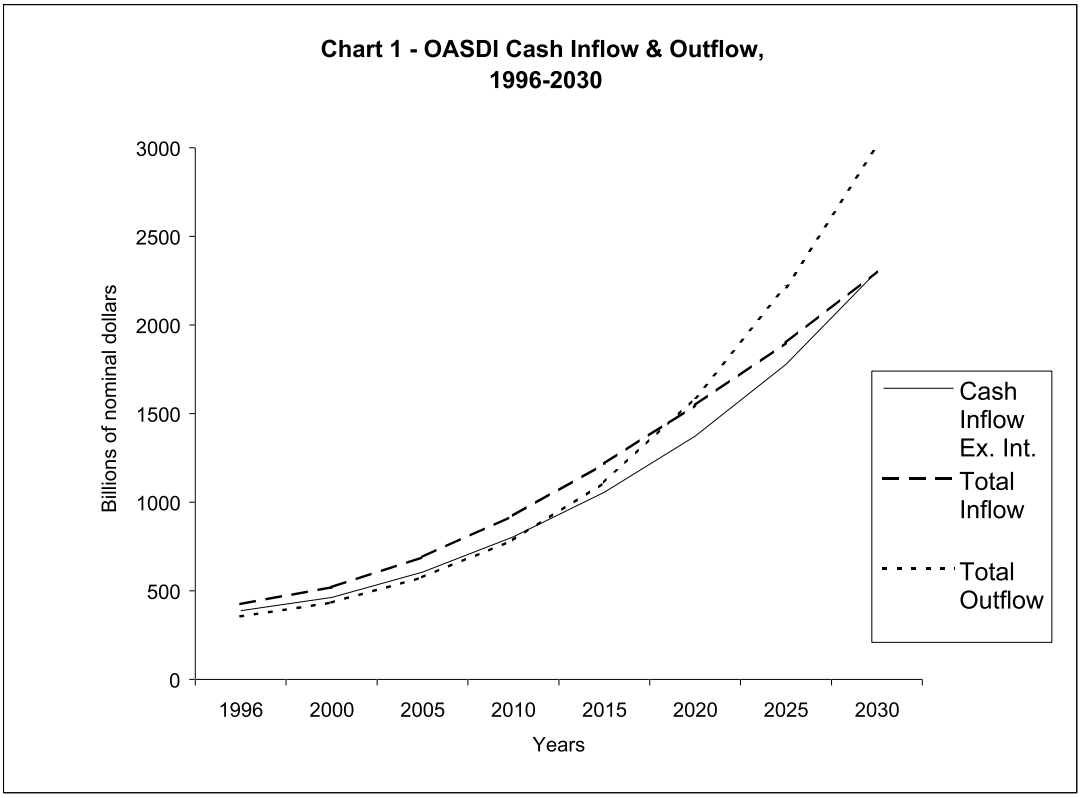
    (3) the ratio of contributors to beneficiaries or "dependency ratio" showing the long-range relationship between the program's beneficiaries and contributors; and

    (4) an analysis of the sensitivity of the projections to changes in assumptions.

116. *Cashflow Projections* - Chart 1 below shows the actuarial estimate of OASDI cash inflow and outflow for each of the next 35 years, in nominal dollars, using data from the OASDI Trustees' annual report. The estimate is based on what the Trustees refer to as the **open group population** (i.e., all persons who will participate in the program as contributors or beneficiaries or both over the next 35 years). Thus, it includes payments from, and on behalf of, employees who will enter the workforce during the next 35 years as well as those now in the workforce.

117. As chart 1 shows, present estimates indicate that, in nominal dollars, cash outflow would start to exceed total inflow (including interest on intragovernmental borrowing/lending) in about 2019. This deficiency would continue at an increasing rate thereafter, require the redemption of investments in Treasury securities held as assets by the trust fund, and result

in the exhaustion of accumulated asset balances in 2029.[21] Even before 2019, outflow would exceed cash inflow from the public (i.e., excluding interest paid by Treasury). Estimates indicate this will happen in about 2012, as shown in chart 1. From about 2012 forward, OASDI would pay more to the public than it would receive in taxes. This would increase the government's financing needs. Compared to a situation in which OASDI taxes equaled outgo, the government would have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.



Source: Data from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

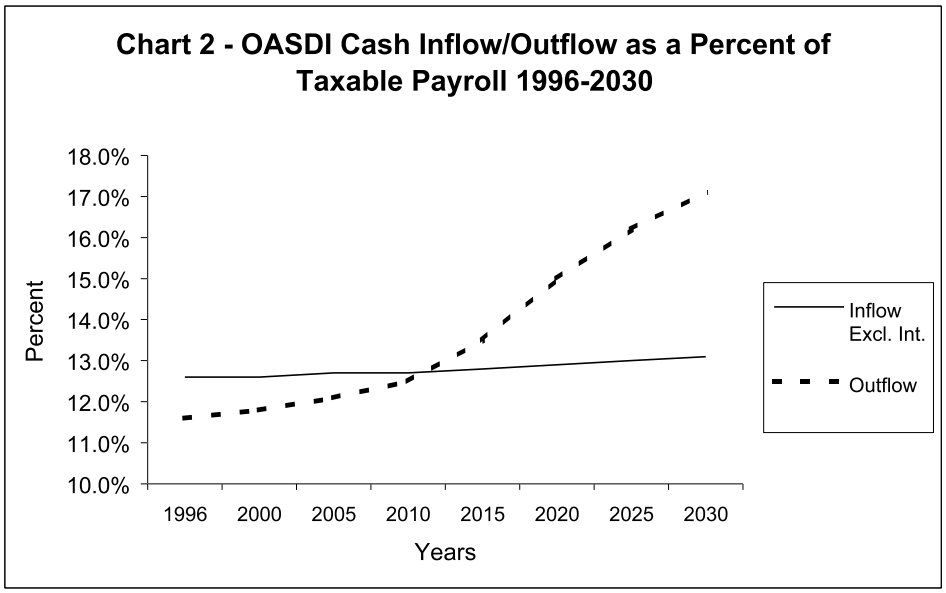
Terms Used In Chart 1

The following terms are used in chart 1:

[21][Please note: the standard does not require information on the year when the assets would be exhausted as the program is currently structured (see par. 117). This information illustrates that management can provide data in addition to that required by the standard where it feels doing so would be useful to readers of the report.]

- **total inflow** includes payroll taxes, income tax on certain OASDI benefits, interest income, and miscellaneous reimbursement from the general fund;
- **cash inflow excluding interest** is income exclusive of interest on trust fund assets;
- **total outflow** includes benefit payments, administrative expenses, net transfers to the Railroad Retirement program, and vocational rehabilitation expenses for disabled beneficiaries.

118. *Percentage of Taxable Payroll* - The excess of cash outflow over inflow is due to a variety of factors including the retirement of the "baby boom" generation and the relatively small number of people born during the subsequent period of low birth rate. As presently constructed, the program receives most of its cash inflow from the 6.2 percent payroll tax that employees and employers each pay, for a total of 12.4 percent of taxable payroll. Chart 2 below illustrates the rising annual cost of the program relative to its annual income as a percentage of taxable payroll.



Source: Data from Tables III A2, 1996 OASDI Trustee's Report.

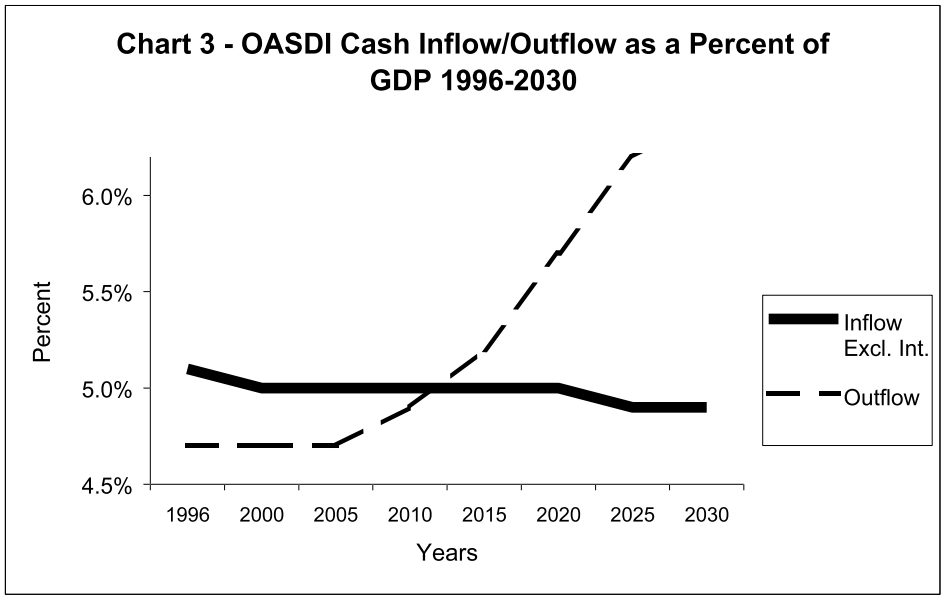
119. The total excess of cash outflow over inflow for OASDI over the next 75 years is estimated to be 2.17 percent of taxable payroll; in other words, a tax increase today of about 1.09 percent of taxable payroll each on employees and employers, over the 6.2 percent they each now pay, would produce enough inflow over 75 years to pay all benefits due under current law.[22] There

[22][Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 2.]

would be trust fund surpluses in the early years of the projection from which the Trustees would acquire Treasury securities to be used to pay benefits later.

120. Stated in terms of actuarial present value, the 2.17 percent deficit equates to an excess of expenditures over contributions of about $3 trillion over the next 75 years from September 30, 1996. The accumulation and subsequent redemption of substantial trust fund assets have economic and public policy implications that go beyond the operation of the OASDI program itself. Discussion of these broader issues is not within the scope of this report.

121. *Percentage of GDP* - In addition to analyzing OASDI operations as a percentage of taxable payroll, viewing them as a percentage of the Gross Domestic Product (GDP) provides an additional perspective on these funds in relation to the capacity of the national economy to sustain them. The GDP represents the total value of goods and services produced in the United States. Chart 3 below shows OASDI's cost as a percentage of GDP.



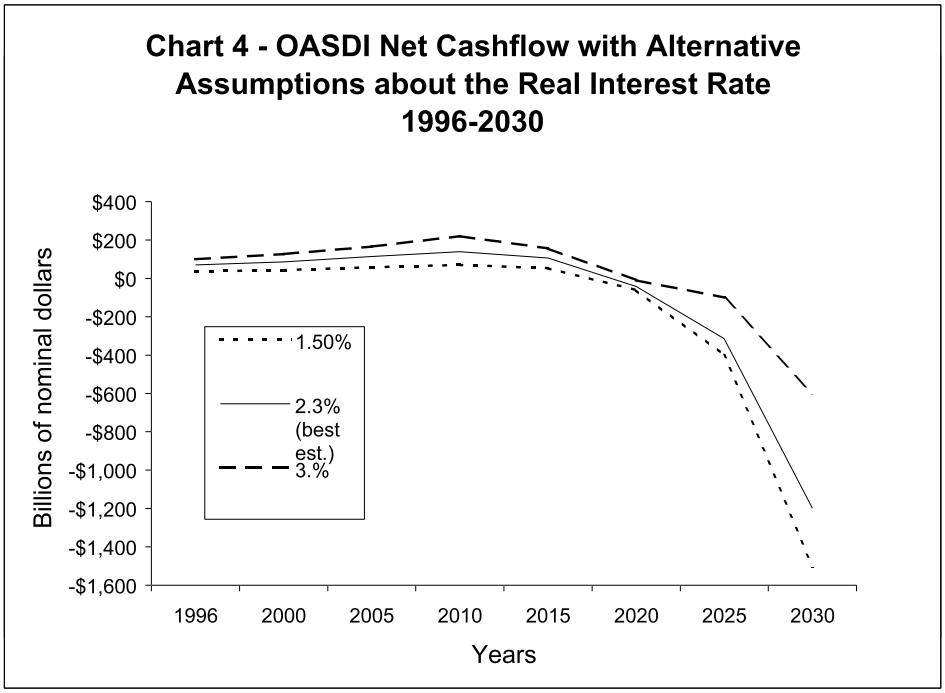
Source: Data from Tables III C1, 1996 OASDI Trustee's Report.

122. In 1996, federal spending for OASDI exceeded $350 billion, which was about 4.7 percent of GDP. By 2030, when most baby boomers will have retired, the program (based on current law) will consume nearly 50 percent more of GDP than it does today—6.4 percent. Nearly all of the increase between now and 2030 will occur between 2010 and 2030, as retired baby boomers become eligible for those programs.

123. ***Sensitivity Analysis*** - As indicated by the assumptions shown at the end of this section, the future cashflow of the OASDI program depends on many economic and demographic assumptions, including GDP, labor factors, unemployment, average wages and self-employment earnings, interest rates on Treasury securities, productivity, inflation, fertility, mortality, net immigration, marriage, divorce, retirement patterns, and disability incidence and termination. The cash inflow will depend on how these factors affect the size and composition of the working population and the level and distribution of wages and earnings. Similarly, the outgo will depend on how these factors affect the size and composition of the beneficiary population and the general level of benefits. Precise long-range projections of these factors is impossible.

124. This section illustrates the sensitivity of the long-range projections to changes in assumptions by analyzing five key individual assumptions: the real interest rate, the death and birth rates, net immigration, and the real wage differential. For this analysis the "best estimate" cost assumptions are used as the reference point, and each assumption is varied within it individually.

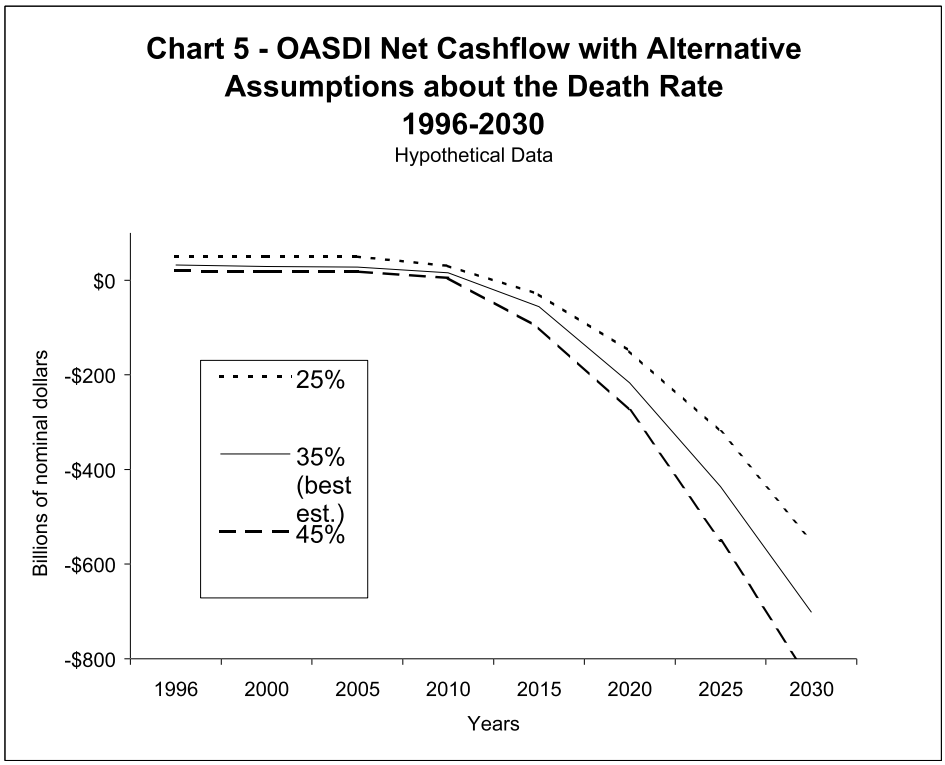
125. *Real Interest Rate* - The "best estimate" long-range cashflow projections presented in Chart 1 above assume a 4 percent increase in Consumer Price Index (CPI) per year after the year 2000 as the inflation rate and a 2.3 percent real interest rate. The "real interest rate" is the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the CPI. Chart 4 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 2.3 percent real interest rate, with the net cashflow that would result from decreasing the real interest rate to 1.5 percent and increasing it to 3 percent.



Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report

As stated above, the estimated total excess of OASDI cash outflow over cash inflow over the next 75 years is $3 trillion. If the annual real interest rate—that is, the difference between the interest on the Treasury securities held by the trust fund and the inflation rate, as measured by the Consumer Price Index (CPI)—is changed from the 2.3 percent used for the best estimate projection to 1.5 percent, the total excess of cash outflow would increase to $3.8 trillion; if the rate were changed to 3 percent, the total excess would decrease to $2.5 trillion.

126. Death Rate - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during 1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.

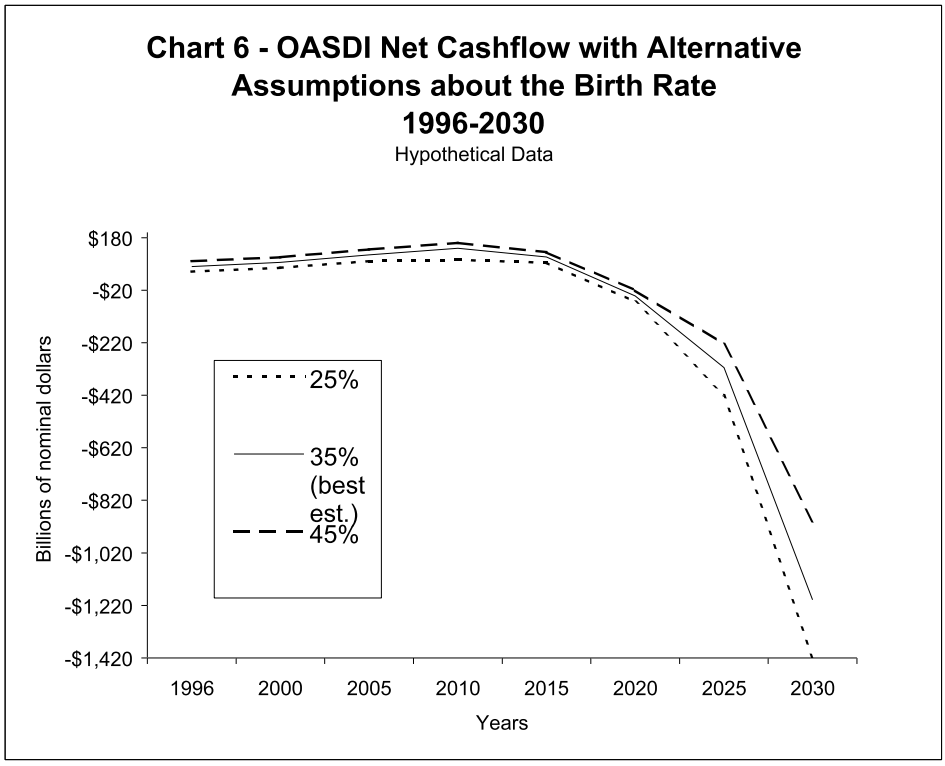


Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Regarding actuarial present values for a 75-year projection period, if the decrease in the death rate is changed from the 35 percent used for the best estimate projection to 15 percent, meaning that more people are dying, the total excess of cash outflow for the period would decrease to $2.1 trillion, from $3.0 trillion; if the rate were changed to 55 percent, the total excess cash outflow would increase to $4.2 trillion.

127. *Birth Rate* - Table 1 below shows the estimated total excess OASDI cash outflow over inflow over a 75 year projection period using a birth rate above and below the rate used for the best estimate projection. This analysis was developed by varying the percentage increase in the birth rate assumed to occur during 1996-2070. The rate used for the best estimate projection assumes a ultimate birth rate in 2070 of 1.9 children per woman. Chart 6 below shows the estimated OASDI cash inflow and outflow using a birth rate above and below the rate used for the projection in Chart 1 above. Chart 6 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1.9 birth rate, with the net

cash outflow that would result from decreasing the rate to 1.6 percent and increasing it to 2.2 percent.



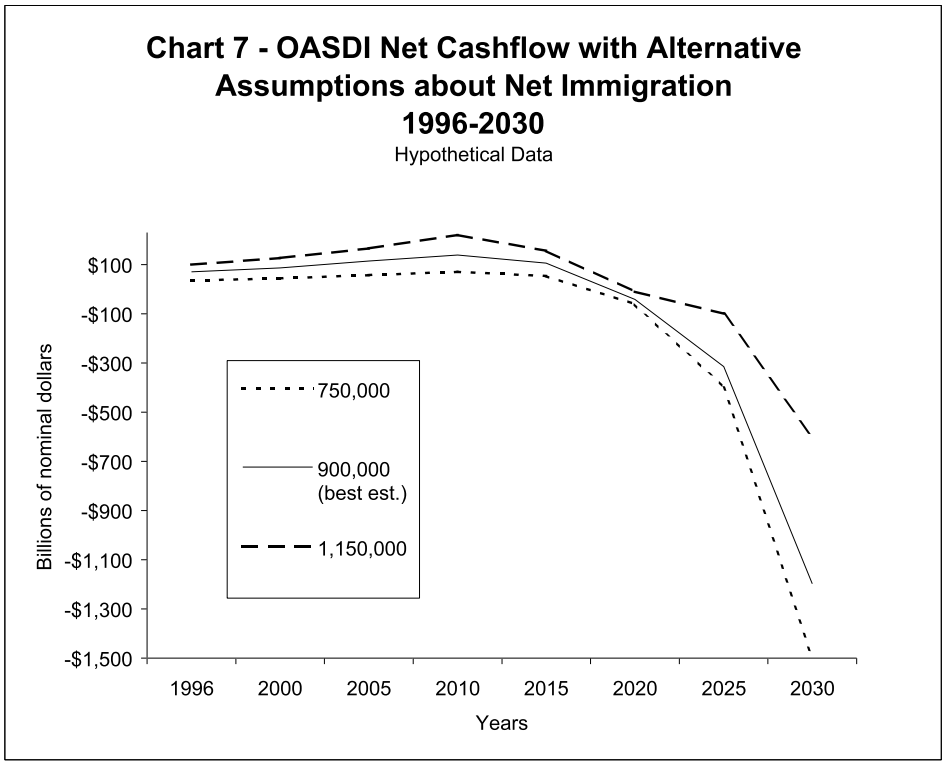
Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Table 1 presents the affect of using rates of 1.6 and 2.2 on the excess of cash outflow over inflow during the projection period. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions - Valuation Period: 1996-2070

Dollars in trillions			
	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	$3.7	$3.0	$2.5

128. *Net Immigration*—Chart 7 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 900,000 per year net immigration rate, with the net cashflow that would result from decreasing the rate to 750,000 and increasing it to 1,150,000.



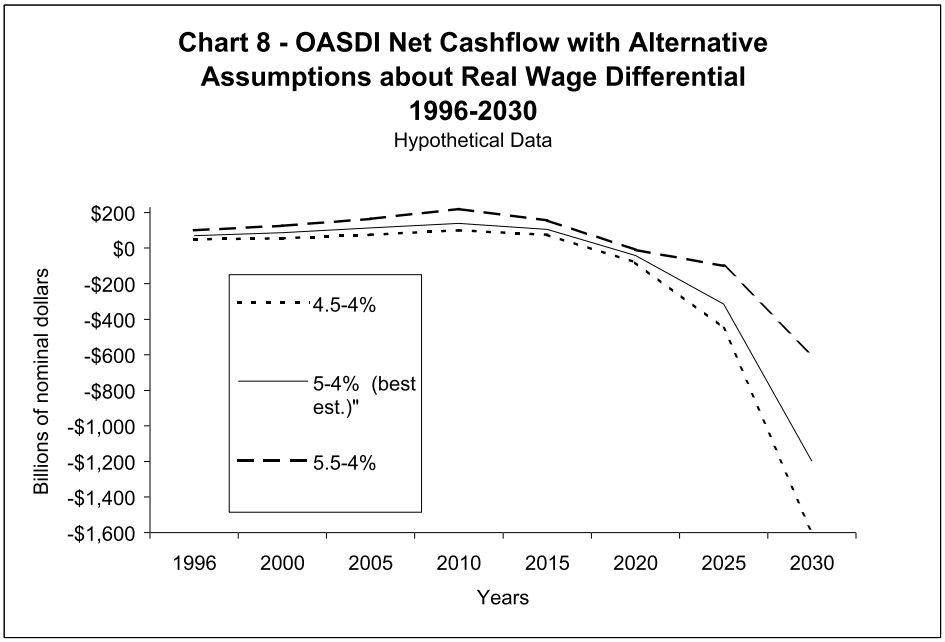
Source: Data regarding "best estimate" from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

Regarding actuarial present values over 75 years, table 2 below shows the estimated total excess of OASDI cash outflow over inflow with assumptions that differ from those used for the "best estimate" projection.

Table 2: Estimated Total Excess OASDI Cash Outflow over Inflow with Various Net Immigration Assumptions - Valuation Period: 1996-2070

Dollars in trillions			
	Net immigration per year		
Valuation Period: 1996-2070	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over cash inflow	$3.2	$3.0	$2.9

129. *Real-Wage Differential* - Chart 8 below compares the estimated OASDI net cash outflow using the best estimate cost assumptions, including the 1 percent real wage differential, with the net cashflow that would result from decreasing the rate to .5 percent and increasing it to 1.5 percent. 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.



Source: Data regarding "best estimate" is from Tables III B1, B3, & C1, 1996 OASDI Trustee's Report.

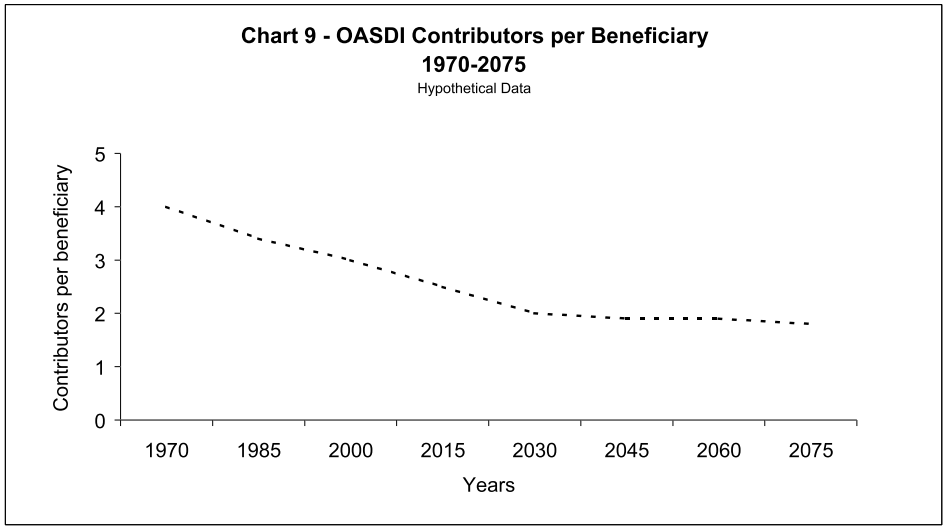
Regarding actuarial present values over 75 years, table 3 below shows the estimated total excess of OASDI cash outflow over inflow with various assumptions about the real-wage differential.

Table 3- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Real-Wage Assumptions - Valuation Period: 1996-2070

Dollars in trillions

	Ultimate percentage in wages-CPI ***The first value in each of the pairs below is the assumed ultimate annual percentage increase in average wages in covered employment. The second value is the assumed ultimate annual percentage increase in the CPI. The difference between the two values is the real-wage differential.]***		
Wages-CPI	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Excess cash outflow over inflow	$3.9	$3.0	$2.3

130. ***Dependency Ratio*** - Chart 9 below shows the estimated number of covered workers per OASDI beneficiary using the Trustees' best estimate. As defined by the Trustees, covered workers are persons having earnings creditable for OASDI purposes on the basis of services for wages in covered employment and/or on the basis of receipts from covered self-employment. As Chart 6 shows, the number of workers to beneficiaries will decline from 3.3 per beneficiary in 1995 to 2 per beneficiary in 2030 and 1.8 in 2075.



Social Security Assumptions-

Assumptions Used

The estimates used in this presentation are based on the assumption that the programs will continue as presently constructed. They give effect to certain additional economic and demographic assumptions, including those in the following table:

	Average Annual Percent Change			Ave. Annl. Interest Rate on Treasury Secur. (%)	Ave. Annl. Unempl. Rate	Ave. no. of children per woman	Death rate per 100,000	Life expectancy	
	GDP	Wages	CPI					Men	Women
1996	2.0	4.0	2.0	6.0	5.0	2.0	757	72	79
2000	2.0	4.3	3.5	6.5	6.0	2.0	731	73	79
2005	2.0	5.1	4.0	6.4	6.0	2.0	700	73	80
2010	1.8	5.0	4.0	6.3	6.0	2.0	677	74	80
2020	1.3	5.1	4.0	6.3	6.0	1.9	638	75	81
2030	1.4	5.0	4.0	6.3	6.0	1.9	603	76	81

These assumptions and the other values on which these displays are based represent the latest and most likely — or "best" — estimates of these values by the Trustees. Estimates made in certain prior years have changed substantially because of revisions to the assumptions due to changed conditions or experience, and to changes in actuarial methodology. It is reasonable to expect more changes for similar reasons in the future.

Unemployment Insurance Programs

131. The U. S. Department of Labor operates two programs classified under federal accounting standards as social insurance, the Unemployment Insurance Program and the Black Lung Disability Benefits Program. Presented below is the required supplementary stewardship information for the Unemployment Insurance Program.

Program Description

132. The Unemployment Insurance (UI) program was created in 1935 to provide income assistance to unemployed workers who have lost their jobs through no fault of their own. The program protects workers during temporary periods of unemployment, through the provision of unemployment compensation benefits. These benefits replace part of the unemployed worker's lost wages and, in so doing, stabilize the economy during recessionals periods by increasing the unemployed worker's lost wages and purchasing power. The UI program operates counter cyclically, paying benefits during recessionary periods and collecting UI tax revenue during periods of recovery.

133. ***Program Administration and Funding*** - The UI program is administered through a unique system of federal-state partnerships, established in federal law but executed through conforming state laws by state officials. The Federal Government provides broad policy guidance and program direction through the oversight of the U.S. Department of Labor, while program details are established through individual state UI statutes, administered through state UI agencies.

134. ***Federal and State Unemployment Taxes*** - The UI program is financed through the collection of federal and state unemployment taxes levied on subject employers and deposited in the unemployment trust fund (UTF). Federal unemployment taxes are used to pay for the administrative costs of the UI program, including grants to each state to cover the costs of state UI operations, as well as the federal share of extended UI benefits. Federal unemployment taxes are also used to maintain a loan account within the UTF, from which insolvent state accounts may borrow funds to pay UI benefits. State UI taxes are used exclusively for the payment of regular UI benefits, and the state's share of extended benefits. These taxes and the UTF established to account for their receipt, investment, and disbursement are discussed below.

135. *Federal Unemployment Taxes* - Under the provisions of the Federal Unemployment Tax Act (FUTA), a federal tax is levied on covered employers, at a current rate of 6.2 percent of the first $7,000 in annual wages paid to each employee. This federal tax is reduced by a credit of up to 5.4 percent granted to employers paying state UI taxes under conforming state UI statutes. Accordingly, in conforming states, employers pay an effective federal tax of .8 percent. Federal unemployment taxes are collected by the Internal Revenue Service.

136. *State Unemployment Taxes* - In addition to the federal tax, individual states finance their UI programs through state tax contributions from subject employers on the wages of covered employees. (Three states also collect contributions from employees.) Within Federal confines, state tax rates are assigned in accordance with an employer's experience with unemployment. Actual tax rates vary greatly among the states and among individual employers within the state. At a minimum, these rates must be applied to the federal tax base of $7,000; however, states may adopt a higher wage base than the minimum established by FUTA. State UI agencies are responsible for the collection of state unemployment taxes.

137. ***Unemployment Trust Fund*** - Federal and state UI taxes are deposited into designated accounts within the UTF. The UTF was established under the authority of Title IX, section 904 of the Social Security Act of 1935, as amended, to receive, hold, invest, loan, and disburse federal and state UI taxes. The U.S. Department of the Treasury invests amounts in excess of disbursing requirements in Treasury securities. The UTF is comprised of the following accounts:

138. *Federal Accounts* - The Employment Security Administration Account (ESAA) was established pursuant to section 901 of the Social Security Act. All tax receipts collected under the FUTA are appropriated to the ESAA and used to pay the costs of federal and state administration of the UI program and veterans employment services, as well as 97 percent of the costs of the state employment services. Excess balances in ESAA, as defined under the act, are transferred to other federal accounts within the fund, as described below.

139. The Federal Unemployment Account (FUA) was established pursuant to section 904 of the Social Security Act. FUA is funded by any excesses from the ESAA as determined in accordance with section 902 of the act. Title XII, section 1201 of the act authorizes the FUA to loan federal monies to state accounts that are unable to make benefit payments because the state UI account balance has been exhausted. Title XII loans must be paid with interest. The FUA may borrow from the ESAA or the Extended Unemployment Compensation Account (EUCA), without interest, or may also receive repayable advances, with interest, from the general fund of the U.S. Treasury when the FUA has a balance insufficient to make advances to the states.

140. The Extended Unemployment Compensation Account (EUCA) was established pursuant to section 905 of the Social Security Act. EUCA provides for the payment of extended unemployment benefits authorized under the federal/state Extended Unemployment Compensation Act of 1970, as amended. Under the extended benefits program, extended unemployment benefits are paid to individuals who have exhausted their regular unemployment benefits. These extended benefits are financed one-half by state unemployment taxes and one-half by FUTA taxes obtained from the EUCA. The EUCA is funded by a percentage of the FUTA tax transferred from the ESAA in accordance with section 905(b)(1) and (2) of the Social Security Act. The EUCA may borrow from the ESAA or the FUA, without interest, or may also receive repayable advances from the general fund of the Treasury when the EUCA has a balance insufficient to pay the federal share of extended benefits. During periods of sustained high unemployment, the EUCA may also receive payments and non repayable advances from the general fund of the Treasury to finance emergency unemployment compensation benefits. Emergency unemployment benefits require congressional authorization.

141. The Federal Employees Compensation Account (FECA) was established pursuant to section 909 of the Social Security Act. FECA provides funds to states for unemployment compensation benefits paid to eligible former federal civilian personnel and ex-service members. Generally, benefits paid are reimbursed to the FECA by the various federal agencies. Any additional resources necessary to ensure that the account can make the required payments to states, due to the timing of the benefit payments and subsequent reimbursements, will be provided by non repayable advances from the general fund of the Treasury.

142. *State Accounts* - Separate state accounts were established for each state and territory depositing monies into the UTF, in accordance with section 904 of the Social Security Act. State unemployment taxes are deposited into these individual accounts and may be used only to pay state unemployment benefits. States may receive repayable advances from the FUA when their balances in the UTF are insufficient to pay benefits.

143. *Railroad Retirement Accounts* - The Railroad UI Account and Railroad UI Administrative Account were established under section 904 of the Social Security Act to provide for a separate unemployment insurance program for railroad employees. This separate unemployment insurance program is administered by the Railroad Retirement Board, an agency independent of the Department of Labor (DOL). DOL is not responsible for the administrative oversight or solvency of the railroad unemployment insurance system. Receipts from taxes on railroad payrolls are deposited in the Railroad UI Account and the Railroad UI Administrative Account to meet benefit payment and related administrative expenses.

144. ***UI Program Benefits*** - The UI program provides regular and extended benefit payments to eligible unemployed workers. Regular UI program benefits are established under state law, payable for a period not to exceed a maximum duration. In 1970, federal law began to require states to extend this maximum period of benefit duration by 50 percent, during periods of high unemployment. These extended benefit payments are paid equally from federal and state accounts.

145. *Regular UI Benefits* - There are no federal standards regarding eligibility, amount, or duration of regular UI benefits. Eligibility requirements, benefit amounts, and benefit duration are determined under state law. Under state laws, worker eligibility for benefits depends on experience in covered employment during a past base period, which attempts to measure the workers' recent attachment to the labor force. Three factors are common to state eligibility requirements: (1) a minimum duration of recent employment and earnings during a base period to unemployment, (2) unemployment not the fault of the unemployed, and (3) availability of the unemployed for work.

146. Benefit payment amounts under all state laws vary with the worker's base period wage history. Generally, states compute the amount of weekly UI benefits as a percent of an individual's average weekly base period earnings, within certain minimum and maximum limits. Most states set the duration of UI benefits by the amount of earnings an individual has received during the base period. Currently, all but two states have established the maximum duration for regular UI benefits at 26 weeks (Massachusetts and Washington state provide 30 weeks). Regular UI benefits are paid by the state UI agencies from monies drawn down from the state's account within the UTF.

147. *Extended UI Benefits* - The Federal/State Extended Unemployment Compensation Act of 1970 provides for the extension of the duration of UI benefits during periods of high unemployment. When the insured unemployment level within a state, or in some cases total unemployment, reaches certain specified levels, the state must extend benefit duration by 50 percent, up to a combined maximum of 39 weeks. Fifty percent of the cost of extended unemployment benefits is paid from the EUCA within the UTF, and 50 percent by the state, from the State's UTF account.

148. *Emergency UI Benefits* - During prolonged periods of high unemployment, Congress may authorize the payment of emergency unemployment benefits to supplement extended UI benefit payments. Emergency benefits were last authorized in 1991 under the EUCA. Emergency benefit payments in excess of $28 billion were paid over the three year period ending in 1994. Emergency benefits were paid from the surplus of federal unemployment taxes in EUCA and, once EUCA balances were exhausted, from general revenues of the U.S. Treasury.

149. *Federal UI Benefits* - Unemployment benefits to unemployed federal workers are paid from the FECA within UTF and then reimbursed by the responsible federal agency. They are not considered to be social insurance benefits. Federal unemployment compensation benefits are not included in this discussion of social insurance programs.

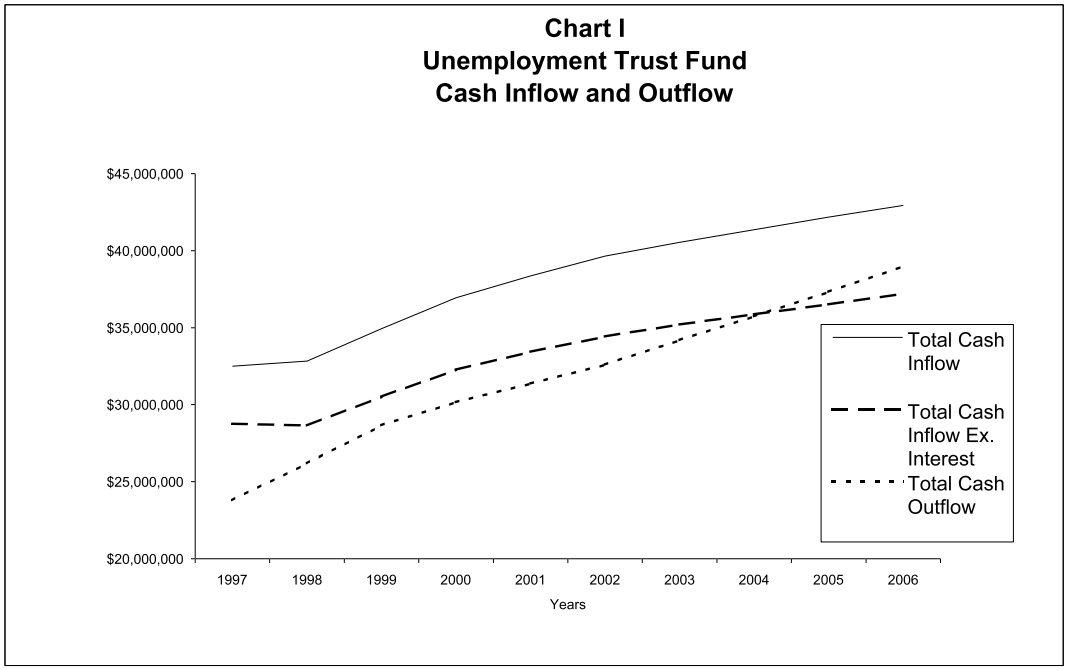
Program Finances and Sustainability

150. At September 30, 1996, total assets within the UTF exceeded liabilities by $54.0 billion.[23] This fund balance approximates the accumulated surplus of tax revenues and earnings on these revenues over benefit payment expenses and is available to finance benefit payments in future periods when tax revenues may be insufficient. Treasury invests this accumulated surplus in federal securities. The net value of these securities at September 30, 1996, was $53.9 billion. These investments accrue interest, which is distributed to eligible state and federal accounts within the UTF. Interest income from these investments during FY 1996 was $3.4 billion. As discussed in Note 1.B.3 to the consolidated financial statements, DOL recognized a liability for regular and extended unemployment benefits to the extent of unpaid benefits applicable to the current period. Accrued unemployment benefits payable at September 30, 1996, were $506.4 million.

151. ***Effect of Projected Cash Inflows and Outflows on the Accumulated Net Assets of the UTF*** - The ability of the UI programs to meet a participant's future benefit payment needs depends on the availability of accumulated taxes and earnings within the UTF. The DOL measures the effect of projected benefit payments on the accumulated net assets of the UTF, under an open group scenario, which includes current and future participants in the UI program. Future estimated cash inflows and outflows of the UTF are tracked by DOL for budgetary purposes. These projections allow the DOL to monitor the sensitivity of the UI program to differing economic conditions, and to predict the program's sustainability under varying economic assumptions. Charts I through IV graphically depict the effect of varying economic conditions on the UTF over the next 10 years.

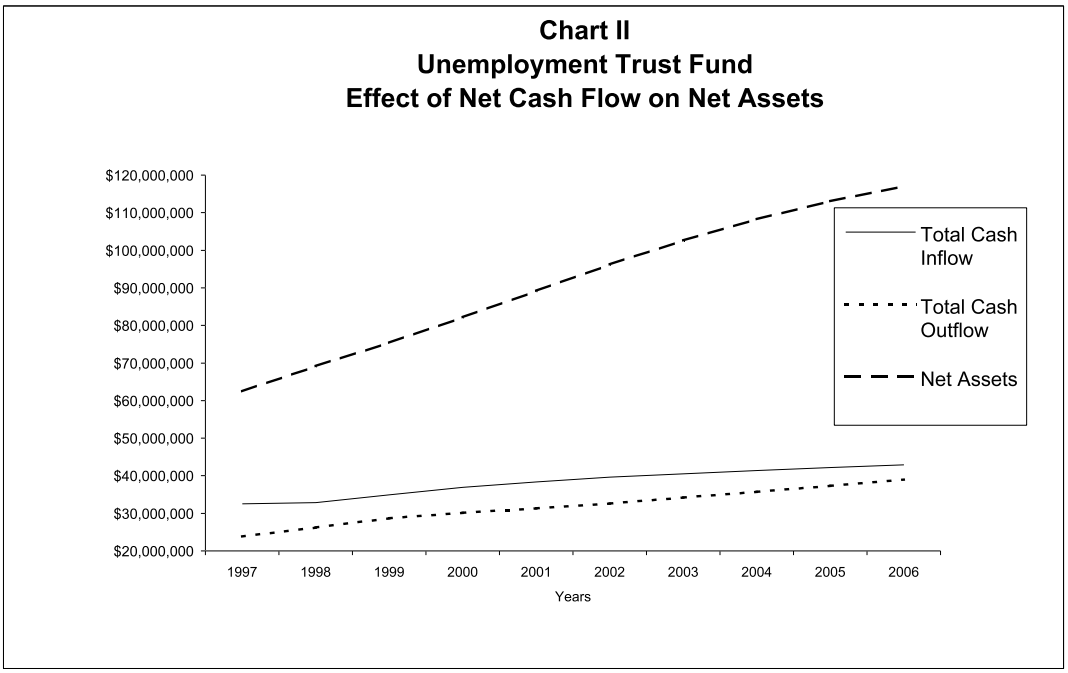
[23][Please note: the standard does not require information on the total amount of securities held at the balance sheet date. This information illustrates that management can provide data in addition to that required by the standard when it feels doing so would be useful to readers of the report.]

152. *Projected Cash Inflows and Outflows Under Expected Economic Conditions* - Chart I depicts projected cash inflow and outflow of the UTF over the next 10 years, under expected economic conditions. Total cash inflow as well as cash inflow excluding interest earnings is displayed. DOL's current estimates were based on an expected unemployment rate of 5.1 percent during FY 1997, increasing to 5.5 percent in FY 2001 and thereafter. These projections indicate net cash inflow through FY 2004, with a crossover to net outflow in FY 2005. Cash inflows combined with interest earnings exceed cash outflows for each of the 10 years presented, although this net excess decreases from $8.7 billion at the end of FY 1997 to $3.9 billion at the end of FY 2006.

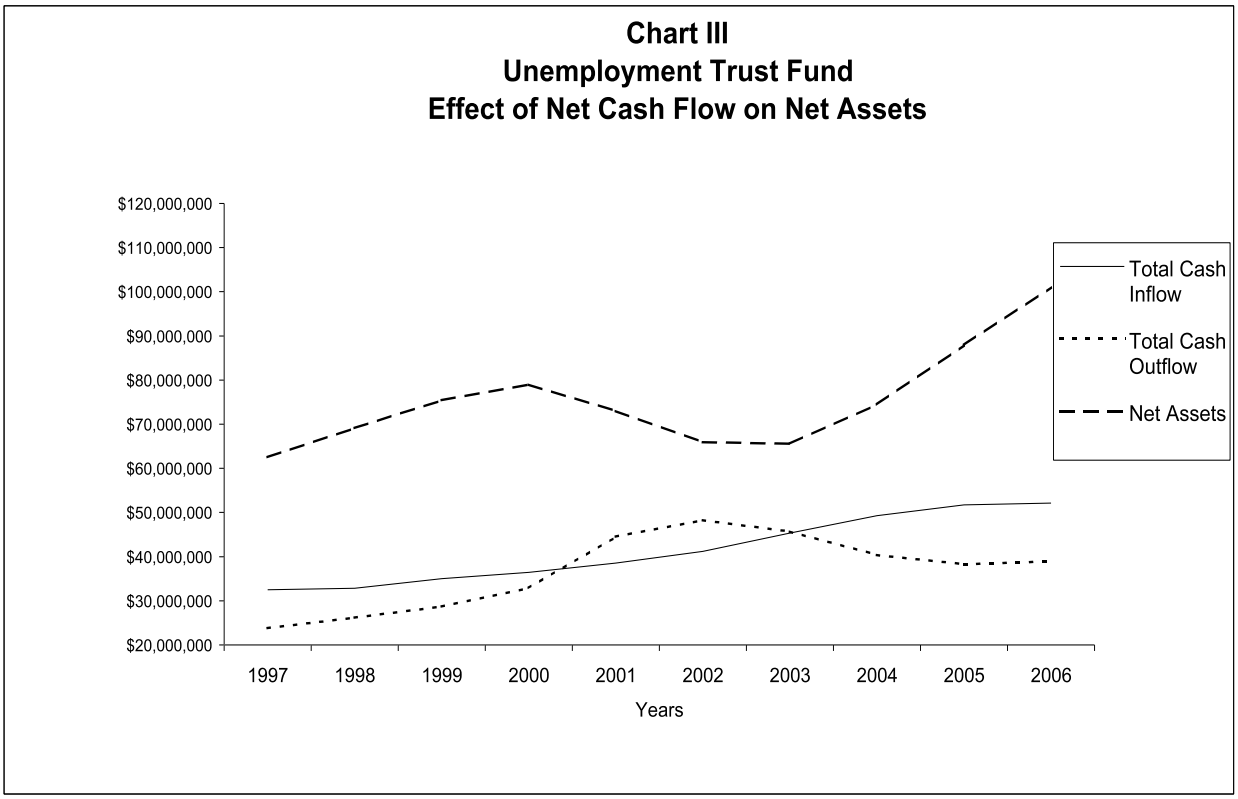


153. *Effect of Expected Cashflows on UTF Assets* - Chart II demonstrates the effect of the expected cash inflow and outflow on the net assets of the UTF over the 10-year period ending September 30, 2006. Yearly projected total cash inflows, including interest earnings, and cash outflows are depicted, as well as the net effect of this cashflow on UTF assets.

Under this scenario, total cash inflow exceeds cash outflow in each of the 10 years projected, although the margin of excess decreases by 55 percent from FY 1997 to FY 2006. Net UTF assets increase by 87 percent over the 10-year period, from $62.5 billion in FY 1997 to $117.0 billion in FY 2006.



154. ***Recession Scenarios***—Charts III and IV demonstrate the effect on accumulated UTF assets of projected total cash inflow and cash outflow of the UTF over the 10-year period ending September 30, 2006, under moderate and severe recession scenarios. Each scenario uses an open group, which includes current and future participants in the UI program. Charts III and IV assume increased rates of unemployment during mild and deep periods of recession.

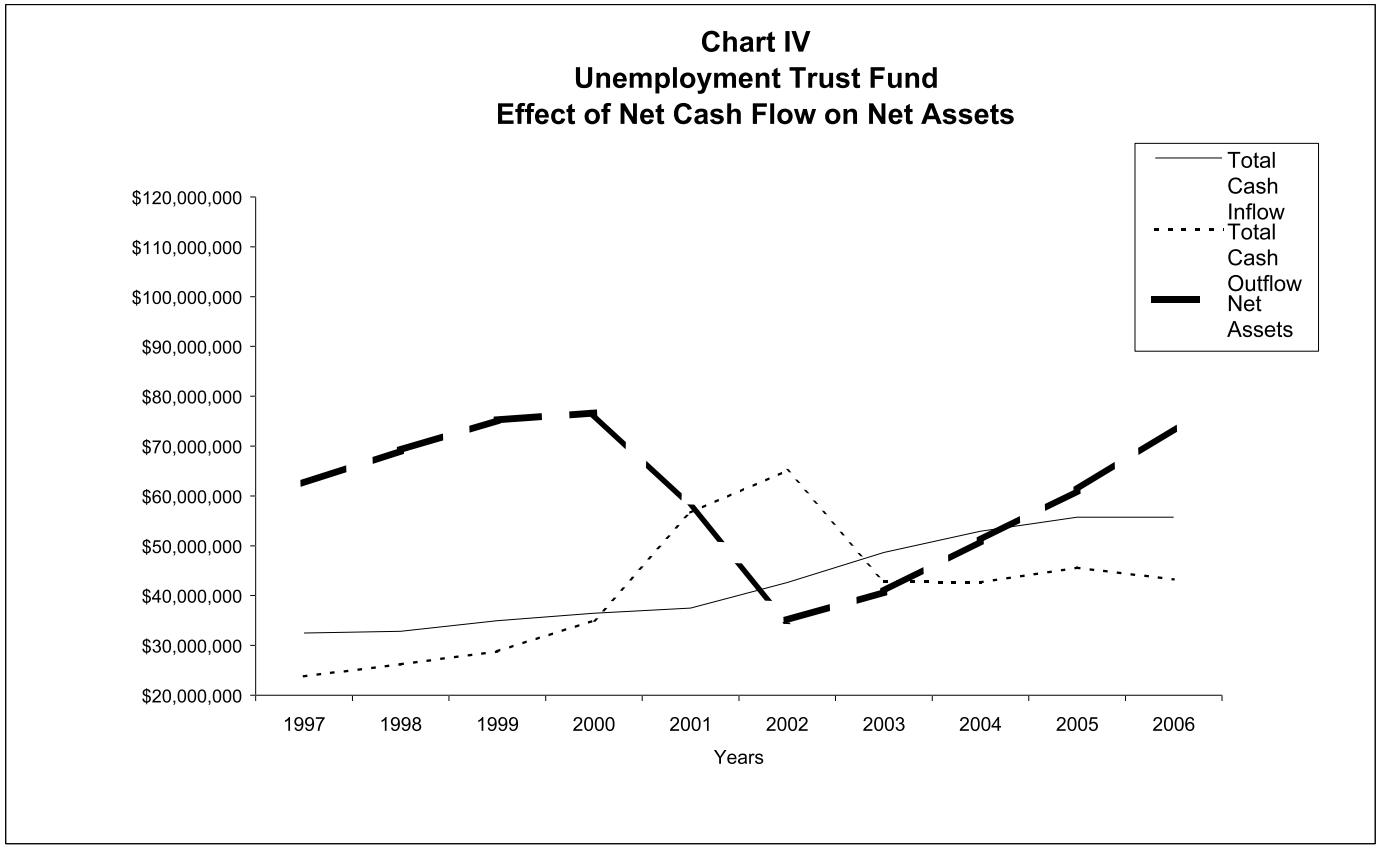


155. *Effect on UTF Assets of Mild Recession* - Chart III shows the projected effects of moderate recession on the cash inflow and outflow of the UTF. Under this scenario, which utilizes a rising unemployment rate peaking at 7.4 percent in FY 2002, net cash outflows are projected to begin in FY 2001, increasing to a maximum of $7.0 billion in FY 2002. Net cash inflow is reestablished in FY 2004 with a drop in the unemployment rate to 6.4 percent.

156. *Effect on UTF Assets of Deep Recession* - Chart IV shows the effect of severe recession on the cash inflow and outflow of the UTF. This scenario assumes a rising unemployment rate peaking at 10.2 percent in FY 2002. Under this scenario, net cash outflows are projected to begin early in FY 2000, increasing to $22.5 billion in FY 2002. During this two-year period, the net assets of the UTF decrease from $76.7 billion to $35.0 billion, a decline of $41.7 billion (54 percent). While aggregate UTF balances remain positive, state accounts without sufficient reserve balances to absorb negative cashflows would be forced to borrows funds from the FUA to meet benefit payment requirements. State borrowing demands could also deplete the FUA, which borrows from the ESAA and the EUCA until they were depleted. The FUA would

then require advances from the general fund of the U.S. Treasury to provide for state borrowing. (See discussion of state solvency measures *infra*.)

157. Net cash inflows are reestablished early in FY 2003, with a drop in the unemployment rate to 7.82 percent. By the end of FY 2006, this positive cashflow has replenished UTF account balances to $73.6 billion, or to within $3.0 billion of their FY 2000 peak. This example demonstrates the counter-cyclical nature of the UI program, which experiences net cash outflows during periods of recession, to be replenished through net cash inflows during periods of recovery.



158. Tables containing the yearly cash inflow, interest earnings, and cash outflow for each scenario are presented in the following pages.

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996
(1) Expected Unemployment Rate

(Dollars in thousands)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,410,218	$ 82,183,369	$ 89,188,172	$ 96,242,575	$ 102,591,615	$ 108,232,958	$ 113,075,913
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,011,000	27,927,000	28,666,000	29,217,000	29,792,000	30,439,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,300,000	6,332,000	6,428,000	6,474,000	6,545,000	6,616,000	6,690,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,273,600	33,444,000	34,425,000	35,215,100	35,864,400	36,517,800	37,220,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,670,414	4,924,397	5,227,889	5,326,384	5,503,356	5,656,406	5,711,029
Total cash inflow	32,498,928	32,830,610	34,937,192	36,944,014	38,368,397	39,652,889	40,541,484	41,367,756	42,174,206	42,931,429
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,875,000	26,443,000	27,619,400	28,831,233	30,329,870	31,765,260	33,267,761	34,821,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,456,087	3,474,974	3,498,455	3,591,026	3,687,876	3,787,445	3,889,713
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,136	3,035	3,011	2,984	3,017	3,033	3,016
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,661,753	30,170,863	31,363,594	32,598,486	34,192,444	35,726,413	37,331,251	38,989,661
Excess of total cash inflow ex. int. over total cash outflow	4,950,484	2,459,325	1,861,847	2,102,737	2,080,406	1,826,514	1,022,656	137,987	(813,451)	(1,769,261)
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,275,439	6,773,151	7,004,803	7,054,403	6,349,040	5,641,343	4,842,955	3,941,768
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,410,218	$ 82,183,369	$ 89,188,172	$ 96,242,575	$ 102,591,615	$ 108,232,958	$ 113,075,913	$ 117,017,681
Total unemployment rate	5.09%	5.12%	5.38%	5.47%	5.50%	5.50%	5.50%	5.50%	5.50%	5.50%

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996
(2) Mild Recessionary Unemployment Rate

(Dollars in thousands)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,427,203	$ 78,997,497	$ 72,977,460	$ 65,947,568	$ 65,595,389	$ 74,470,094	$ 87,923,108
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,889,000	31,018,000	35,304,000	39,150,000	41,096,000	40,839,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	34,129,000	37,265,000	41,603,100	45,587,400	47,667,800	47,479,400
Interest on Federal securities	3,744,328	4,179,810	4,485,592	4,324,625	4,389,403	3,957,469	3,737,486	3,670,448	4,053,078	4,639,297
Total cash inflow	32,498,928	32,830,610	35,009,192	36,467,225	38,518,403	41,222,469	45,340,586	49,257,848	51,720,878	52,118,697
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	24,930,015	29,083,333	40,393,938	44,027,625	41,544,306	36,305,687	34,175,845	34,832,298
State administrative costs	3,357,406	3,561,582	3,513,672	3,541,887	3,875,374	3,956,055	3,877,026	3,804,276	3,816,045	3,861,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,716,768	32,896,931	44,538,440	48,252,361	45,692,765	40,383,143	38,267,864	38,971,582
Excess of total cash inflow ex. interest over total cash outflow	4,950,484	2,459,325	1,806,832	(754,331)	(10,409,440)	(10,987,361)	(4,089,665)	5,204,257	9,399,936	8,507,818
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,292,424	3,570,294	(6,020,037)	(7,029,892)	(352,179)	8,874,705	13,453,014	13,147,115
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,427,203	$ 78,997,497	$ 72,977,460	$ 65,947,568	$ 65,595,389	$ 74,470,094	$ 87,923,108	$ 101,070,223
Total unemployment rate	5.09%	5.12%	5.38%	5.60%	6.57%	7.43%	7.07%	6.42%	5.62%	5.50%

U.S. Department of Labor - Required Supplemental Stewardship Information - Cash Inflow and Outflow of the Unemployment Trust Fund excluding the Federal Employees Compensation Account For the Ten Year Period Ended September 30, 1996

(3) Deep Recessionary Unemployment Rate

(Dollars in thousands)	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance, start of year	$ 53,800,832	$ 62,495,644	$ 69,134,779	$ 75,247,218	$ 76,661,227	$ 57,496,183	$ 34,990,203	$ 40,790,676	$ 51,029,964	$ 61,156,933
Cash inflow										
State unemployment taxes	22,681,000	22,442,000	24,195,000	25,837,000	27,001,000	33,246,000	40,275,000	44,151,000	46,310,000	45,904,000
Federal unemployment taxes	6,046,000	6,141,000	6,201,000	6,169,000	6,139,000	6,177,000	6,224,000	6,335,000	6,462,000	6,549,000
Deposits by the RRB	27,600	67,800	127,600	136,600	101,000	70,000	75,100	102,400	109,800	91,400
Total cash inflow ex. interest	28,754,600	28,650,800	30,523,600	32,142,600	33,241,000	39,493,000	46,574,100	50,588,400	52,881,800	52,544,400
Interest on Federal securities	3,744,328	4,179,810	4,413,592	4,313,207	4,254,058	3,108,756	2,055,502	2,331,404	2,840,149	3,202,881
Total cash inflow	32,498,928	32,830,610	34,937,192	36,455,807	37,495,058	42,601,756	48,629,602	52,919,804	55,721,949	55,747,281
Cash outflow										
State unemployment benefits	20,179,000	22,357,000	25,038,000	31,171,000	52,201,000	60,454,000	38,737,870	38,517,260	41,302,761	38,980,713
State administrative costs	3,357,406	3,561,582	3,513,672	3,599,087	4,189,974	4,385,055	3,819,826	3,890,076	4,016,245	4,004,112
Federal administrative costs	165,641	169,182	170,441	171,565	172,610	172,612	174,589	176,885	179,237	181,644
Interest on tax refunds	3,248	3,299	3,165	3,071	2,943	2,894	2,869	2,920	2,962	2,953
RRB withdrawals	98,821	100,412	99,475	97,075	93,575	93,175	93,975	93,375	93,775	93,575
Total cash outflow	23,804,116	26,191,475	28,824,753	35,041,798	56,660,102	65,107,736	42,829,129	42,680,516	45,594,980	43,262,997
Excess of total cash inflow ex. interest over total cash outflow	4,950,484	2,459,325	1,698,847	(2,899,198)	(23,419,102)	(25,614,736)	3,744,971	7,907,884	7,286,820	9,281,403
Excess of total cash nflow over total cash outflow	8,694,812	6,639,135	6,112,439	1,414,009	(19,165,044)	(22,505,980)	5,800,473	10,239,288	10,126,969	12,484,284
Balance, end of the year	$ 62,495,644	$ 69,134,779	$ 75,247,218	$ 76,661,227	$ 57,496,183	$ 34,990,203	$ 40,790,676	$ 51,029,964	$ 61,156,933	$ 73,641,217
Total unemployment rate	5.09%	5.12%	5.38%	6.65%	9.07%	10.15%	7.82%	7.28%	7.05%	6.43%

159. ***States Minimally Solvent*** - Another measure of the sufficiency of accumulated UTF assets to meet future benefit payment requirements analyzes the adequacy of each state's accumulated net assets or reserve balance to provide a defined level of benefits over a defined period of time. To be considered minimally solvent, a state's reserve balance should provide for one year's projected benefit payment needs based on the highest levels of benefit payments experienced by the state over the last 20 years. A ratio of 1.0 or greater indicates a state is minimally solvent. States below this level are the most vulnerable to exhausting their funding in a recession. States exhausting their reserve balance must borrow funds from the FUA to make benefit payments. During periods of high sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury general fund.

160. Chart V presents the state-by-state results of this analysis at September 30, 1996, in descending order, by ratio. As the table illustrates, 23 states failed to meet the minimum solvency test of 1.0 at September 30, 1996.

Chart V

Minimally Solvent		Not Minimally Solvent	
State	**Ratio**	**State**	**Ratio**
Virgin Islands	2.89	Maryland	0.99
New Mexico	2.43	Alaska	0.94
New Hampshire	2.18	Nevada	0.94
Vermont	2.17	Alabama	0.90
Georgia	1.96	Kentucky	0.71
Mississippi	1.93	Arkansas	0.64
Oklahoma	1.86	Ohio	0.63
Utah	1.84	Pennsylvania	0.62
Delaware	1.74	Massachusetts	0.58
Wyoming	1.65	Michigan	0.57
Kansas	1.63	Minnesota	0.56
Puerto Rico	1.6	Maine	0.54
Virginia	1.58	North Dakota	0.54
Indiana	1.57	California	0.53
Florida	1.55	Illinois	0.50
Iowa	1.39	Rhode Island	0.47
Nebraska	1.37	Missouri	0.45
North Carolina	1.32	Dist. of Col.	0.45
Arizona	1.28	West Virginia	0.42

(Continued From Previous Page)

Minimally Solvent		Not Minimally Solvent	
State	**Ratio**	**State**	**Ratio**
Idaho	1.26	Texas	0.33
South Carolina	1.24	Connecticut	0.31
Louisiana	1.23	New York	0.13
Oregon	1.2		
Wisconsin	1.18		
Montana	1.13		
Colorado	1.08		
Tennessee	1.08		
Washington	1.07		
Hawaii	1.06		
South Dakota	1.06		

Governmentwide Entity Perspective

(Note: This pro forma illustration is a partial display featuring Social Security and Medicare and is not intended to be the full consolidated presentation wherein all social insurance programs would be summarized and consolidated in accordance with par. 32.)

Stewardship Information: Consolidated Statement of Social Insurance - 75-Year Projection[a] as of September 30, 1996 [HYPOTHETICAL DATA]

Dollars in Trillions

	Prior Years				
	1996	**1995**	**1994**	**1993**	**1992**
Actuarial present value of future benefit payments[b] during the 75-year period to or on behalf of:					
Current participants not yet having attained retirement age[c]	$X	$X	$X	$X	$X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Current participants who have attained retirement age[c]	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Those expected to become participants (i.e., new entrants)	X	X	X	X	X
OASDI	[X]	[X]	[X]	[X]	[X]
HI	[X]	[X]	[X]	[X]	[X]
SMI	[X]	[X]	[X]	[X]	[X]
Other	[X]	[X]	[X]	[X]	[X]
Subtotal—benefit payments for the 75-year period	X	X	X	X	X
Less the actuarial present value of future contributions and tax income during the 75-year period from and on behalf of:					
Current participants who have not yet attained retirement age[c]	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]
Current participants who have attained retirement age[c]	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]

(Continued From Previous Page)

Dollars in Trillions

	Prior Years				
	1996	**1995**	**1994**	**1993**	**1992**
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]
Those expected to become participants (i.e., new entrants)	Y	Y	Y	Y	Y
OASDI	[Y]	[Y]	[Y]	[Y]	[Y]
HI	[Y]	[Y]	[Y]	[Y]	[Y]
SMI	[Y]	[Y]	[Y]	[Y]	[Y]
Other	[Y]	[Y]	[Y]	[Y]	[Y]
Subtotal—benefit payments for the 75-year period	Y	Y	Y	Y	Y
Excess of actuarial present values of future benefit payments over future contributions and tax income for the 75-year period [d]	**$X**	**$X**	**$X**	**$X**	**$X**

Notes to the Statement:

[a]The projection period for new entrants covers the next 75 years. The projection period for current participants (or 'closed group") would theoretically cover all of their working and retirement years, a period that could be greater than 75 years a in few instances. As a practical matter the present values of future payments and contributions for/from current participants beyond 75 years are not material.

[b] "Benefit payments" include administrative expenses.

[c] The actuarial net present value of the excess of future benefit payments to current participants (that is, to the "closed group" of participants) over future contributions and tax income from them or paid on their behalf is calculated by subtracting the actuarial present value of future contributions and tax income by and on behalf of current participants from the actuarial present value of the future benefit payments to them or on their behalf.

[d]The fund balance—which represents the accumulated excess of all past cash inflow, including interest on intragovernmental securities, over all past cash outflow within the program—for fiscal year 1996 is $ X_1 trillion. The fund balances for 1995-2, in trillions, were $$X_2$, X_3, X_4, X_5, respectively. The accumulated excess of cash inflow over outflow at the valuation date consists of a small amount of cash for current operations with the balance invested in Treasury securities. When presented for redemption, these securities will represent a first claim on the resources of the government.

Program Description

161. As discussed in Note X to the *CFS*, a liability of $75 billion is included in "Other Liabilities" on the balance sheet for unpaid amounts of Old-Age, Survivors, Disability Insurance (OASDI), Medicare (HI and SMI), and other social insurance benefits due to recipients or service providers for periods ended on or before September 30, 1996. Most of this amount was paid in October 1996.

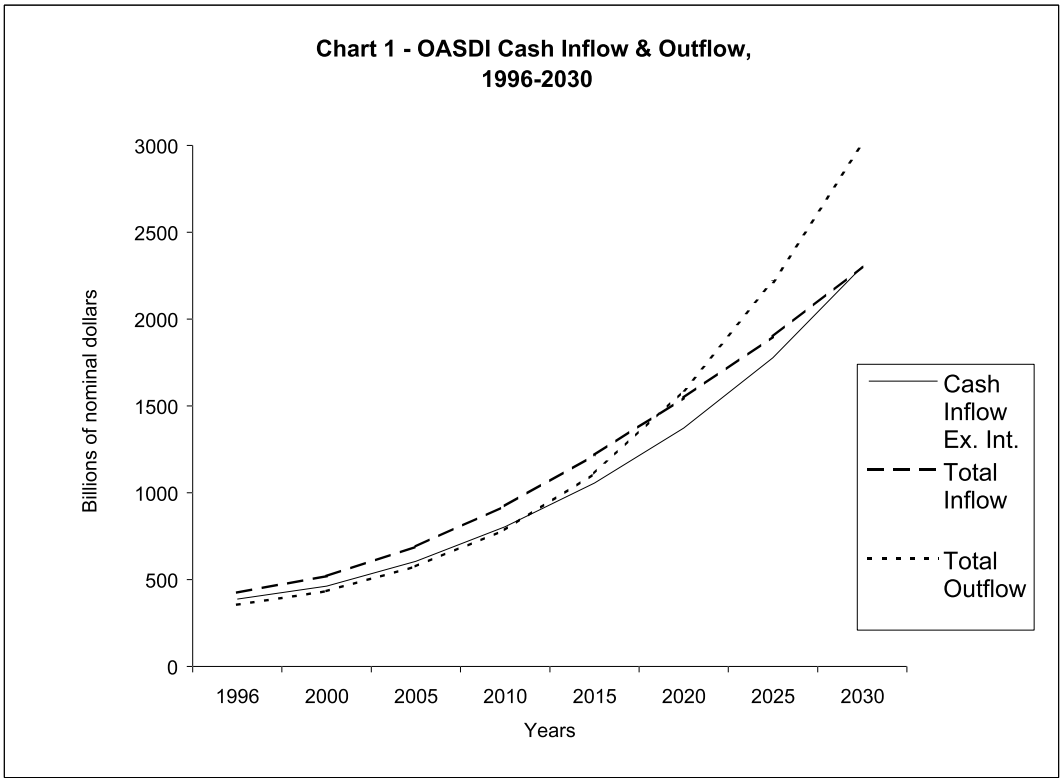
162. While no liability has been recognized on the balance sheet for future payments beyond the amount due as of September 30, actuarial estimates of future program activities have been prepared for the social insurance programs. Long-term actuarial views are a critical element in assessing the financial condition of social insurance programs. In addition, social insurance programs must be assessed as a large and growing part of the governmentwide

financial entity where they impact the balance between future government obligations and resources.

163. By projecting receipts from all sources and outlays for all federal programs for all purposes—as is the goal when analyzing trends in the federal budget, and as shown for the short-term in the Current Services Estimate, which shows the current and six future years (see page XX of this report)—it is possible to examine whether there will be sufficient resources to support all the government's ongoing responsibilities. It is also possible to see the interrelationship among the various types of government receipts (e.g., income taxes, payroll taxes, exchange revenue) and outlays (e.g., social insurance, national defense), where increases/decreases in one area of the budget can be offset by decreases/increases in other areas. Another perspective for assessing the financial condition of the government is its relationship to the national economy as measured by the GDP.

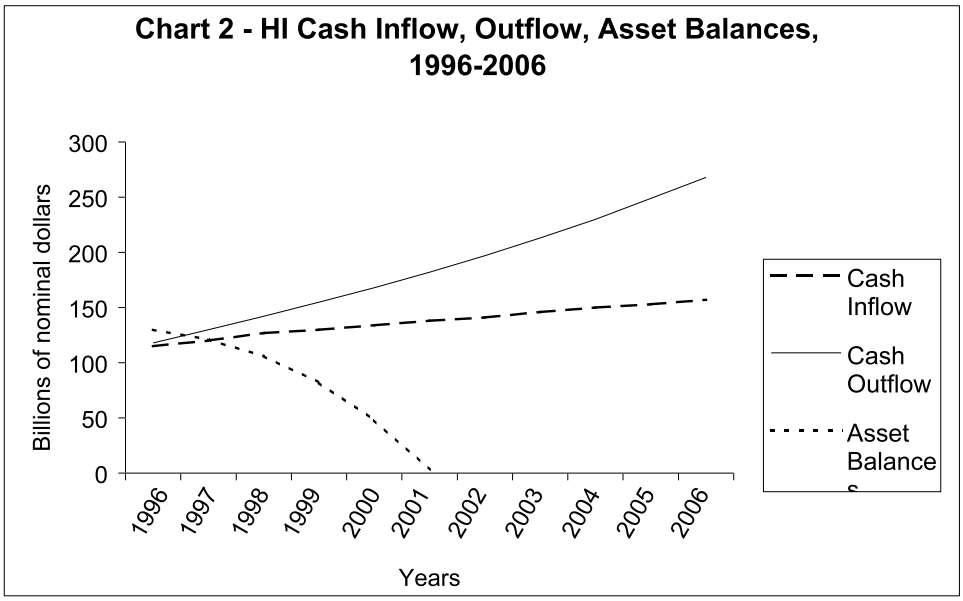
164. The actuarial present values and projections presented here for Social Security and Medicare, which are by far the largest social insurance programs, use the best estimate of the programs' actuaries of future costs over periods ranging up to 75 years. Estimates extending so far into the future, however, are inherently uncertain; and the uncertainty is greater for the later years in the period.

165. As shown in Chart 1, under current policies Social Security cash outflow will exceed inflow from the public in about 2012.



Source: Data from Tables III B1, B3, C1, 1996 OASDI Trustee's Report.

166. The Medicare Hospital Insurance (HI) program cash outflow exceeded annual cash inflow in FY 1996. using the actuaries' best estimate, the HI program will be insolvent in 2001, as shown in Chart 2 below. Projected HI payroll tax will meet a declining share of cash outflow under present law. Tax receipts are expected to equal 84 percent of cash outflow in 1997 and 74 percent in 2001 and would cover less than one-third of costs 75 years from now.

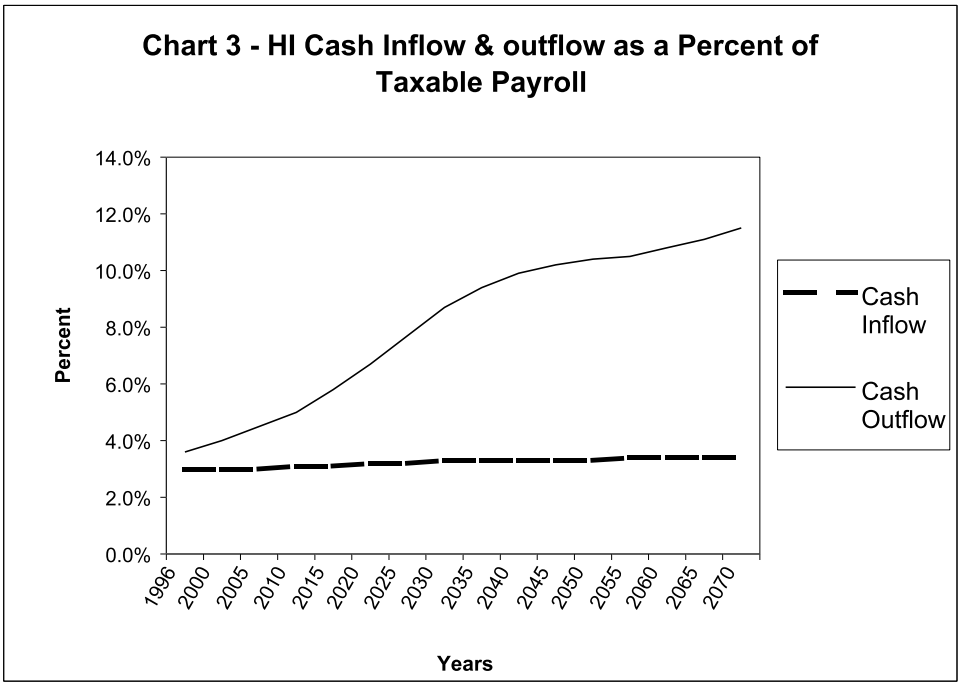


Source: Data from Table II D3, 1997 HI Trustee's Report.

167. The Medicare Supplementary Medical Insurance (SMI) is funded by premiums paid by participants and annual general fund appropriations. Current law provides for annual calculations of expected cost. Premiums, which currently cover approximately 25 percent of the program's cost, are expected to pay 16 percent by 2006 and decline further thereafter.

168. SMI benefits have been growing rapidly. Expenditures have increased 45 percent over the past five years. During this period the program grew about 14 percent faster than the economy as a whole, despite efforts to control costs.

169. As presently constructed, the HI program receives most of its income from the 1.45 percent payroll tax that employees and employers each pay, for a total of 2.9 percent of taxable payroll. Chart 3 below illustrates the cost rate of this program relative to its income rate as a percentage of taxable payroll.



Source: Data from Table II A.2, 1997 OASDI Trustee's Report.

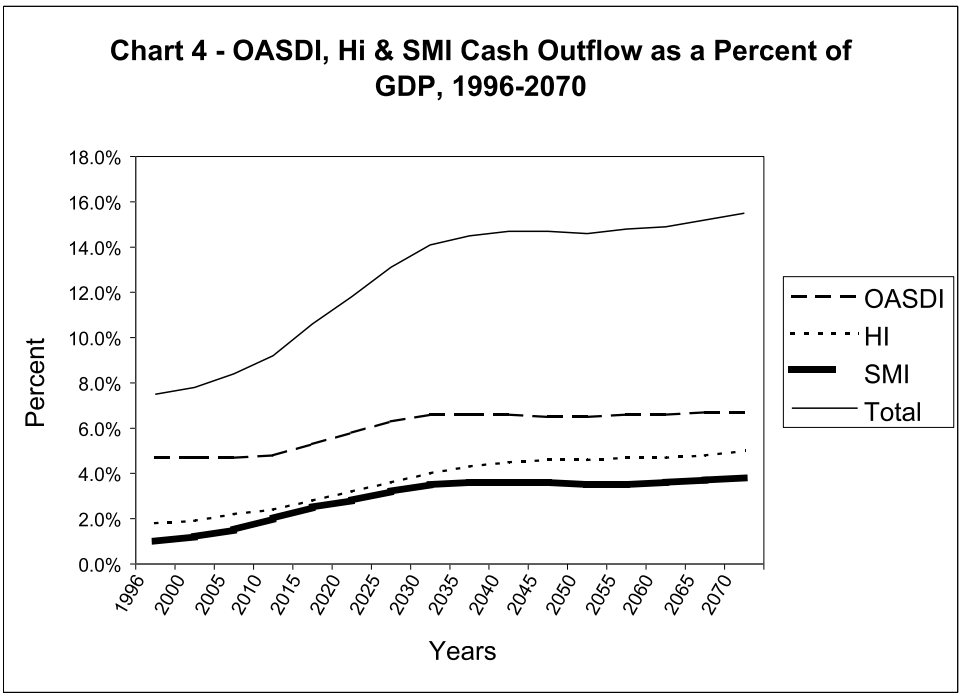
170. Medicare is currently paying and, from 2012 forward, OASDI would pay more to the public than they receive in taxes thereby increasing the government's financing needs. Compared to a situation in which taxes or other financing sources equalled cash outflow, the government will have to finance this difference by increased borrowing from the public, spending cuts, tax increases, or some combination of these measures.

171. ***Growing Disparity Between Rates of Income and Outgo*** - The excess of OASDI and HI cash outflow over inflow and the decreasing percent of SMI cost covered by premiums is due to the increasing cost of existing medical care; the increased utilization of existing and new health care techniques; and, in later years, the retirement of the "baby boom" generation and the relatively small number of people born during the subsequent period of low birth rate. For example, the OASDI Trustees' best estimate shows a long-term actuarial deficit over the next 75 years of 2.17 percent of taxable payroll—in other words, a tax increase today of 1.09 percent of taxable payroll each for employees and employers, over the 6.2 percent they each now pay would produce enough revenue to pay benefits under current law, over 75 years.[24]

[24][Please note: the standard does not require information on the total excess of cash outflow over inflow as a percentage of taxable payroll. It requires a cashflow projection as a percentage of taxable payroll as in Chart 3.]

Increasing the payroll tax from 12.4 to 14.6 represents a payroll tax increase of about 17 percent. The 2.17 percent deficit represents, in terms of present value, an excess of $3.1 trillion of expenditures over contribution.

172. ***Social Insurance in Relation to the National Economy*** - The security of benefits and the distribution of financing costs for social insurance programs cannot be determined solely on the basis of the financial and actuarial status of the programs by themselves. Sustainability from the governmentwide entity perspective is better measured in terms of a healthy relationship between social insurance programs—and, indeed, the entire budget—and the national economy, as measured by the GDP. Relative to the national economy, federal spending for OASDI, HI, and SMI was 7 percent of GDP in 1996—$550 billion. By 2030, when most baby boomers will have retired, these programs are projected to consume nearly 100 percent more of GDP than they do today—14 percent, as shown in Chart 4.



Source: Data from Table III C1, 1996 OASDI Trustee's Report and Table III B1, 1997 HI Trustee's Report.

173. This projected increase needs to be understood in the context of other projected future claims on future resources including general assistance programs (e.g., Medicaid) and other federal programs. Nearly all of the increase between now and 2030 in the OASDI, HI, and SMI programs will occur between 2010 and 2030, as retired baby boomers become eligible for

those programs. In terms of the number of workers to beneficiaries in the combined OASDI and HI programs, a decline will occur from about 3.5 per beneficiary in 1995 to 2 per beneficiary in 2030.

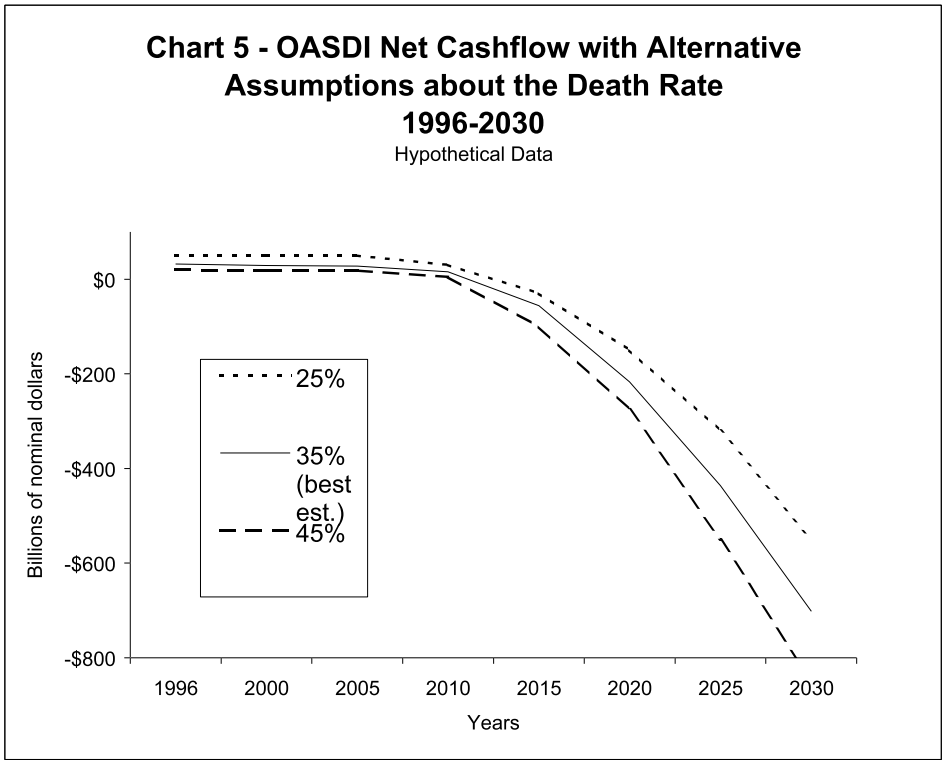
174. ***Sensitivity Analysis***[25] - The future cashflow of the OASDI, Medicare, and other social insurance programs depends on many economic and demographic assumptions. Precise long-range projections of these factors is impossible.

175. This section illustrates the sensitivity of the long-range projections to changes by analyzing six key individual assumptions. For this analysis the "best estimate" cost assumptions are used as the reference point, and each assumption is varied within it individually.

176. *Death Rate* - Chart 5 below shows the estimated OASDI cash inflow and outflow using a death rate above and below the rate used for the projection in Chart 1 above. This analysis was developed by varying the percentage decrease in the death rate assumed to occur during

[25][Please note: this section provides examples of some of the sensitivity analysis that would be provided at the consolidated level. The consolidated entity would summarize the sensitivity analyses from the individual social insurance entities.]

1996-2030. The rate used for Chart 1 above assumes a 35 percent decrease. Chart 5 assumes 25 percent and 45 percent decreases.



Source: Data for "best estimate" is from Tables III B1, B3, C1, 1996 OASDI Trustee's Report.

177. *Real Interest Rate*—The total excess of OASDI cash outflow over inflow on the basis of the best estimate cost assumptions is $3.0 trillion over the valuation period of 1996-2070. If the annual real interest rate for Treasury securities is changed from the 2.3 percent used for the best estimate to 1.5 percent, the excess of cash outflow would increase to $3.8 trillion; if the rate were changed to 3 percent, the excess of cash outflow would decrease to $2.5 trillion.

178. *Birth Rate* - Table 1 shows the effect of using birth rates of 1.6 and 2.2 children per woman, instead of the 1.9 rate used for the best estimate projection, on the total excess OASDI cash outflow over inflow over the period 1996-2070. The rate is assumed to increase gradually from its current level to reach the ultimate values in 2070.

Table 1- Estimated Total Excess OASDI Cash Outflow over Inflow with Various Birth Rate Assumptions - Valuation Period: 1996-2070

Dollars in trillions			
	Ultimate Birth Rate Per Woman		
Valuation Period: 1996-2070	1.6 births	1.9 births (from best estimate cost assumptions)	2.2 births
Excess of cash outflow over cash inflow	$3.7	$3.0	$2.5

179. *Net Immigration*—Table 2 below shows the total excess of OASDI cash outflow over inflow with various assumptions about the magnitude of net immigration.

Table 2- Estimated OASDI Actuarial Balances with Various Net Immigration Assumptions

Dollars in trillions			
	Net immigration per year		
Valuation Period: 1996-2070	750,000	900,000 (from best estimate cost assumptions)	1,150,000
Excess of cash outflow over inflow	$3.2	$3.0	$2.9

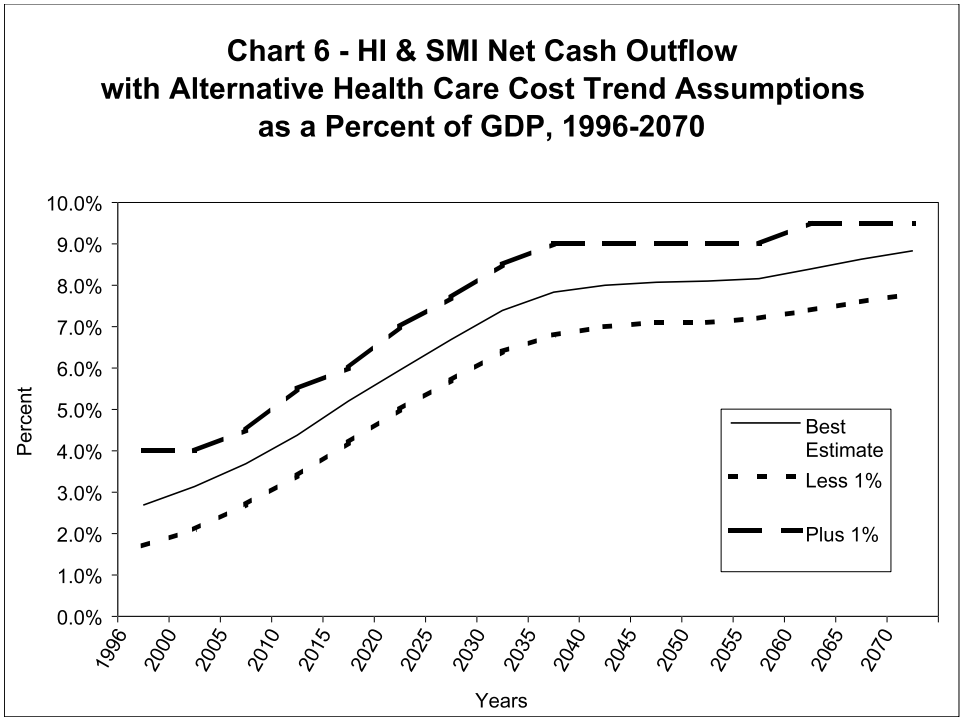
180. *Real-Wage Differential* - Table 3 below shows the total excess OASDI cash outflow over inflow with various assumptions about the real-wage differential. The real-wage differential is the difference between the annual percentage increase in wages in covered employment and the Consumer Price Index.

Table 3- Estimated OASDI Actuarial Balances with Various Real-Wage Assumptions - Valuation Period: 1996-2070

Dollars in trillions			
	Ultimate percentage in wages-CPI[a]		
Wages-CPI	4.5-4.0	5.0-4.0 (from best estimate cost assumptions)	5.5-4.0
Excess cash outflow over inflow	$3.9	$3.0	$2.3

[a] [The first value in each of the pairs below is the assumed ultimate annual percentage increase in average wages in covered employment. The second value is the assumed ultimate annual percentage increase in the CPI. The difference between the two values is the real-wage differential.]

181. *Health Care Cost Trend*—Chart 6 below shows the estimated HI and SMI net cash outflow using a health care cost factor 1 percent above and 1 percent below that used for the "best estimate" projection. Factors such as wage increases and price increases may simultaneously affect both HI payroll tax income and the costs incurred by hospitals and other providers of medical care to HI and SMI beneficiaries. Other factors, such as the utilization of services by beneficiaries or the relative complexity of the services provided, can affect provider costs without affecting HI payroll tax income. The sensitivity analysis shown in Chart 6 illustrates the financial effect of any combination of such factors that results in aggregate provider costs increasing by 1 percent faster or slower than the "best estimate" assumptions.



Source: Data for "best estimate" is from Table III B1, 1997 HI Trustee's Report.

Appendix C - Historical Background

182. **Practice Prior to Federal Accounting Standards Advisory Board (FASAB)** - Although this statement is applicable to other social insurance programs, Social Security historically has been the primary focus when considering accounting for social insurance. Over the decades, the debates about Social Security have to some extent paralleled debates in the nonfederal accounting community about how to apply accrual concepts in accounting. During this time, a continual evolution in accounting practice has led to increased recognition on the face of the financial statements and disclosure in notes to financial statements of formerly unreported commitments such as pensions and other postretirement benefits such as health care.

183. Since the 1950s, the Treasury Department and the Office of Management and Budget (OMB) have been furnishing reports on federal contingencies and commitments. From the early 1950s, the reports showed, among other commitments, the face value of loan guarantees and federal insurance but not the actuarial status of social insurance programs.

184. In 1967, Congress began requiring a commitments and contingencies report (*Liabilities and Other Financial Commitments of the United States Government*) that was to include liabilities of federal annuity programs and their actuarial status. The programs in that report included most of the social insurance programs that are the subject of these accounting standards: Social Security, Medicare, Railroad Retirement, Black Lung, and Unemployment Insurance. The report was tied with the regular business-type reporting of federal agencies required by the Treasury Department (e.g., balance sheets, operating statement, supplemental schedules).

185. From 1976 until 1985, the "prototype" *Consolidated Financial Statements of the United States Government* (*CFS*) recognized a liability for Social Security using a calculation similar to that called for in APB 8 (1966), which defined a variety of acceptable actuarial methods for measuring pension expense and required that any accumulated, unfunded pension expense be recognized as a liability. However, the expense shown on the *CFS* operating statement included only cash benefit payments and not what the *CFS* called the "noncash amount"—or the change in the unfunded liability.

186. After 1966 the importance of information about pensions grew due to increases in the number of plans and amounts of pension assets and obligations. Significant changes occurred in both the legal environment (e.g., Employee Retirement Income Security Act) and the economic environment (e.g., higher inflation and interest rates).

187. APB 8 was superseded by FASB Statement of Financial Accounting Standards (SFAS) No. 87, *Employer's Accounting for Pensions*, published in December 1985. FASB noted the years of

accounting controversy over measuring costs and liabilities resulting from defined benefit pension plans. After considering the range of comments on its *Preliminary Views* document and on its exposure draft, FASB concluded that, although it did not recognize the full projected benefit obligation on the balance sheet, SFAS 87 represented a worthwhile improvement in financial reporting. SFAS 87 made accounting for pensions more independent of the financing arrangements, provided more standardization in measurement of the pension expense and liability, and required at least a "minimum liability" to be recognized in employers' balance sheets.

188. The Social Security liability was de-recognized in the *CFS* for 1985; but a similar closed group (to new entrants),[26] "liability type" number continued to be disclosed in a footnote along with the open group, "cashflow" or "financing type" number. The closed group population includes all current participants, that is, retirees and covered workers. The "open group" includes all current participants plus all future participants over the next 75 years. Disclosure of the closed group number was discontinued in the *CFS* after 1994.

FASAB Exposure Drafts on Liabilities & Stewardship

189. Social insurance was addressed in the Board's exposure draft (ED) on *Accounting for the Liabilities of the Federal Government* in November 1994. The *Liabilities* ED proposed defining a federal liability in terms generally similar to the definition used by privately owned entities in the United States: a probable and measurable future sacrifice of resources based on a past transaction or event. However, to accommodate the unique circumstances of the Federal Government, both the *Liabilities* ED and the subsequent Statement of Federal Financial Accounting Standards No. 5 distinguished between exchange and **non**exchange transactions and provided distinct accounting for liabilities resulting from these two types of transactions.

190. Private sector accounting concepts and standards distinguish between reciprocal transactions (such as payments to an employee for services rendered) and non reciprocal transactions (such as contributions pledged to a not-for-profit entity). This is generally analogous to the federal distinction between exchange and nonexchange transactions. Private sector accounting standards, however, do not recognize liabilities differently based upon whether they arise from reciprocal or non reciprocal transactions.

191. For nonexchange transactions, the *Liabilities* ED provided that a liability would be recognized for any unpaid amounts due and payable as of the reporting date. This includes

[26]"Closed group" will be used synonymously with "closed group (to new entrants)."

amounts due from the federal entity to pay for benefits, goods, or services provided under the terms of the program, whether or not such amounts have been reported to the federal entity (e.g., estimated Medicare payments due to health providers for service that has been rendered and that will be financed by the federal entity but that have not yet been reported to the federal entity).

192. After much debate, social insurance benefits were classified as nonexchange transactions. The *Liabilities* ED proposed that such programs recognize the following as expense in the statement of net cost: (1) the benefits and expenses paid during the year (except those accrued at the end of the prior year) and (2) the benefits and expenses due and payable at the end of the year. The latter were to be recognized as liabilities on the balance sheet. The *Liabilities* ED noted that the FASAB contemplated a federal reporting model encompassing extensive disclosure and supplementary reporting and that the Board was addressing such reporting for social insurance in a separate project. Also, the *Liabilities* ED contained an alternative view whereby a minimum liability—representing the actuarial present value of total lifetime benefits due to be paid to people eligible to receive social insurance benefits at the balance sheet date—would be recognized on the balance sheet.

193. The Board considered the responses to the *Liabilities* ED in conjunction with its continuing development of supplementary information for social insurance programs. The majority of respondents favored the alternative view, that is, recognition of a minimum liability. Because the *Liabilities* ED had focused on balance sheet presentation and did not contain any proposed supplementary disclosures and because the magnitude and complexity of the issues were so great, the Board chose to issue a standard on liabilities without any additional requirements for social insurance and to expose the supplementary information for comment. In August 1995, the Board released for comment proposed required supplementary information for social insurance programs in the exposure draft on *Supplementary Stewardship Reporting* ("*Stewardship* ED").

194. The *Stewardship* ED did not change the recognition point for expenses and liabilities published in the *Liabilities* ED. However, it proposed the following three liability-type measures to be reported as required supplementary information accompanying the financial statements: (1) a "minimum liability" (present value of benefits due to all currently eligible to receive them) and (2) the actuarial net present value of benefits and payments to (a) the closed group (that is, current program participants) and (b) the "open group" (current and future program participants) for the next 75 years. In addition, it proposed a "money's worth" measure (data showing the change over time in the ratio of the net present value of actual or estimated average aggregate lifetime benefits paid to and contribution received from and on behalf of similarly aged participants).

195. The response to the *Stewardship* ED's required supplementary stewardship information package regarding social insurance was generally favorable. The majority of respondents

said that the information was either very useful or useful. Others, including representatives of the administrative agencies for Social Security and Medicare, objected to reporting any information other than that based on the open group methods and assumptions. Also, opposition arose from the agency administering unemployment insurance and Black Lung benefits, stating that although its programs should be included as social insurance, the RSSI package designed for Social Security did not fit its programs because they involved short-term benefits or had other unique aspects.

196. After deliberating the issues, the Board concluded in May 1996 that additional investigation and further deliberation were required. The Board noted:

- the strength of feelings on the issues (with one side firmly believing that the closed group estimate is a liability that should be recognized on the consolidated balance sheet of the Federal Government and, at the opposite pole, others who firmly believe that the closed group estimate is meaningless, could be misleading, and should not be disclosed at all in federal financial reports);
- the magnitude and complexity of the issues; and
- that changes to social insurance programs were being studied and discussed frequently and seriously within government and by the public.

197. The Board directed the staff to continue researching social insurance accounting, focusing especially on identifying the following:

- the characteristics of such programs, the appropriate display of information in the financial statements, and any additional information that should be required;
- the means for measuring financial data in such information; and
- the desirability of other indicators (ratios of data to Gross Domestic Product (GDP) or "covered payroll") to describe the status of programs.

The Board instructed the staff to be mindful of developments in the policy studies of Social Security in structuring its research and its recommendations.[27] In early 1997, the Board began again to deliberate the issues. The standard is a product of this project.

[27]SFFAS No. 8, *Supplementary Stewardship Reporting*, par. 117. The studies included the 1994-96 Social Security Advisory Council whose report, published in January 1997, reflected the lack of consensus on long-term financing for Social Security. The Council members agreed on how to define the size of the financing problem (by using the Social Security Administration actuaries' "best estimate" projection to derive an actuarial deficit of 2.17 percent of payroll over the next 75 years). They also agreed that two long-range goals should be (1) to eliminate the 2.17 percent 75-year deficit and (2) to have the fund in stable condition at the end of the 75-year period. However, the Council offered three sharply different models for the future of Social Security. These models did contain some common features (e.g., all three would increase from 35 to 38 the number of years used to compute benefits and tax Social Security benefits in the same way that contributory defined-benefit pensions are treated under the federal income tax). In addition to the Advisory Council, academics and scholars were studying, for example, the Chilean and United Kingdom experiments with privatization of public pension plans.

Appendix D - Glossary

See also Consolidated Glossary in “Appendix E: Consolidated Glossary.”