Federal Accounting Standards Advisory Board

Accounting for Social Insurance, Revised

Statement of Federal Financial Accounting Standards

Preliminary Views

Written comments are requested by April 16, 2007

October 23, 2006

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

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

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

Exposure drafts, Statements of Federal Accounting Standards and Concepts, Interpretations, FASAB newsletters, and other items of interest are posted on FASAB's website, at www.fasab.gov.

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October 23, 2006

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

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the preliminary views of members regarding a proposed Statement of Federal Financial Accounting Standards entitled *Accounting for Social Insurance, Revised*. Social insurance comprises five programs; however, two programs, Social Security and Medicare, are of special significance because of the high rate of participation among citizens, the fiscal challenges related to the programs and the challenges associated with incorporating estimates of future cash flows of this magnitude in financial statements. Specific questions for your consideration appear on page 15 but you are welcome to comment on any aspect of this proposal. As discussed below, the Board is presenting two differing views, supported by different Board members, on accounting for social insurance. Your response would be more helpful to the Board if you explain the reasons for your position, whether you agree or disagree with one or both of the Views, and any alternative you propose.

In 2003 the Board decided to evaluate the existing social insurance accounting standard because of continuing concerns about the accounting for social insurance programs. Fundamental questions about social insurance programs can be addressed by financial reporting, including whether social insurance programs are sustainable as currently constructed; whether the Government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and what is the likelihood that these programs will be able to provide social insurance benefits at current levels to those who are planning on receiving them. The information provided as a result of this proposed standard should help users make these assessments while providing for the complexity of these programs and the uncertainty of long-term projections.

From the outset of this project, members have agreed upon the objectives of financial reporting for social insurance programs and yet have differing views about how best to achieve the objectives. For example, all members agree that it is extremely important to provide useful financial information about the sustainability of social insurance programs, and that in the consolidated Financial Report of the United States Government such information should be presented for the Government as a whole. Members agree that social insurance information should be included in the basic financial statements, should be audited, and should be "transparent" – that is, readily understandable to an interested, non-expert reader. Members also agree that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. However, members have differing views about what should be reported in the financial statements.

A key difference between these views is the point in time that a liability for social insurance benefits and related expense are recognized. Six members believe that an expense is incurred and a liability arises for social insurance programs when participants substantially meet eligibility requirements during their working lives in covered employment, and that some portion of the benefits accumulated at the balance sheet date should be recognized as a liability (Primary View). Three members believe that, consistent with current reporting requirements, an expense is incurred and a liability arises for social insurance programs when the participants have met all eligibility requirements and the benefit amount is "due and payable" (Alternative View).

Both views would present a statement of social insurance (SOSI) showing the present values of projected future program revenues and scheduled benefits, changes in such present values during the reporting period, and other sustainability disclosures, although the proposed information presented and presentation format differ.

The three members supporting the Alternative View would present a statement of fiscal sustainability and additional sustainability information in the context of all federal programs and as an integral component of social insurance reporting, subject to additional refinement in connection with a broader FASAB project on sustainability. The six members supporting the Primary View agree in principle that a statement of fiscal sustainability and additional sustainability reporting may be needed. While the members supporting the Primary View welcome and encourage the development of additional supplementary sustainability reporting, they believe it should be in addition to the Primary View proposal. These members favor making it the subject of a separate project, which the Board is currently undertaking with its Sustainability Taskforce, because it has implications for a wide variety of issues.

Rationales for these two views are provided in this preliminary views document. The Primary View held by Messrs. Mosso, Allen, Farrell, Patton, and Schumacher, and Ms. Cohen is presented first followed by the Alternative View held by Messrs. Dacey, Reid, and Werfel.

One member abstains from an expression of views but supports issuance of the preliminary views document so that responses can be considered.

The Board resolves such differing views through research of the issues, careful deliberation, and due process. Exposure for comment is an essential part of due process. In order to achieve the Board's objective of improved financial reporting for social insurance programs, I am asking that you consider both the Primary and Alternative Views very carefully, and offer any other viewpoints you have for achieving the Board's objective. In addition, it would be most helpful if you would explain the reasons for your views.

Responses in electronic form should be sent by e-mail to comesw@fasab.gov. All responses are requested by April 16, 2007. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please also mail your comments to:

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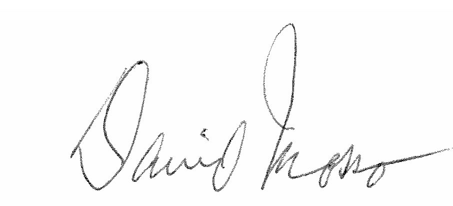
Washington, DC 20548

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

The Board's rules of procedure provide that it may hold one or more public hearings on any preliminary views or exposure draft document. A public hearing is tentatively scheduled for May 23, 2007, for this preliminary views document. Notice of the date and location of public hearings are published in the Federal Register and in the FASAB newsletter.



David Mosso
Chairman

Executive Summary

What is proposed in each view?

Social insurance programs include Social Security, Medicare, Railroad Retirement, Black Lung and Unemployment Insurance. Extensive information on social insurance programs is currently required by generally accepted accounting principles. The Board is proposing improvements in the information provided about the effect of social insurance programs. This preliminary views document contains two views of how financial reporting for social insurance can be improved, a Primary View and an Alternative View.

Both views would recognize a liability for social insurance benefits, but differ on the point in time that a liability and related expense are recognized. Both views would present a statement of social insurance showing the present values of projected future program revenues and scheduled benefits, changes in such present values during the reporting period, and other sustainability disclosures, although the information presented and presentation format differ. The Alternative View also would present a statement of fiscal sustainability and additional sustainability information in the context of all federal programs and as an integral component of social insurance reporting, subject to additional refinement in connection with a broader future FASAB project on sustainability. The Primary View would agree in principle that a statement of fiscal sustainability and additional sustainability reporting may be needed, but favor making it the subject of a separate project because it has implications for a wide variety of issues. This Executive Summary provides an overview of the two views and the basis for each view. To obtain a more complete understanding of these complex issues, respondents should read the more detailed discussion of these views in the sections that follow the Executive Summary.

The Primary View proposes to change the statement of social insurance (SOSI) from what is currently required by Statement of Federal Financial Accounting Standards (SFFAS) 17, as amended, *Accounting for Social Insurance*,[1] and to change the recognition and measurement of expense and liability for Social Security, Medicare, and Railroad Retirement programs currently required in SFFAS 17. Under the Primary View proposal, the expense would be recognized on the statement of net cost when participants become fully insured and thus substantially meet the eligibility conditions for future benefits under the programs and as scheduled benefits increase due to additional work in covered employment by fully insured individuals. For Social Security, Medicare, and Railroad Retirement programs, participants become fully insured when they complete sufficient work in covered employment, e.g., for Social Security and Medicare, 40 quarters or equivalent of work in covered employment. The liability would be the accumulated unpaid expense as of the reporting date. Those supporting the Primary View believe that their proposed recognition and measurement standard would conform to the new definition for liability and expense proposed in the recently issued Exposure Draft of a Concepts

[1] August 1999.

Statement entitled *Definition and Recognition of Elements of Accrual-Basis Financial Statements* (*Elements* ED).

In addition to changing the expense and liability recognition points, the Primary View would link the amounts reported for social insurance on the balance sheet and statement of net cost to the SOSI. Such linkage or "articulation" would illustrate how the amounts reported on these principal financial statements relate to the present values of the cash inflow and outflow over the next 75 years that are presented in the SOSI.

In addition, under the Primary View the SOSI would present the reasons for the changes in SOSI present values during the reporting period on the face of the SOSI.

Also, the Primary View would retain the required supplementary information now required in SFFAS 17. That is, it would retain the graph of cash flows over 75 years in nominal dollars and as a percentage of GDP and taxable payroll, the "dependency ratio" of contributors to beneficiaries, and the sensitivity analysis.

The Alternative View proposes to maintain the recognition and measurement of expense and liability for Social Security, Medicare, and Railroad Retirement program benefits currently required in SFFAS 17. That is, the entity would recognize a liability and a related expense for social insurance benefits when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods or services). At that point, those who support the Alternative View believe the Government has a present obligation and the benefits become "due and payable."[2] Thus, under the Alternative View the amounts reported on the balance sheet and statement of net cost for social insurance benefits would not change from what is currently reported under SFFAS 17. The Alternative View would also retain the current SOSI and the supplementary information now required in SFFAS 17, such as the "dependency ratio" of contributors to beneficiaries, and the sensitivity analysis. In addition, as explained in further detail below, the Alternative View proposes consideration of deferring revenue recognition for earmarked revenues in excess of benefit payments for social insurance programs. Deferring revenue would alter the current calculation of change in net position since it would result in recognition of a liability for earmarked revenues not used to finance the current cost of operations.

Those supporting the Alternative View believe their proposed recognition and measurement standard would be consistent with the proposed definition for liability and expense currently under consideration in the *Elements* ED.

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

The Alternative View would add a new principal financial statement entitled the "statement of changes in social insurance," that would show the reasons for changes during the period in the present value amounts presented in the statement of social insurance. In addition, the consolidated Financial Report of the United States Government would include as required supplementary information a new statement entitled the "statement of fiscal sustainability," that would provide sustainability information on the entire Government, including information necessary to assess the sustainability of social insurance programs and information on **intergenerational equity**[*]. The Alternative View would also require disclosure of additional information that will assist in understanding the sustainability of social insurance programs, including key measures of fiscal sustainability and intergenerational equity, projected annual cash flows, and changes in fiscal sustainability during the reporting period.

Why do the members support these views?

Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other nonexchange transactions and government-acknowledged events) has been a long-standing source of controversy in government accounting. In its fifteen years of operation the Board has issued several exposure drafts related to social insurance reporting. The three principal exposure drafts that led to the current reporting model were:

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

In each of these exposure drafts, the issue of accrual accounting for social insurance programs has been controversial.

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

Nonetheless, the Primary View reflects the preliminary conclusion of the majority of Board members that the compromise is flawed because it fails (1) to recognize the accruing cost of social insurance programs in each reporting period and the accumulated liability for benefits payable at a determinable date under current law, and (2) to fully explain the change in the net present value of program related cash flows.

[*] Words in the Glossary, Appendix D, are in **boldface** the first time they appear.

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

The Primary View is that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities. The Primary View's principal focus is on the economic cost being incurred for social insurance programs and the accumulation thereof. The Board members supporting the Primary View believe that a key objective of the principal financial statements should be to report the estimated costs incurred during the reporting period and the amount of those costs that will have to be financed in future periods. Supporters of the Primary View believe such costs represent the accrued liability portion of long-term actuarial projections.

The members supporting the Primary View believe that the differing views among Board members regarding when sufficient eligibility conditions are met to create a liability and a "present obligation" is the key distinction between the Primary and Alternative Views. The members supporting the Primary View believe that the distinction between exchange and nonexchange transactions that is among the points emphasized in the Alternative View is not determinative. For them, an expense may be incurred and a liability arise equally for exchange, nonexchange, or quasi-exchange transactions so long as a present obligation exists. The Government has many programs for which it incurs large liabilities and yet receives nothing or little in exchange other than promotion of the general welfare. In addition, members supporting the Primary View note the quasi-exchange features of social insurance programs such as the relationship between wages earned in covered employment and benefits accrued and payroll taxes paid, both of which are based on wages in covered employment. They note also the way the programs are structured, including the use of "trust funds" and the "investment" of excess payroll taxes in special Treasury securities.

In addition to amounts reported on the principal financial statements, the Primary View is specifying the note disclosure and supplementary information that must accompany the principal financial statements to provide information about the sustainability of these programs and a perspective on these complex programs. This information includes projections of **all** future social insurance receipts and outlays over the next 75 years in nominal dollars and as a percent of GDP and taxable payroll, as well as the "dependency ratio" of contributors to beneficiaries. This information is similar to the additional supplementary information proposed in the Alternative View, except that the Alternative View would add projections of non-social insurance cash flow.

[See the basis for conclusions for the rationale for the Primary View, paragraphs A1–A106.]

Members supporting the Alternative View believe that the basis for recognition of a liability and cost for social insurance established in SFFAS 17 (i.e., due and payable) remains appropriate, but that SFFAS 17 does not (1) recognize important information concerning the fiscal sustainability of social insurance programs, or (2) fully explain the change in the net present value of program-related cash flows.

Members supporting the Alternative View see a fundamental distinction in financial reporting of exchange transactions, which are voluntary market exchanges of goods and services for a price, and nonexchange transactions resulting from decisions made collectively by the Congress and the President to levy taxes and to authorize programs.

This distinction is made in FASAB concepts, standards, and statements, e.g., the statement of net cost, as well as by other standard setters, including the Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB). It is also the difference between offsetting collections and governmental receipts in the Budget.

The Alternative View is that social insurance programs comprise two separate nonexchange transactions – the compulsory payment of taxes during an individual's working life and the Government's payment of benefits after the individual has satisfied all eligibility criteria. In the Alternative View expenses and liabilities are incurred for social insurance programs when the participants have met all eligibility requirements and the amount of the benefit is "due and payable" to or on behalf of beneficiaries. Liabilities include claims incurred but not reported (IBNR). Hence, the Alternative View is that benefits beyond the due and payable amount are not present obligations of the Government and should not be recorded as expenses or liabilities in the current period. In addition:

(1) Recognition of such future social insurance benefits as current expenses and liabilities would result in a substantial mismatch of net costs for nonexchange programs in the current year and the services provided in that year - disrupting an alignment that allows programs to match costs with results;

(2) Recognition of future social insurance benefits on the financial statements would diminish significantly the relative size and importance of other expenses and liabilities shown on the financial statements; as a result the financial statements would contain misleading information about the Government's true financial position and would inappropriately shift the focus away from other expenses and liabilities that are managed by Federal agencies; and

(3) Given the ability of the Federal Government to change the laws relating to social insurance programs and the unsustainability of current benefit payments with current financing, about which beneficiaries are on notice, amounts of benefit payments are uncertain and not reliably estimable.

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

The Board members supporting the Alternative View agree that a key objective of the principal financial statements should be to report the costs incurred during the reporting period. But they believe that the costs are incurred when all eligibility requirements are met and benefits are due and payable.

Earmarked revenues in excess of the amounts needed for current benefit payments have accumulated in large amounts in some social insurance funds. These excess amounts are assets of the funds and are invested in special Treasury securities, which earn interest. When the component entity requires redemption of these securities to make benefit payments or other expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. The investments in Treasury securities (an asset) held by the various earmarked funds and the liability of the U.S. Treasury to redeem the securities are treated as intragovernmental eliminations when the consolidated U.S. Government-wide financial statements are prepared. Therefore, the consolidated net position of the Federal Government reported on the U.S. governmentwide financial statements does not include the effect of the claim on the U.S. Treasury that the various funds hold, just as the consolidated net position does not include the effect of other intragovernmental claims. Instead, the U.S. governmentwide financial statements include the cumulative results of operations of earmarked funds – currently a large positive balance – as an offset against the cumulative results of operations of the general fund – currently a large negative balance. The result is that the financing provided by earmarked fund operations to general fund operations – which would otherwise be financed through the issuance of debt to the public, tax increases or other financing sources – is not shown on the face of the U.S. Government balance sheet. With the implementation in 2006 of SFFAS 27, *Identifying and Reporting Earmarked Funds*,[3] this issue will be illuminated in the agency performance and accountability reports and analyzed in the Financial Report of the United States Government.

Consequently, in addition to the due and payable amount, members supporting the Alternative View believe that recognition of deferred revenue equal to the earmarked revenues in excess of program costs should be considered. If this option were adopted, earmarked revenues collected for social insurance programs in excess of program liabilities (as defined above and in existing liability standards) incurred would be recorded as deferred revenues. During periods when earmarked revenues are deferred because they exceed program costs, the liability for deferred revenue would increase or accumulate and earmarked revenues would equal costs. During periods when previously deferred revenues are used to finance program costs, the liability for deferred revenue would

[3] December 28, 2004.

decrease. This concept should be considered by the Board as a separate project, however, because it would require revising portions of SFFAS 7, *Accounting for Revenue and Other Financing Sources*,[4] and the supporting arguments also may apply to numerous other funds with "excess" earmarked revenues.

The Alternative View would also retain the SOSI and other supporting sustainability information required in SFFAS 17. The Alternative View would retain the 75-year cash flow projections for Social Security and Medicare Hospital Insurance, dependency ratio and other required supplementary information from SFFAS 17, including projections of **all** future social insurance receipts and outlays over the next 75 years in nominal dollars and as a percent of GDP and taxable payroll, as well as the "dependency ratio" of contributors to beneficiaries.

In addition to amounts reported on the principal financial statements, the Alternative View proposes a new principal financial statement that would provide the reasons for all of the changes during the period in the present values of benefits and receipts presented in the SOSI. To the extent appropriate, presentation of such a statement could be combined with the SOSI.

Moreover, members supporting the Alternative View propose new sustainability and intergenerational equity reporting in addition to the sustainability information presented in the SOSI and supporting disclosures and separate from the balance sheet and statement of net cost. Members supporting the Alternative View believe that such reporting would reflect the unique nature of social insurance programs, the extent of the Government's responsibilities for these and other programs, and the Government's ability to adjust these responsibilities. The Alternative View would present the fiscal sustainability of social insurance in the context of sustainability of the Government as a whole in the consolidated Financial Report of the United States Government. The Alternative View would also require disclosure of additional information that will assist in understanding the sustainability of social insurance programs, including key measures of fiscal sustainability and intergenerational equity, projected annual cash flows, and changes in fiscal sustainability during the reporting period. Further, members supporting the Alternative View believe that any analysis of scheduled future benefits must include a consideration of future earmarked revenues.[5] This view would present the statement of fiscal sustainability and additional sustainability information in the context of all federal programs and as an integral component of social insurance reporting, subject to additional refinement in connection with a broader FASAB project on sustainability.

It is extremely important to note that both the Primary View and the Alternative View call for sustainability reporting. Both the Primary and Alternative Views would add information to

[4] May 1996.

[5] See pars. 16f, 16h, 16k, 16n, 16u, and 16z for the Primary View standard regarding Medicare Supplementary Medical Insurance ("SMI") and A61 – A62 in the basis for conclusions.

the SOSI presentation regarding the changes in SOSI amounts during the period. The Primary View would also tie line items to the balance sheet and statement of net cost. The Alternative View would present the SOSI changes in a new principal financial statement, which could be combined with the SOSI. Both the Primary and Alternative Views would retain the 75-year cash flow projections, dependency ratio and other required supplementary information from SFFAS 17. The Alternative View also proposes new supplementary information on the sustainability of all Government programs, which the supporters of that View believe is critical to understanding the sustainability of social insurance programs.

While the members supporting the Primary View welcome and encourage the development of additional supplementary sustainability reporting, they believe it should be in addition to the primary view proposal. These members favor making it the subject of a separate project, which the Board is currently undertaking with its Sustainability Taskforce. Those supporting the Primary View believe that reporting on sustainability is not a substitute for or alternative to their proposal to alter expense and liability recognition on the statement of net cost and balance sheet. They believe that these different statements serve different objectives.

The members supporting the Alternative View fully support accrual accounting and providing information to assist policymakers in making policy decisions about social insurance, including the long-term solvency of social insurance and changes in long-term solvency during the reporting period, along with underlying causes. These members believe the Alternative View provides this information through accrual of a due and payable liability for social insurance benefits and the presentation of statements of social insurance, of changes in social insurance, and of fiscal sustainability that provide a comprehensive analysis of the long-term solvency of the social insurance programs and annual changes therein. Also, SFFAS 27 requires additional information on and segregated reporting of earmarked funds, including those related to social insurance, for such information as trust fund assets, liabilities, revenues, and costs. The members supporting the Alternative View believe that financial statements prepared in accordance with generally accepted accounting principles should present relevant information about social insurance to inform policymakers and the public, including full information on earmarked nonexchange revenues. These members believe that an appropriate understanding of the sustainability of social insurance requires a consideration of not only the social insurance programs, but also of the government as a whole because of the significant interrelationship between the two and the need to consider tradeoffs.

[See the basis for conclusions for the rationale for the Alternative View, especially paragraphs A109 – A169.]

How are the views presented in the document?

The body of the document is structured as follows:

Primary View – Proposed Standards (pars. 1 – 41)
Alternative View – Proposed Standards (pars. 42 –87)

The above sections provide a brief introduction and the detailed standards necessary to accomplish the reporting envisioned under each view.

Basis for Conclusions – Primary and Alternative Views (pars.A1 –A185)

The Basis for Conclusions provides the rationale for each view.

Primary View – Pro Forma Illustrations (p. 100)
Alternative View – Pro Forma Illustrations (p. 114)

Comprehensive illustrations are provided for each view.

Following these sections are other appendices providing fact sheets, a glossary and a list of abbreviations.

Table of Contents

Request for Comments

The FASAB encourages you to become familiar with all proposals in this proposed Statement before responding to the questions in this section. The paragraphs cited in parentheses in a question are particularly relevant to that issue, but other portions of the document also may enhance your understanding of the question.

The Board also would welcome your comments on other aspects of the proposals in this preliminary views document. Because the proposals may be modified before an exposure draft is issued, it is important that you comment on the proposal that you agree with as well as the one that you disagree with and/or any aspects of either. Comments that include the reasons for your views will be especially appreciated.

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

Wendy M. Comes, Executive Director
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All responses are requested by April 16, 2007.

Questions for Respondents:

Q1. This preliminary views document presents two views of an accounting standard for social insurance. The key difference between the views is the timing of expense and liability recognition for social insurance programs.

The Primary View would change the expense and liability recognition point established in SFFAS 17, *Accounting for Social Insurance,* (as amended) for Social Security, Medicare, and Railroad Retirement (see pars. 18 and 32 for the proposed standard). Under the Primary View, expense and liability would be recognized when participants become **fully insured** under the terms of the programs. (See pars. A9–A53 in the basis for conclusions for more.) For Social Security and Medicare, fully insured status essentially occurs at 40 quarters or equivalent of work in covered employment and this would be considered the first obligating event. Additional obligating events would occur as fully insured participants continue work in covered employment. The Primary View is that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities.

Under the Alternative View, the obligating event for liability recognition would continue to be considered the point when the participant meets all eligibility requirements for benefits and benefit payments become “due and payable.” (See pars. 65—73 for the proposed standard). Thus, the Alternative View would not change the SFFAS 17 liability recognition.

There are at least two other possible obligating events for liability recognition: (1) when participants begin work in covered employment and continuing as long as such work continues (see pars. A22 –A32 in the basis for conclusions for more), and (2) “threshold eligibility” at age 62 for Social Security and 65 for Medicare (see par. A33 in the basis for conclusions for more).

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

Q2. The recent FASAB exposure draft regarding a Statement of Federal Financial Accounting Concepts entitled *Definition and Recognition of Elements of Accrual-Basis Financial Statements*[6] (*Elements* ED) explained that satisfying the definition of a financial statement element such as a liability is a necessary but not sufficient condition for an item to be recognized in financial statements (*Elements* ED, par. 6). In other words, under the proposed liability concept, it would be possible for an item to meet the liability definition but not be recognized in the financial statements because it is not capable of being measured or for other reasons discussed in the ED should not be recognized (see *Elements* ED, pars. 6—8). [Also, see Alternative View Basis for Conclusions paragraphs A170 – A174 for a discussion of the effect of uncertainty on expense and liability recognition.]

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

Q3. The Primary View proposes to change the SOSI by (1) adding line items tying to (or "articulating with") the revised expense and liability amounts reported on the statement of net cost and the balance sheet, respectively; and (2) adding a new section to the SOSI that would explain the changes in the SOSI amounts from the beginning to the end of the reporting period. (See par. 16 in the standard and Appendix B for an illustration.) The Alternative View proposes to leave the SOSI unchanged but to add a new principal financial statement entitled "statement of changes in social insurance," which could be combined with the SOSI. The new statement would provide an explanation for changes to the present value amount included in the statement of social insurance. (See par. 43 in the proposed standard and Appendix C for an illustration.)

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

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

Please provide the rationale for your answers.

[6] The *Elements* ED is available at www.fasab.gov/exposure.html.

Q4. The Alternative View proposes that a statement of fiscal sustainability be presented in the consolidated Financial Report of the United States Government. The statement would be included as required supplementary information. (See Appendix C for an illustration.) The new statement would provide sustainability information on the entire Government, including information to assess the sustainability of social insurance programs and information on intergenerational equity. (See pars. 43 in the standard and A163 in the basis for conclusions for a discussion of the proposal and Appendix C for an illustration.)

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

Q5. In addition to recognizing the due and payable amount, members supporting the Alternative View believe that the Board should consider recognition of deferred revenue for earmarked revenues in excess of related program costs, for social insurance and other earmarked funds, but as a separate project. Such recognition would require revising portions of SFFAS 7, *Accounting for Revenue and Other Financing Sources*, and the supporting arguments also may apply to numerous other funds with such "excess" earmarked revenues. Recognition of deferred revenue as a liability would result in a change to the balance sheet from existing standards. Under existing standards, there is no difference in the timing of revenue recognition between earmarked and nonearmarked revenues. Also under existing standards, component entities display the portion of cumulative results of operations attributable to earmarked funds on their balance sheets and the U.S. governmentwide balance sheet displays separately the portion of net position attributable to earmarked funds. In developing this document, the Board did not deliberate on the merits of recognizing deferred earmarked revenue. [See pars. 67 in the standard and A148 -- A149 in the basis for conclusions for the rationale for this View.]

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

Q6. The Primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information. (See pars. 15 – 37 for the Primary View and pars. 64 – 84 for the Alternative View.)

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

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

Primary View – Proposed Accounting Standard

Please note: Paragraphs 1-41 contain the Primary View proposed accounting standard.

Introduction

Purpose

1. The Primary View would change the recognition and measurement of liability and expense for certain social insurance programs. A liability and expense would be recognized for the Old-age, Survivors, and Disability Insurance ("Social Security"), Medicare, and Railroad Retirement programs when participants have met the conditions specified in current law to attain fully insured status. Participants become **fully insured** when they complete sufficient work in covered employment, for example, for Social Security and Medicare 40 quarters or equivalent of work in covered employment. The Primary View conforms to the new definitions for the liability and expense elements being exposed for comment simultaneously in the recently issued Exposure Draft for a Concepts Statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements* (*Elements* ED).

2. The Primary View would modify the statement of social insurance (SOSI) to provide additional line items breaking out the liability and expense amounts. SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*,[7] changed the status of the SOSI from "required supplementary stewardship information" (RSSI) to a basic or principal statement. However, heretofore the SOSI has not "articulated with" or tied to amounts on the balance sheet or the statement of net cost. Under the Primary View the SOSI shows the liability and expense amounts reported on the balance sheet and the statement of net cost and thereby relates these amounts to the present values of future cash flow reported on the SOSI.

3. The Primary View would rescind Statement of Federal Financial Accounting Standards (SFFAS) 17, *Accounting for Social Insurance*,[8] and SFFAS 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*.[9]

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[7] July 17, 2003.
[8] August 1999.
[9] November 1, 2004.

Scope

4. The Primary View proposed standard would continue to apply to component entities and the consolidated governmentwide entity for the following Federal programs: Old-age, Survivors, and Disability Insurance (OASDI or "Social Security"), Medicare Hospital Insurance (Part A) ("Medicare HI"), Supplementary Medical Insurance (Parts B and D) ("Medicare SMI"), Railroad Retirement Benefits (RRB) (exclusive of the RRB pension tier[10]), Black Lung benefits (BLB), and Unemployment Insurance for the general public (UI). The Primary View would be applied only to these five programs.

5. The Primary View would not affect the accounting standard for the Black Lung benefits (BLB) and Unemployment Insurance for the general public (UI). The provisions of SFFAS 17 with respect to these two programs would be incorporated into this statement for convenience. SFFAS 17 would be rescinded.

Background

6. As noted in the Federal Accounting Standards Advisory Board's (FASAB or "Board") Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting* (*Objectives*), [11] 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 and has unique access to financial resources in that it has the power to tax, to borrow, and to create money.

7. The Federal Government engages in many activities that have no counterpart or are a relatively small part of the activities in the private sector. 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 provides a wide variety of welfare benefits to low-income households and adjusts tax rates and certain other benefits based on income levels. 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 2006 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

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

[11] September 2, 1993.

budget.

8. In SFFAC 1 the Board established four major reporting objectives around which accounting standards should be organized. Taken together the *Objectives* have provided 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. The four objectives are:

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

9. Although they are all important, Objectives 2 and 3 guided the development of the proposed social insurance standard. Objective 2 states that Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

10. The expenses the government incurs in providing services cannot be matched against revenue to measure "net income." Government services are not usually provided in exchange for voluntary payments or fees. Moreover, directly measuring the value added to society's welfare by government actions is difficult. Nonetheless, expenses can be matched against the services provided year by year and the results analyzed in relation to a variety measures. Similarly, long-range estimates (and ranges of estimates) of future costs and other obligations highlight the 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).

11. Objective 3 states that Federal financial reporting should assist users in assessing the impact of the Government's operations and investments for the period and how the Government's and the nation's financial condition has changed and may change in the future. This objective is based on the Government's responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services but on the requirement that the Government report the broad outcomes of its actions.

12. In light of Objectives 2 and 3, fundamental questions about social insurance programs can be addressed by financial reporting. These include whether programs are sustainable as currently constructed; whether the Government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and what is the likelihood that these programs will be able to provide benefits at current levels to those who are planning on receiving them. The information provided as a result of this standard will help users make these

assessments while providing for the complexity of these programs and the uncertainty of long-term projections.

13. To meet the objectives of Federal financial reporting, the Primary View would require, among other things, that:

    1. The statement of social insurance (a principal statement) provide detailed information regarding future cash flows, sources of changes in expected future cash flows and how those flows relate to the balance sheet and the statement of net cost.
    2. Liabilities and expense be recognized when social insurance participants become fully insured and for work completed in covered employment thereafter from the beginning to the end of the reporting period.
    3. Supplementary information be provided illustrating trends and uncertainty, and highlighting projections such as benefits as a percent of GDP in future years.

Effective Date

14. Under the Primary View the proposed standard would be effective for periods ending after September 30, 2009.

Primary View – Proposed Accounting Standard

15. The following five programs are the sole programs subject to this standard:[12]

    1. Old-age, Survivors, and Disability Insurance (OASDI or "Social Security");
    2. Medicare Hospital Insurance (Medicare HI) (Part A) and Medicare Supplementary Medical Insurance (Medicare SMI) (Parts B and D);[13]
    3. Railroad Retirement benefits (RRB);
    4. Unemployment Insurance for the general public (UI); and
    5. Black Lung benefits (BLB).

Statement of Social Insurance

(*See Appendix B for a pro forma illustration of the statement of social insurance. The line items on the illustrative SOSI in Appendix B correspond to the sub-paragraphs of paragraph 16 immediately below. Thus, if one is reviewing the illustrative SOSI in Appendix B and wanted more information about a line item, one should refer to paragraph 16. For example, note that sub-paragraph 16g would be the liability amount on a balance sheet and sub-paragraph 16r would be the total expense amount for a particular social insurance program on a statement of net cost, and that there are corresponding line items on the illustrative SOSI.*)

16. Under the Primary View the component entities administering the Social Security, Medicare, and Railroad Retirement programs would present a statement of social insurance (SOSI) as a principal financial statement.[14] The SOSI would contain

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[12] These are the same five programs identified as social insurance in Statements of Federal Financial Accounting Standards (SFFAS) 17, par. 14.

[13] Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) created the Medicare Advantage (MA) program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to Medicare beneficiaries, and must provide all Medicare covered services. Many MA plans offer additional services such as prescription drugs, vision and dental benefits to beneficiaries. MA costs were $44.5 billion of the total $329.8 billion in Medicare benefit costs in FY 2005. A substantial increase in Medicare Advantage plans is projected for 2006 as the provisions of the MMA give higher payments to MA plans. The Federal Government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and should be accounted for accordingly.

[14] From the FASAB Consolidated Glossary, "Principal Financial Statements"; and see SFFAC 2, *Entity and Display* (April 20, 1995), paragraph 74, for a listing of the financial statements and other information that a financial report should include. The FASAB considers principal financial

actuarial present values of each of the following cash flows:[15]

(*Please note: The sections labeled "a" through "bb" below are the same as the line items illustrated for the pro forma SOSI in Appendix B; that is, the line items labeled "a" through "bb" on the SOSI correspond to the sections immediately below. The section descriptions below provide full explanations for the line items. Note that section/line item "g" is the liability amount that would be recognized and displayed on the balance sheet and section/line item line "r" is the expense amount that would be recognized and displayed on the statement of net cost. The alphabetic characters, e.g., "a," "b," etc., and the specific wording of SOSI line items in Appendix B are illustrative. The entity would not be required to use them when preparing its own SOSI or other financial statements.)*

<u>All future payroll and income tax (from taxation of benefits) during the projection period from or on behalf of:</u>

a. **Current participants** who have attained (1) fully insured status[16] by completing sufficient work in covered employment as of the end of the reporting period <u>and</u> (2) retirement age or disability status.
b. Current participants who have <u>not</u> yet attained retirement age or disability status (for example, the SSA has assumed an age of 15 years for new participants and an age of 62 years for retirement).
c. **Future participants** (that is, new entrants) who are expected to participate during a projection period encompassing substantially all the present value attributed to a. and b. immediately above.[17]
d. Total for a. through c. immediately above.

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statements an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information. [See SFFAC 2, paragraph 71, footnote 12.]

[15] This requirement does not apply to the Black Lung benefits and UI programs.

[16] See Glossary term "Fully Insured."

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

All future expenditures for benefit payments to or on behalf of current and future participants during the projection period. These would be disaggregated based on the status of the participant and relationship of the future expenditures to past or future work in covered employment as follows:

e. Current participants who have attained (1) fully insured status by completing sufficient work in covered employment as of the end of the reporting period and (2) retirement age or disability status (same group as in a. above). The present value amount would include the future benefits attributed to past work in covered employment. Past work is work completed prior to the end of the reporting period. The present value amount would exclude any additional benefits attributable to future work in covered employment (see subsection j. below). The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.

f. Current participants who have attained (1) fully insured status but (2) have not yet attained retirement age or disability status. The present value amount would include the future benefits attributed to past work completed in covered employment. Past work is work completed prior to the end of the reporting period. The present value amount would exclude any additional benefits attributable to future work in covered employment (see subsection j. below). The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.

g. Subtotal e. and f. immediately above. For Social Security, Medicare, and RRB equivalent programs, this amount represents the liability to be reported on the balance sheet. Cross-referencing between the two basic statements would be required.

h. Current participants who have not attained fully insured status by completing sufficient work in covered employment as of the end of the reporting period. The present value amount would include the future benefits attributed to past work completed in covered employment. Past work is work completed prior to the end of the reporting period. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.

i. Subtotal g. and h. immediately above.

j. For all current participants (that is, same group as in e., f., and h. above), the present value of future benefits attributable to future work in covered employment after the end of the reporting period, if any.

k. For future participants (that is, new entrants) who are expected to participate during a projection period encompassing substantially all the present value attributed to i. and j. immediately above, the present value of future benefits attributable to future work in covered employment after the end of the reporting period. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.

l. Total for I., j., and k. immediately above.

Net present value of cash flow during the projection period:

m. Subtract the present value of future payroll tax and income tax on benefits [d. above] from the present value of future expenditures [l. above] to derive a total excess of future benefit payments over future payroll and income tax (on taxation of benefits) (or payroll and income taxes over benefits).

The change in the present value of estimated future payments during the reporting period attributable to:

Fully Insured Current Participants

n. Current participants becoming fully insured during the reporting period and fully insured current participants' increased benefits from work completed in covered employment from the beginning to the end of the reporting period. For SMI participants, this measure would be the net present value of the increase in future benefits less future premiums to be paid by participants.

o. Interest on the liability during the period, at the discount rate employed, due to the passage of time. Measuring the value of the liability as a present value requires the application of interest.

p. **Prior service cost** attributable to changes in law or policy, if any. Prior service cost is the cost of retroactive benefits granted to fully-insured current participants in the reporting period (including benefits that are granted to retirees). A negative prior service cost results in the event of retroactive benefit reductions. The cost is the increase or decrease in the present value of benefits attributable to work in covered employment completed prior to the date of the amendment by fully insured participants. Amendments to the social insurance plans may increase or decrease benefits based on work in covered employment in prior periods, i.e., retroactive benefit changes.

q. Actuarial losses or gains related to the liability as of the reporting date, if any. Actuarial gains and losses result from (1) deviations between actual experience and the actuarial assumptions[18] used and (2) changes in the assumptions.
r. Net cost for the period (subtotal of n. through q.) For Social Security, Medicare HI, and RRB equivalent programs, this amount is the total expense to be reported on the statement of net cost. Thus, the statement of net cost and amounts on lines n., o., p., and q. of the SOSI would cross-reference.
s. The change in the present value of estimated future payments attributable to benefit payments during the current accounting period. Benefit payments reduce the liability.
t. Net change in the liability for the period (subtotal of r. minus s.). The components of cost (that is, n. through q. above), the benefits paid during the period (that is, line s. immediately above), and the resultant net change in the liability would be required to be disclosed in the notes to the financial statements (see subsequent sections of the Primary View).

<u>Not-Fully-Insured Current Participants</u>

For the not-fully-insured participants, the same information as required above (lines n. through r.):

u. The increased potential benefits attributable to work completed in covered employment from the beginning to the end of the reporting period of not-fully-insured current participants during the reporting period. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.
v. Interest on the potential benefits to not-fully-insured current participants during the period, at the discount rate employed, due to the passage of time.
w. **Prior service cost** attributable to changes in law or policy, if any. The cost is the increase or decrease in the present value of benefits attributable to work in covered employment completed prior to the date of the amendment by not-fully-insured participants.
x. Actuarial losses or gains related to the present value of potential benefits of not-fully-insured participants as of the reporting date, if any.
y. Net of lines u. through x. for the period.

[18] An actuarial assumption is the value of a parameter, or other choice, having an impact on an estimate of a future cost, income, or other actuarial item of a program under evaluation. Actuarial Standard of Practice (ASP) No. 32, *Social Insurance*, Section 2, "Definitions." See http://www.actuarialstandardsboard.org/asops.htm

All Participants during the Projection Period

z. The change in the present value attributable to future work in covered employment during the period from changes in law or policy. Prospective benefits granted in the reporting period to all participants, including retirees, create future costs. Negative future costs result in the event of prospective benefit reductions. Amendments to the social insurance plans may increase or decrease future benefits from future work in covered employment. The present value of future benefits would include expected benefits for optional coverage participants are expected to elect and would be net of any payments required to elect the optional coverage. For example, for Medicare SMI participants premiums are currently required of participants. In addition, certain co-payments or deductibles may be required and would reduce the expected benefit payments for the program.

aa. The change in the present value of estimated future payments attributable to actuarial losses or gains related to benefits attributable to future work in covered employment.

bb. Total changes in net present value [line "l." above for the current reporting period less line "l." for the prior reporting period].

Notes to the SOSI would present the following:

cc. 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**.

Component Entity Basic Financial Statements

(*See Appendix B for pro forma illustrations of the statement of net cost, the statement of changes in net position, and the balance sheet.*)

17. The basic financial statements of the component entity will display the following:

1. ***Balance Sheet*** – A single liability line item would be displayed on the balance sheet along with a reference to the SOSI and the line item thereon that reflects the liability amount. This amount is represented by line g. in paragraph 16 above.

   Assets of social insurance programs should be reported separately from the liability. Assets should not be netted against the liability, nor should projected return on assets be netted against expense. Assets should be carried at their acquisition cost, adjusted for amortization, if appropriate. For investments in market-based and marketable securities, the market value of the investment should be disclosed.[19]

[19] See SFFAS 1, *Accounting for Selected Assets and Liabilities*, March 30, 1993.

2. ***Statement of Net Cost*** – The statement of net cost would display, as separate components of operating cost allocated to programs, line items for:

   (1) the change in the present value attributable to participants becoming fully insured during the reporting period and fully insured participants' increasing benefits due to work completed in covered employment from the beginning to the end of the reporting period (amount in line n. in par. 16 above), and
   (2) interest on the obligation for the current year (amount in line o. in par. 16 above) would be displayed

   Prior service costs (amount in line p. in par. 16 above) and actuarial gains or losses (amount in line q. in par. 16 above), if any, would be presented as separate, non-operating costs that are part of the total cost on the statement of net cost.

Component Entity Liability and Expense Recognition

Social Security, Medicare, and Railroad Retirement

18. For Social Security, Medicare and RRB benefits, a liability and an expense would be recognized as described above in paragraph 16.g and 16.n.–q, respectively.

Unemployment Insurance

19. For Unemployment Insurance (UI), a liability and expense would be recognized for:

    1. The amounts due to states and territories for benefits they have paid to beneficiaries but for which they have not withdrawn funds from the unemployment trust fund (UTF) as of fiscal year-end.
    2. The 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.

20. A UI expense will also be recognized for the reporting period for amounts withdrawn from the Federal unemployment trust fund (UTF) by states and territories to pay benefits to beneficiaries that pertain solely to the current fiscal year. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior accounting period pursuant to sub-paragraphs 19.1 and 19.2 immediately above would not be recognized as an expense of the current period.

Black Lung Benefits

21. For Black Lung Benefits the expense recognized for the reporting period would 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.

22. BLB beneficiaries substantially meet conditions when benefits are due and payable[20] to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported. (IBNR).

Assumptions

23. The present values used for the SOSI and for the liability and expense estimates should be based on the entity's **best estimates** of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law. Actuarial assumptions should be based on the actual past experience of the covered group but should emphasize expected long-term future trends rather than give undue weight to recent past experience. The actuarial assumptions should also take into account relevant factors that may create material differences in future experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice,[21] as revised from time to time by the Actuarial Standards Board.

24. The rate used to discount the pension obligation should be within the entity's best-estimate range of anticipated experience under the social insurance program taking into account past experience and reasonable expectations. It should reflect relevant measurement-specific factors, and be consistent with every other economic assumption selected by the actuary for the measurement.

Valuation Date

25. All projections and estimates proposed in the Primary View would be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon

[20] Under the due and payable standard, the expense recognized for the reporting period would 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 would be social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including IBNR claims.
[21] See ASP No. 32, *Social Insurance*, ASP No. 4, *Measuring Pension Obligations*, especially paragraph 3.4, Actuarial assumptions, and ASP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligation.*

("current year") as possible and no more than one year prior to the end of the current year, with projections to the end of the fiscal year taking into account major factors that affect the results that are known at the time of the projection. This valuation date should be consistently followed from year to year.

Component Entity Note Disclosure

26. Component entities would include the following the notes:

    1. The entity would provide a brief statement explaining that the expense, liability and SOSI amounts are estimates based on current law, that current law may be changed in the future, and actual cost will vary, sometimes greatly. For example:

        APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

        Our consolidated 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 law which may change in the future. Actual results could differ materially from the estimated amounts. We believe that some of the more critical estimates and related assumptions that affect our financial condition and results of operations are in the areas of growth of average employee earnings, interest rate used to compute the interest credited to the trust funds, employment, healthcare cost trends, and inflation. Our critical accounting estimates were discussed with our Audit and Finance Committee.

    2. The assumptions that underlie the amounts reported for the SOSI and for the liability and expense would be included in notes that are presented as an integral part of the principal financial statements.

    3. Components of the change in the liability account, i.e., present value of future payments, interest on the liability, actuarial gains or losses, if any, and prior service cost, if any. This information would be the same as in the changes section of the SOSI, lines n. through t. in paragraph 16 above. For example, the note may contain the following table:

Liability Account	(millions)
Beginning Liability, FY 2010	$XX,XXX,XXX
Add: accrued expense for the year	
PV of future benefits from work in covered employment	X,XXX,XXX
Interest on the liability	X,XXX,XXX
Prior service cost	X,XXX,XXX
Actuarial gains	X,XXX,XXX
Subtotal	XX,XXX,XXX
Less: Payment to beneficiaries	(XXX,XXX)
Ending Liability, FY 2010	$XX,XXX,XXX

4. The benefits accrued by participants who have completed less than sufficient work in covered employment. This is a line item on the SOSI, see sub-paragraph 16y.

5. For the same time period as used for the SOSI, the total of any future outlays (see sub-paragraph 16 l) in excess of statutorily provided future resources for all participants who are currently participating in the programs and those who would be participating over the projection period.

Component Entity Required Supplementary Information

27. The following information would be required supplementary information, except to the extent that the preparer elects to include some or all of it in notes that are presented as an integral part of the principal financial statements. The component entity responsible for the social insurance program would include in its financial report 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:

    1. the long-term sustainability and financial condition of the program;
    2. the trends revealed in the data; and
    3. 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, along with the implications thereof.

The entity should consider both narrative and graphic presentations.

28. The information on financial and actuarial status would include the following measures and data:

1. *Projections* – Projections of cash flow for those person 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 Trustees have used a projection period of 10 years for short-term and 75 years for long-term projections). The projection would 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 would include the following:

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

      1. Total cash inflow from:

         a. all sources and
         b. excluding net interest on intragovernmental borrowing/lending,[22] and

      2. Total cash outflow.

      The narrative accompanying the cash flow data would 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.

   (b) The actuarial estimate provided for total cash inflow excluding net interest and total cash outflow (see sub-paragraph 28.1.(a).1.b and 28.1.(a).2 immediately above) as a percentage of:

      3. **Taxable payroll**[23] and
      4. **Gross Domestic Product** (GDP).[24]

2. *Ratio of Contributors to Beneficiaries*[25] – With respect to the Social Security and

[22] "Interest on intragovernmental borrowing" refers to interest earned by the social insurance program on obligations of the U.S. Government.
[23] Medicare SMI, UI and Black Lung benefits programs either are not financed by earmarked payroll taxes or are financed by payroll taxes on employers as determined by the states that can vary from state to state; therefore these programs are not required to provide this estimate.
[24] This requirement does not apply to the Railroad Retirement, Black Lung benefits, and UI programs.
[25] The Medicare SMI, Black Lung benefits, and UI programs are financed by, respectively, premiums paid by covered participants and general fund contributions (Medicare SMI); direct

Medicare 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 cash flow projections (e.g., 75 years), using the program managers' best estimate.[26]

3. State-by-State Analysis – The component entity administering the UI program would provide a state-by-state analysis illustrating the relative solvency of individual state programs. The analysis would 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.

Component Entity Sensitivity Analysis

29. Component entities should provide sensitivity analysis appropriate for their particular social insurance program. The SSA, Medicare and Railroad Retirement programs should provide, at a minimum, sensitivity analysis of the liability, expense, and SOSI amounts. What is appropriate should be considered based on what future trends might emerge, the utility of the information to the users and policy-makers, and the relative burden on the component resources. Components are encouraged to explore areas of analysis that might be appropriate. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of **stochastic modeling** as an augment or alternative to sensitivity analysis.

30. The UI program would illustrate sensitivity of the projections that would be required by paragraph 28.3 to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).

Governmentwide Accounting and Reporting

31. Under the Primary View the proposed standard for governmentwide accounting and reporting for social insurance programs would be the same as that for component entities, except as provided below. Thus, the governmentwide entity should refer to the relevant paragraphs of the proposed standard for component entities in the

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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 contributions to beneficiaries. The OASDI trustees refer to the ratio of beneficiaries to contributors as the "dependency ratio."

[26] Medicare SMI is financed by premiums paid by covered participants and general fund contributions and therefore is not required to provide the ratio of contributors to beneficiaries.

preceding section for a description of the information to be provided. The level of detail at the CFR level should be less than at the component level.

Governmentwide Entity Liability and Expense Recognition

32. Liability and expense recognition are the same as for the component entity. (See pars. 16-22).

Governmentwide Entity Display

33. The line items displayed on the consolidated governmentwide entity's financial statements would be the same as for the component entities, including SOSI, except that disaggregation into cost components for each component entity would not be required for the operating statement. (See par. 17) The governmentwide entity may summarize and combine financial statement components as needed for the purposes of display.

Governmentwide Entity Note Disclosure

34. The governmentwide entity notes to the financial statements would explain that the liability, expense, and SOSI amounts are estimates based on current law, that current law may be changed in the future, and that actual amounts will vary, sometimes greatly.

35. The governmentwide entity would identify in the notes to the financial statements the component entities that have publicly available reports with detailed financial and actuarial information about social insurance programs. This reference would include sensitivity analysis of the liability, expense, and SOSI amounts.

36. The consolidated governmentwide entity would disclose the underlying significant assumptions used to derive the liability, expense, and SOSI amounts in notes to the financial statements.

Governmentwide Entity Sensitivity Analysis

37. The govenmentwide entity would provide sensitivity analysis of the liability, expense, and SOSI amounts as required supplementary information. The goal of the sensitivity analysis should be to disclose the range of expected results for the liability, expense, and SOSI amounts. Sensitivity analysis presented in the past should provide a guide as to appropriate analysis to the made in the future, but should not prejudice the selection of analyses to be included or excluded. The governmentwide entity may summarize and combine component entity sensitivity analysis.

Rescission of Standards

39. Under the Primary View SFFAS 17 and 26 would be rescinded. Continuing provisions of those two standards would be incorporated in this statement.

Materiality

40. The provisions of the accounting standards proposed in the Primary View would not be applied to immaterial items.

Effective Date

41. Under the Primary View the standard would be effective for periods beginning after September 30, 2009.

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

Alternative View -- Proposed Accounting Standard

Please note: Paragraphs 42-86 contain the Alternative View proposed accounting standard.

Introduction

Purpose

42. The FASAB members who support the Alternative View acknowledge the widely accepted conclusion that social insurance programs, as presently structured, are unsustainable under current financing arrangements. Therefore, members who support the Alternative View believe it is crucial that Federal financial reporting provide accurate and transparent information to Americans so that they can make well-informed decisions for themselves and their Government. In this regard, members who support the Alternative View note that such reporting must include information on the Government's long-term commitments for social insurance under current law as well as all other Government programs.

43. The Alternative View supports this objective with two new complementary statements:

    a. A statement of changes in social insurance that (1) reconciles beginning and ending net present values reported in the SOSI for social insurance programs, and (2) provides the significant reasons for changes in net present value during the period; and

    b. A statement of fiscal sustainability that provides supplementary information on the long-term sustainability of the Government as a whole, which incorporates social insurance programs into a comprehensive presentation with other Federal programs. Fulfilling the Stewardship Objective of SFFAC 1 requires the reporting of not only a balance sheet and a statement of net cost, but also, an assessment of the sustainability of social insurance programs and the Government as a whole.

44. The Alternative View supports the SFFAC 1 reporting model, which is more complex than the traditional business reporting model. Also, the Alternative View differentiates the accounting and reporting for social insurance programs from employee benefits, as they are fundamentally different in nature. The Alternative View model more aptly fits the unique nature of the Federal Government and fills the needs of financial report users as required by SFFAC 1.

45. Assessing governmentwide sustainability, or the affordability of all of the Federal Government's future responsibilities, is essential for assessing the sustainability of

social insurance programs under current law. Social Security and Medicare costs are so large and the retired population and their health care costs are growing so rapidly that these programs will not only apply pressure to reduce expenditures for other programs, but will also constitute a growing share of gross domestic product. Thus, information presented by the Alternative View would provide more transparency to support an appropriate resolution of issues affecting resource allocation, fiscal policy, and economic growth for the nation.

46. Net costs of Federal programs “can be matched against the provision of services year by year.” This principle, from SFFAC 1, has been implemented by FASAB standards for more than 15 years , has proven useful in analyzing the cost and results of programs, and articulates with a balance sheet, which shows what the Government owns and owes as a result of past operations. Both the statement of net costs and the balance sheet contribute to effective and efficient Government operations.

47. Members who support the Alternative View believe that Federal financial reporting should reflect the principle of matching the cost of Government operations during a particular year with the services provided by the Government during that year. They believe that, just as future Government spending on programs such as defense, education or Medicaid is not a present obligation of the Government, future social insurance spending is not a present obligation. Members who support the Alternative View also believe that the balance sheet, which shows what the Government owns and owes as a result of past operations, should include as liabilities only those items that are present obligations of the Government.

48. As is currently required under SFFAS 17 and proposed under the Alternative View, a liability for all social insurance programs will continue to be recognized for social insurance benefits due and payable[27] to or on behalf of beneficiaries at the end of the reporting period, including IBNR claims. Similarly, the expense recognized for the reporting period will continue to 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. In addition, the SOSI, which became a principal financial statement beginning in fiscal year 2006, will continue to display currently required information about the present value of projected future revenues and scheduled benefits. It is important to continue to report information that is consistent with other publicly reported information on these programs.

49. The Alternative View is consistent with the current position of the International Public Sector Accounting Standards Board (IPSASB), which supports recognition of a

[27] Under the due and payable standard, the expense recognized for the reporting period would 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 would be social insurance benefits due to be paid to or on behalf of beneficiaries at the end of the reporting period but not disbursed until after the end of the period, including IBNR claims.

liability for all social policy obligations (generally social insurance programs and other nonexchange benefit programs) only when all eligibility criteria have been satisfied. This results in reporting a liability that generally would be the amount of the next benefit payment, which is essentially equivalent to FASAB's current definition of due and payable. (See paragraph A138 for further details). In addition, the Alternative View is consistent with IPSASB's view that it is important to also report information concerning the sustainability of all government programs, including social insurance programs. Social policy commitments are a significant factor in most countries' governmental expenditures. Also, the Alternative View is consistent with the view of a number of other nations that have reported information about sustainability of government programs. Further, Governmental Accounting Standards Board (GASB) Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions, par. 21,* states that "providers [of nonexchange benefits] should recognize liabilities (or a decrease in assets) and expenses from government-mandated or voluntary nonexchange transactions, and recipients should recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all applicable eligibility requirements, including time requirements, are met."

Scope

50. The Alternative View applies to component entities and the consolidated governmentwide entity for the following Federal programs: Old-age, Survivors, and Disability Insurance (OASDI or "Social Security"), Medicare Hospital Insurance (Part A) ("Medicare HI"), Supplementary Medical Insurance (Parts B and D) ("Medicare SMI"), Railroad Retirement Benefits (RRB) (exclusive of the RRB pension tier[28]), Black Lung benefits (BLB), and Unemployment Insurance for the general public (UI).

51. Under the Alternative View SFFAS 17 and SFFAS 26 would be rescinded. Continuing provisions of those two standards are incorporated in this statement.

Background

52. As noted in SFFAC 1, the Federal Government is unique when compared with any other entity in the country.

53. In SFFAC 1, *Objectives*, the Board established four major reporting objectives for Federal accounting standards. For more than fifteen years, the *Objectives* have provided a framework for assessing the existing accountability and financial reporting systems of the Federal Government and for considering how new accounting

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

standards might enhance those systems. The four objectives seek to hold the Government accountable for:

1. Budgetary Integrity (the integrity and legality with which it uses the people's money);
2. Operating Performance (the effectiveness and efficiency with which it operates and delivers services);
3. Stewardship (the sustainability of its service delivery and revenues); and
4. Systems and Control (the quality of its data, systems and controls).

54. Although all four of the objectives are equally important, Objectives 2 and 3 guided the development of the proposed social insurance standard. Objective 2 states that Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities

55. The expenses the Government incurs in providing services cannot be matched in a traditional sense against revenue to measure "net income" because Government services are not usually provided in exchange for voluntary payments or fees. "Nonetheless, expenses can be matched against the provision of services year by year," as noted in SFFAC 1. This principle from SFFAC 1 has been implemented by FASAB standards for fifteen years, and has proven useful in analyzing the costs and results of programs. The Alternative View continues this valuable matching of cost with the delivery of services for social insurance and all other programs.

56. Objective 3 states that Federal financial reporting should assist users in assessing the impact of the Government's operations and investments for the period and how the Government's and the nation's financial condition has changed and may change in the future. This objective is based on the Government's responsibility for the general welfare of the nation in perpetuity. It focuses not on the provision of specific services, but on the requirement that the Government report the broad outcomes of its actions.

57. In light of Objective 3, fundamental questions about social insurance programs can be addressed by accounting standards, including whether these programs are sustainable as currently constructed; whether the Government's financial condition improved or deteriorated as a result of its efforts to provide these and other programs; and how long these programs will be able to provide benefits at current levels. As noted in SFFAC 1, financial condition is a broader and more forward-looking concept than that of financial position. The information that is proposed under the Alternative View will help users address these questions.

58. The SOSI, which will be subject to a full audit for fiscal year 2006, was the first step in including an assessment of sustainability of social insurance programs in agency and

governmentwide reports. It is based on long-range actuarial estimates (and ranges of estimates) of future costs. These statements help to analyze benefit payments to different participants under current law, as well as economic and demographic changes (e.g., in the cost of health care and in life expectancies).

59. Given the different nature of government, a business reporting model that is focused on the balance sheet and the income statement alone is inadequate for government financial reporting.

60. Unlike business, governments do not seek to maximize profit; rather, governments seek to maximize the well-being of their citizens. Unlike business, government assets are not used to earn a return on investment; rather, government assets are used to provide transfers and services to citizens. Unlike business, which may cease operations, governments are expected to continue in perpetuity. Also, unlike business, government sets, and may change at any time, laws determining its own operations and unilaterally controls nonexchange revenues and expenses.

61. The Federal Government is not only different from business; it is also different from state and local governments. Unlike state and local governments, the Federal Government provides comprehensive social insurance coverage to its citizens and provides, for example, the nation's defense. In addition, unlike state and local governments, the Federal Government has the ability to create money and operate in a sustained deficit position. Finally, unlike state and local governments, the Federal Government's credit worthiness is based, in part, on the nation's economic condition and the underlying tax base.

62. To meet the Objectives of Federal financial reporting, the Alternative View would require, among other things, that:

    1. Liabilities and expense would continue to be recognized for those social insurance benefits that are due and payable to or on behalf of beneficiaries at the end of the reporting period, including IBNR claims.
    2. The statements of social insurance and of changes in social insurance (principal statements) provide detailed information regarding the present value of future cash flows, sources of changes in expected future cash flows, changes in such present values during the period and the reasons for such changes.
    3. A supplementary statement of fiscal sustainability for the governmentwide entity illustrates the long-term sustainability of the social insurance and other Federal programs (both in dollars and as a percentage of GDP), highlighting trends, reasons for changes in sustainability measures during the period, and the sensitivity of such sustainability information to changes in policy, economic, and other significant assumptions.

Effective Date

63. Under the Alternative View, the proposed standard would be effective for periods beginning after September 30, 2009.

Alternative View – Proposed Accounting Standard

64. The following five programs are the sole programs subject to this proposed standard:[29]

    a. Old-age, Survivors, and Disability Insurance (OASDI or "Social Security");
    b. Medicare Hospital Insurance (Medicare HI) (Part A) and Medicare Supplementary Medical Insurance (Medicare SMI) (Parts B and D);[30]
    c. Railroad Retirement benefits (RRB);
    d. Unemployment Insurance for the general public (UI); and
    e. Black Lung benefits (BLB).

Statement of Financial Position/Balance Sheet

65. Under the Alternative View and consistent with existing Standards, except for UI, the entity should recognize a liability and a related expense for social insurance benefits when all eligibility requirements are met and benefits are due and payable to or on behalf of beneficiaries at the end of the reporting period, including IBNR claims. With respect to social insurance programs, the Government has a present obligation when all eligibility criteria are met such that an individual beneficiary is entitled to receive a benefit (e.g., a cash payment, goods or services). At that point, the benefits become due and payable. For example, in Medicare HI, a present obligation occurs when an eligible participant satisfies individual eligibility requirements (including, for example, having completed 40 quarters or equivalent of work in covered employment and having attained age 65) and receives an eligible medical service from an eligible service provider. Only after the covered medical services have been provided does the Federal Government have a present obligation to pay the service provider. A present obligation under the Medicare--SMI program also requires, at a minimum,

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[29] These are the same five programs identified as social insurance in Statements of Federal Financial Accounting Standards (SFFAS) 17, par. 14.

[30] Medicare also includes a "Part C." The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) created the Medicare Advantage (MA) program that is sometimes referred to officially as Part C. MA provides Parts A, B, and now D through private health insurance plans. Those who are entitled to Part A and enrolled in Part B may choose to join a MA plan, if there is a plan available in their area. MA plans have their own providers or a network of contracting health care providers. All MA plans are currently paid a per capita premium, assume full financial risk for all care provided to Medicare beneficiaries, and must provide all Medicare covered services. Many MA plans offer additional services such as prescription drugs, vision and dental benefits to beneficiaries. MA costs were $44.5 billion of the total $329.8 billion in Medicare benefit costs in FY 2005. A substantial increase in Medicare Advantage plans is projected for 2006 as the provisions of the MMA give higher payments to MA plans. The Federal Government's commitment for components of Part C (i.e., hospital, physician, drugs) would be the same as for Parts A, B, and D and should be accounted for accordingly.

that participants elect to participate in the program and pay monthly premiums. The Basis for Conclusions provides a more detailed discussion of liability recognition. 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.

66. Consistent with existing Standards, under the Alternative View, for Unemployment Insurance (UI), a liability and expense would be recognized for (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. A UI expense would also be recognized for the reporting period for amounts withdrawn from the Federal UTF by states and territories to pay benefits to beneficiaries that pertain solely to the current reporting period. Such costs would be recognized as a component of expense and not as a reduction of the recognized liability. Amounts paid that pertain to and reduce the liability recognized in the prior reporting period pursuant to this paragraph, items (1) and (2), would not be recognized as an expense of the current reporting period.

67. SFFAC 1 supports the concept that costs of federal programs should be matched against the provision of services year by year. Social insurance programs are funded largely on a pay-as-you-go basis so that earmarked social insurance program revenues (e.g., payroll taxes, premiums) are used mainly to pay current benefits. Any earmarked social insurance program revenues in excess of program costs incurred by the earmarked funds during the period are invested in Government securities. Supporters of the Alternative View believe that the liability for the social insurance programs should continue to be due and payable amounts. However, in addition to the due and payable amount, recognition of deferred earmarked revenue equal to the earmarked social insurance program revenues in excess of program costs should be considered. If this option were adopted, earmarked revenues collected for social insurance programs during the reporting period in excess of program liabilities (as defined in paragraph 65 above and existing liability standards) would be recorded as deferred earmarked revenues. This concept should be considered by the Board as a separate project, however, because it would require revising portions of SFFAS 7 and the supporting arguments also may be applied to numerous other funds with earmarked receipts. (See paragraphs A148 - A149 for further explanation.)

Statement of Social Insurance

(*See Appendix C for a pro forma illustration of the Statement of Social Insurance.)*

68. The component entities administering the Social Security, Medicare, Railroad Retirement and Black Lung programs and the governmentwide entity would continue

to present a statement of social insurance (SOSI) as a principal financial statement.[31] The SOSI would retain presentation of actuarial present values of each of the following cash flows:[32]

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

(a) to or on behalf of current participants who have attained retirement age or are otherwise receiving benefits,

(b) 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),

(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 or otherwise receiving benefits;

All future contributions, other earmarked taxes, premiums, and state transfers during the projection period:

(d) from or on behalf of current participants who have attained retirement age or otherwise receiving benefits (same group as in (a) above),

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

(f) from or on behalf of those who are expected to become plan participants or otherwise receiving benefits (same group as in (c) above) during the same projection period used in (c) immediately above.

Net present value of cash flow during the projection period:

(g) the actuarial present value of future payroll tax contributions and other 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

[31] From the FASAB Consolidated Glossary, "Principal Financial Statements": See SFFAC 2, *Entity and Display* paragraph 74, for a listing of the financial statements and other information that a financial report should include. The FASAB considers principal financial statements an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information. [SFFAC 2, paragraph 71, footnote 12.] (See also "Basic Financial Statements")

[32] This requirement does not apply to the Black Lung benefits and UI programs.

benefit payments [(a)+(b)+(c)] to derive a total excess of future benefit payments over future payroll tax contributions and other 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,

(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 payroll tax contributions and other tax income from them or paid on their behalf (see (d) and (e) above) is calculated by subtracting the actuarial present value of future payroll tax contributions and other 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)], and

(j) significant assumptions underlying the information that would be required in subparagraphs (a)- (i) above

69. Required Supplementary Information should present:

1. *Projections* – Projections of cash flow for those person 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 Trustees have used a projection period of 10 years for short-term and 75 years for long-term projections). The projection would 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 would include the following:

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

      1. Total cash inflow from:

         a. all sources and
         b. excluding net interest on intragovernmental

borrowing/lending,[33] and

2. Total cash outflow.

The narrative accompanying the cash flow data would 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.

(b) The actuarial estimate provided for total cash inflow excluding net interest and total cash outflow (see sub-paragraph 69.1.(a).1.b and 69.1.(a).2 immediately above) as a percentage of:

1. **Taxable payroll**[34] and
2. **Gross Domestic Product** (GDP).[35]

2. *Ratio of Contributors to Beneficiaries* – for OASDI and Medicare-HI, the ratio of the number of covered workers to the number of beneficiaries (commonly called the “dependency ratio”) during the projection period.

70. The information that would be required in subparagraphs 68(a)-(h) would be presented for the current reporting period and for each of the prior four years.

71. The information that would be required in subparagraphs 68(a)-(h) would be presented for the current reporting period and for each of the prior four years.

72. For the UI program, required supplementary information should 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.

Statement of Changes in Social Insurance

(*See Appendix C for a pro forma illustration of the Statement of Changes in Social Insurance.)*

[33] “Interest on intragovernmental borrowing” refers to interest earned by the social insurance program on obligations of the U.S. Government.
[34] Medicare SMI, UI and Black Lung benefits programs either are not financed by earmarked payroll taxes or are financed by payroll taxes on employers as determined by the states that can vary from state to state; therefore these programs are not required to provide this estimate.
[35] This requirement does not apply to the Railroad Retirement, Black Lung benefits, and UI programs.

73. Each entity (including the governmentwide entity) presenting a SOSI should present a statement of changes in social insurance (which could be combined with the SOSI) that includes:

    a. A reconciliation of beginning and ending actuarial net present value of future payroll tax contributions, other income and future expenditures during the projection period for each material social insurance program, the sum of all other social insurance programs, and in total. These amounts should agree with amounts reported in the SOSI.

    b. The significant reasons (e.g., changes in valuation period, economic assumptions, demographic assumptions, legislation, etc.) and related amounts for changes during the period in the present values for each material social insurance program, the sum of all other social insurance programs, and in total.

74. In addition, the entity should disclose in the footnotes a narrative discussion of:

    a. The significant changes in social insurance responsibilities during the period and the reasons therefore.

    b. The key variables affecting the Federal Government's social insurance responsibilities (e.g., demographics, health care cost growth).

Statement of Fiscal Sustainability

(*See Appendix C for a pro forma illustration of the statement of fiscal sustainability and related disclosures. If one is reviewing the illustrative statement of fiscal sustainability in Appendix C and wants more information about a line item, one should refer to paragraphs 75 and 76.)*

75. The governmentwide entity should present, as required supplementary information, a statement of fiscal sustainability and related information (described below) to assess the long-term sustainability of social insurance in the context of other Federal programs. Information about the sustainability of the Government as a whole is important to assessing the sustainability of social insurance programs, and in particular, to assessing the likely availability of general fund resources to finance Medicare—SMI benefits. As additional experience is gained with these additional disclosures, the Board should consider whether to require some of this information as basic financial information.

76. The statement of fiscal sustainability and supporting information should present the following key components of sustainability in support of social insurance reporting. As appropriate, these key components may be added to or amended as the Board separately considers the needs of broader sustainability reporting beyond social insurance.

a. The present value of the projected receipts and outlays related to all federal programs, for both 75 year and infinite horizons, in dollars and as a percentage of the present value of GDP. Due to their significance, at a minimum, the statement should include information about:

    1. Scheduled Social Security benefits, payroll and other earmarked taxes, and benefits net of earmarked taxes;
    2. Scheduled Medicare—HI benefits, payroll other earmarked taxes, and benefits net of earmarked taxes;
    3. Scheduled Medicare—SMI benefits, related premiums and state transfers, and benefits net of premiums and transfers
    4. Other federal program outlays, net of earned and earmarked receipts
    5. Other receipts
    6. Net receipts/outlays, in total and separately for Social Security, Medicare—HI, and all other programs
    7. A summary of receipts, including the amounts related to each of items (a) through (f) immediately above
    8. A summary of outlays, including the amounts related to each of items (a) through (f) immediately above.

b. Information that will assist in understanding the sustainability of social insurance programs, including (1) different measures of sustainability (e.g., fiscal imbalance [the present value of net receipts/outlays plus public debt] and fiscal gap [assumes the public debt is maintained at a constant percentage of GDP]) (2) sustainability measures under a variety of fiscal assumptions, (3) the intergenerational equity of social insurance programs, (4) projection of fiscal sustainability and intergenerational equity measures for future periods sufficient to illustrate the trends, and (5) information about the fiscal burden on individual citizens, full-time workers, and households.

c. The information, on an annual basis, that is used to determine the amounts reported in the statement of fiscal sustainability, including interest costs.

d. A description of major federal responsibilities, other than social insurance, that are not shown separately on the statement of fiscal sustainability.

e. A reconciliation of changes in the present value of net receipts/outlays during the period, along with related narrative describing the nature of such changes, which would illustrate the extent to which the Federal Government's financial condition had changed during the year.

f. Significant assumptions used in calculating the above information, including definitions or descriptions of each of the assumptions.

g. An analysis of the sensitivity of the information in the statement of fiscal sustainability, and in particular the fiscal gap, to changes in significant assumptions, such as:

   1. varying fiscal policy assumptions (spending, tax rates)
   2. discount rates
   3. other assumptions (e.g., health care cost increases, longevity, average retirement age, immigration, birth and death rates, productivity growth, real interest rates, real wage growth, and the unemployment rate)

Assumptions

77. The present values used for the SOSI and statement of changes in social insurance should be based on the entity's best estimates of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law. Actuarial assumptions should be based on the actual past experience of the covered group, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. The actuarial assumptions should also take into account relevant factors that may create material differences in future experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice,[36] as revised from time to time by the Actuarial Standards Board.

78. The rate used to discount the future cash flows should be within the entity's best-estimate range of anticipated experience under the social insurance program taking into account past experience and reasonable expectations. It should reflect relevant measurement-specific factors, and be consistent with other economic assumptions.[37]

Valuation Date

79. Consistent with current requirements, all projections and estimates proposed by the Alternative View would be made as of a date (the valuation date) as close to the end of the fiscal year being reported upon as possible and no more than one year prior to the end of the reporting period. This valuation date should be consistently followed from year to year. Also, the financial statements should disclose the nature of any events, after the valuation date but before financial statements are issued, that could materially affect the estimates and, if available, an estimate of the potential impact.

[36] See Actuarial Standards of Practice (ASP) No. 32, *Social Insurance*, ASP No. 4, *Measuring Pension Obligations*, especially paragraph 3.4, Actuarial assumptions, and ASP No. 27, *Selection of Economic Assumptions for Measuring Pension Obligation.*
[37] See ASP No. 32, ASP No. 4, especially paragraph **5.2.4**, and ASP No. 27.

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

> **APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**
>
> The financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. Further, the estimates are based on current conditions that may change in the future. Actual results could differ materially from the estimated amounts. We believe that some of the more critical estimates and related assumptions are related to social insurance and sustainability. In each of these areas, the financial statements include information to assist in understanding the effect of changes in assumptions to the related information. Our critical accounting estimates were discussed with our Audit and Finance Committee.

Sensitivity Analysis

81. Entities should provide sensitivity analysis appropriate for their particular social insurance program. The SSA, Medicare, Railroad Retirement, and Black Lung programs should provide sensitivity analysis of the SOSI amounts. Appropriate considerations include future trends, the utility of the information to the users and policy-makers, and the relative burden on the component entity resources. Providing analysis or disclosure for one or more periods will not imply that such analysis or disclosure is appropriate in the future, although the reasons for discontinuing a particular sensitivity analysis should be addressed in the annual report. Entities may consider disclosing the results of **stochastic modeling** as an augment or alternative to sensitivity analysis.

82. The UI program would illustrate sensitivity of the projections that would be required by paragraph 81 to changes in the unemployment rate assumption. The illustrations should reflect the effect of increasing the unemployment rate (1) by approximately one percentage point and (2) to a level sufficient to put stress on the system (e.g., to simulate the largest recession occurring within the last 25 years).

Component Entity Accounting and Reporting

83. Component entities should report the information that would be required by paragraphs 43 to 82 above. In addition, the component entity responsible for the social insurance program would include in its financial report a clear and concise description of the program, how it is financed, how benefits are calculated, and its financial and actuarial status.

Governmentwide Entity Accounting and Reporting

84. Under the Alternative View, the proposed standard for governmentwide accounting and reporting for social insurance programs would be the same as that for component entities; however, the level of detail at the governmentwide level should be less than at the component level. In addition, the governmentwide entity should report the statement of fiscal sustainability and related information would be required in paragraphs 75 and 76 above. Supplementary information related to the SOSI and statement of fiscal sustainability may be combined where appropriate.

Rescission of Standards

85. Under the Alternative View, SFFAS 17 and 26 would be rescinded. Continuing provisions of those two standards would be incorporated in this statement.

Materiality

86. The provisions of the proposed accounting standards in the Alternative View would not be applied to immaterial items.

Effective Date

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

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

Appendix A: Primary View – Basis for Conclusions

Please note: Paragraphs A1-A106 contain the basis for conclusions for the Primary View and paragraphs A107-A185 contain the basis for conclusions for the Alternative View.

Primary View Basis for Conclusions

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

Background

A2. Expense and liability recognition for social insurance programs (as well as potential expense and liability recognition for other nonexchange transactions and government-acknowledged events) has been a long-standing source of controversy in government accounting. In response to the 2002 exposure draft, the American Institute of CPAs (AICPA) Liaison Task Force endorsed earlier comments made by the AICPA's Federal Accounting and Auditing Subcommittee in response to the 1998 exposure draft. Those comments were:

> Like a significant majority of the respondents to [the 1995] exposure draft, the Subcommittee agrees that the Government should recognize liabilities for its long-term obligations under social insurance programs. It believes that the arguments summarized in paragraphs 73 through 79 of the social insurance exposure draft make a convincing case for such liability recognition. The Subcommittee believes that social insurance programs are exchange programs. With each period of covered employment, workers and their employers exchange a commitment to pay earmarked taxes for a promise from the Government to provide social insurance benefits in the future. Workers rely on these promises in planning their own retirements and their employers rely on them in determining the level of pension and other postretirement benefits to provide their employees.
>
> In issuing the liability standard, FASAB concluded that it was questionable whether adequate information concerning social insurance could be presented in a single, point-in-time number on the balance sheet. The Subcommittee agrees that a single liability

number presented in the balance sheet would not present adequate information on social insurance programs. However, it disagrees that the presentation of the required supplementary stewardship information should relieve the Government of the responsibility to report a liability for social insurance where such a liability exists.

The Subcommittee believes that the amount to be recognized as a liability should be based on events that have already occurred as of the balance sheet date and which are reliably measurable at that date. For example, a participant's payment of all required contributions and attainment of age and other eligibility criteria would indicate that a liability to that participant exists. Thus, it supports a measure based on accounting methods that are familiar to financial statement users and that can be adapted to social insurance programs, including those in Statements of Financial Accounting Standards Nos. 87, *Employers' Accounting for Pensions*, and 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Because the closed group estimate is based on projections of events to occur in the future, the Subcommittee does not support reporting the closed group amount as a liability, as discussed in paragraph 77 of the exposure draft. As a transition step towards full recognition of the liability for social insurance benefits, the government could initially recognize liabilities for social insurance programs based on the net present value of amounts due to those who are eligible to receive them at the balance sheet date.

A3. In addition, economists and others interested in public policy continue to express concern about the completeness of information available to assess the financial position and results of operation of the Federal Government. While these concerns were not raised in the context of accounting standard-setting, some members believe the concerns demonstrate an interest in information different than that produced by the current standards.

A4. In his February 2003 testimony[38], former Federal Reserve Chairman Alan Greenspan explained his views regarding the need for accrual-based information to inform decision-makers:

> An accrual-based accounting system geared to the longer horizon could be constructed with a reasonable amount of additional effort. … **An accrual system would allow us to keep better track of the government's overall accrued obligations and deferred assets. Future benefit obligations and taxes would be recognized as they are incurred rather than when they are paid out by the government.** (footnote 2: In particular, a full set

[38] Testimony of Chairman Alan Greenspan, *Federal Reserve Board's semiannual monetary policy report to the Congress,* Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, February 11, 2003.

> of accrual accounts would give the Congress, for the first time in usable form, an aggregate tabulation of federal commitments under current law, with various schedules of the translation of those commitments into receipts and cash payouts.) …Accrual-based accounts would lay out more clearly the true costs and benefits of changes to various taxes and outlay programs and facilitate the development of a broad budget strategy. [Emphasis added]

A5. Other commentators have asserted that users of the financial statements may be confused if the effects of future reform were an increase in a recognized liability – public debt – and a decrease in an unrecognized liability for future social insurance benefits.[39] For example, a reform proposal could promise to improve overall fiscal balance, reducing the negative net present value of all future outlays and revenues. If the proposal accomplished this by increasing today's deficits while cutting tomorrow's outlays by a larger amount, under current budget rules, it would mistakenly be reflected as "too expensive." Some believe the numbers users focus on now (i.e., the annual, generally cash deficit) distract us from the numbers that matter (total liabilities). Permitting an incomplete presentation of financial position and changes in financial position would confuse users. Users would be unable to clearly determine whether the Government's financial position improved or deteriorated during the reporting period.

A6. More recently, the winter 2004 volume of the Harvard Journal on Legislation[40] presents a proposal by Howell E. Jackson to incorporate information regarding Social Security costs and obligations arising from ongoing work in covered employment in the Federal accounting system. Professor Jackson and six respondents review the merits and demerits of this approach for Social Security. Some respondents opposed accruing long-term obligations for Social Security benefits and others supported doing so. While the volume is too complex to summarize in a meaningful fashion, the response provided by Peter A. Diamond and Peter R. Orszag offered the following insight:

> Accrual accounting measures, which are already available to experts, would be a useful addition to the information provided regularly to the public and should be more easily available and more widely cited. They should not, however, replace the central measures now used in policy discussions.[41]

A7. Messrs. Greenspan, Jackson, Diamond and Orszag were not commenting directly on Federal financial accounting standards and the members supporting the Primary View do not wish to suggest that these individuals would endorse the Primary View.

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[39] Peter Fisher, Opinion, *Financial Times*, March 27, 2003.

[40] The journal is available in its entirety at http://www.law.harvard.edu/students/orgs/jol/vol41_1/

[41] Diamond, Peter A. and Peter R. Orszag, *Comment: Accrual Accounting for Social Security*, Harvard Journal on Legislation, Volume 41, Number 1, page 173.

Nonetheless, their viewpoints are informative to members regarding the benefits to decision makers of information about the long-term obligations and costs related to ongoing work in covered employment. The Memorandum of Understanding that created the Board directs the Board to consider the budgetary information needs of executive agencies and users of Federal financial information. The members supporting the Primary View believe the budgetary decision-makers identified in the above comments will benefit through enhanced Federal financial statements that would result from adoption of the Primary View. The enhancements proposed in the Primary View would bring the Federal balance sheet much closer to presenting "total liabilities" and the statement of net cost much closer to presenting the cost of transactions and events occurring during the period. In addition, citizens and citizen intermediaries would gain access to information used by experts.

Scope

A8. Although the Board discussed certain characteristics that most social insurance programs have,[42] the Board decided, for the purposes of SFFAS 17, *Accounting for Social Insurance,* to identify the five specific programs that were subject to its provisions. The Board, including those members supporting the Primary View, continues to believe that definitive criteria would be unworkable. As the Board stated in SFFAS 17:

> 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 individual 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.[43]

The Board, including those members supporting the Primary View, believes that no other programs should be included in the standard at this time.

New Liability and Expense Definitions

A9. In conjunction with this preliminary views document the Board has issued an exposure draft on concepts entitled *Definition and Recognition of Elements of Financial Statements* ("*Elements* ED"). The *Elements* ED amends the current liability and expense definitions found in SFFAS 5, *Accounting for Liabilities of the Federal Government*.[44] The amended definition is as follows:

A liability is a present obligation of the Federal Government to provide assets or

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[42] SFFAS 17, pars. 15-21
[43] SFFAS 17, par. 45
[44] September 1995.

services to another entity at a determinable date, when a specified event occurs, or on demand.

A10. The *Elements* ED also defines expense in terms of the new asset and liability definitions. The expense definition is as follows:

An expense is a decrease in assets, an increase in liabilities, or a combination of both from providing cash or cash equivalents, goods or services, or any other activity (excluding repayments of borrowing) performed during the reporting period.

A11. Pursuant to the liability definition in the *Elements* ED, a liability of the Federal Government has two essential characteristics: (1) it constitutes a present obligation to provide assets or services to another entity; and (2) the Federal Government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur. The rationale for the definition is explained in the *Elements* ED.

Past Transactions or Events and Obligating Events

A12. The *Elements* ED explains that *present* obligations arise as a result of past transactions or other events. A present obligation is incurred when the Government takes a specific action or an event occurs that obligates it to make a future payment or to provide a future service to another entity. The obligating event is critical for identifying liabilities.

A13. The *Elements* ED states that a present obligation should be distinguished from a mere expression of future intent, such as the Government's announcement of intent or publication of a plan to acquire equipment or to incur future obligations for employees or citizens. Thus, accrued expenses and liabilities for social insurance exclude expenses attributable to obligating events occurring in the future. Expenses are recognized only when obligating events occur.

A14. The existence of an obligation is determined by the provisions of current law. While laws can be altered, financial reports address conditions as they exist at the end of the reporting period. The possibility that circumstances will change is not considered. For example, environmental cleanup liabilities and employee pensions are determined based on current law.

A15. Thus, future events – including potential changes in law – do not trigger or prevent expense and liability recognition. Future events, even if they are virtually certain to occur, cannot be considered with respect to liability and expense except in conjunction with measuring the present value of a past event.

Obligating Event: Social Security, Medicare and Railroad Retirement

A16. The Board members supporting the Primary View believe that the obligating events for Social Security Old-Age, Survivors and Disability Insurance (OASDI or "Social Security"), Medicare, and Railroad Retirement benefits (RRB) occur when (1) participants initially become fully insured by completing sufficient work in covered employment and thereby become eligible for future benefits and (2) when subsequent work in covered employment increases the present value of the future benefit. The completion-of-sufficient-work event and subsequent work in covered employment represent the points at which the participant has substantially met conditions for **eligibility**.

A17. The Primary View is that conditions for receiving a future benefit are *substantially met* when the participants become fully insured, and the omission of the effects of these events results in an incomplete reporting of costs and liabilities. The Primary View's principal focus is on the economic cost being incurred for social insurance programs and the accumulation thereof. The Board members supporting the Primary View believe that a key objective of the principal financial statements should be to report the estimated costs incurred during the reporting period and the amount of those costs that will have to be financed in future periods. Such costs represent the accrued liability portion of long-term actuarial projections.

A18. The members supporting the Primary View believe that the differing views among Board members regarding when sufficient eligibility conditions are met to create a liability and a "present obligation" is the key distinction between the Primary and Alternative Views. The members supporting the Primary View believe that the distinction between exchange and nonexchange transactions that is among the points emphasized in the Alternative View is not determinative. For them, an expense may be incurred and a liability arise equally for exchange, nonexchange, or quasi-exchange transactions so long as a present obligation exists. The Government has many programs for which it incurs large liabilities and yet receives nothing or little in exchange other than promotion of the general welfare. In addition, members supporting the Primary View note the quasi-exchange features of social insurance programs such as the relationship between wages earned in covered employment and benefits accrued and payroll taxes paid, both of which are based on wages in covered employment. They note also the way the programs are structured, including the use of "trust funds" and the "investment" of excess payroll taxes in special Treasury securities. [See the basis for conclusions for the rationale for the Primary View, especially paragraphs A9–A106.]

A19. In addition, the Primary View is specifying the note disclosure and supplementary information that must accompany the principal financial statements to provide information about the sustainability of these programs and a perspective on these complex programs. This information includes projections of **all** future social insurance receipts and outlays over the next 75 years in nominal dollars and as a percent of GDP and taxable payroll, as well as the "dependency ratio" of contributors to beneficiaries. This information constitutes most of the additional supplementary information proposed in the Alternative View, except that the Alternative View would add projections of non-social insurance cash flow. The Alternative View suggests how this additional information might be structured and possible other information that might be useful in assessing the sustainability of all Government spending (see par. 76); but this information is yet to be developed. While the members supporting the Primary View welcome and encourage the development of additional supplementary sustainability reporting, they believe it should be considered in addition to the Primary View proposal. They favor making it the subject of a separate project, which the Board is currently undertaking with its Sustainability Taskforce.

A20. The Primary View is that the liability is the present obligation to provide future benefits, and is measured in terms of present value of future benefits attributable to past work. The expense is the increase in the liability occurring during the reporting period. It is the actuarial present value of benefits attributed by the social insurance program's **benefit formula** initially based on sufficient work in covered employment and possibly incremented thereafter by additional work in covered employment attributable to the reporting period. Because Social Security is pay-related with benefits based on average wages, benefits are increased each year for the effect of the change in an employee's average wage.

A21. Participants' Social Security benefits are calculated using their average earnings from the 35 years in which they earned the most, indexed for increases in the average wage level since the year the earnings were received. The total indexed earnings for the 35 years are divided by 35 years and then by 12 months to derive the participant's "**average indexed monthly earnings**." A formula is applied to these earnings to derive the amount the participant will receive at full retirement age – which was 65 years of age but is gradually increasing to 67.

Various Commentators' Views on Accounting for Social Security

A22. Some argue that under full accrual accounting the obligating event would occur when participants begin working in covered employment rather than waiting until 40 quarters are attained because costs are incurred at that point. They argue that to do otherwise is to ignore costs that are being incurred just as certainly as, for example, post-employment health care of employees. They argue that ignoring these costs and relying on cash flow accounting and projections disguises an inherent upside cash flow bias that makes the program's finances appear better than they actually are.

A23. They note that work in covered employment causes two cash flows between the individual and the Government: immediate payroll tax inflows and future benefit payment outflows many years later. They believe full accrual accounting would report those two cash flow consequences in the period that work is performed by discounting the distant future benefit payments and reporting them together with the immediate tax withholdings.

A24. They draw attention to the differences between accrual accounting and cash accounting. Cash accounting and accrual accounting would be the same for tax receipts, but accrual accounting would allocate estimated future benefit payments to the time periods when work is performed. If the plan is not funded or is under-funded, an accrual deficit would accumulate over the work life of the individual.

A25. They emphasize that the accrual accounting model is concerned equally with measuring costs and revenues for a period and measuring asset and liability positions at the beginning and the end of the period. Part of the accrual accounting process is to analyze and classify the reasons for change from one period to another, and to link rigorously the period flows with period-to-period ending positions.

A26. They feel accrual measures should be reported in accrual-based financial reports. Such reports would provide valuable trend information to policy makers and the citizenry regarding the deteriorating financial health of the social security program. Accountability would have been established in a way that allowed more informed scrutiny from within the Government and from without.

A27. They note that accrual accounting would complement cash flow measures. They readily acknowledge that accrual accounting is not a substitute for the kinds of cash flow measures that have traditionally been used for managing the social security program. They argue instead that accrual accounting would add accrued benefit cost and liability measures to social insurance financial reporting.

A28. They emphasize the predictive and feedback value of accrual accounting. Accrual accounting provides comprehensive information about where the entity stands financially at the end of each period, and is a good starting point for predicting where one is headed and for planning corrections. They believe a series of point-in-time accrual measurements along with measurements of activities between points provides a track record that is a source of insights useful for forecasting and planning.

A29. They argue also that accrual accounting would anchor the forecasts needed to measure accrued costs and liabilities to real people with real work histories, people that exist right now in a known economic environment. They believe this is a firm base for trend analysis and for forecasting beyond which every variable in the forecasting model becomes more uncertain and the results become less reliable. They believe trends of "open group" projections where all participants – retirees, disabled people, workers, future participants, born and unborn, and future immigrants – are included over the period, for example, 75 years, are too uncertain to analyze with confidence.

A30. They note that accrual accounting represents a system of accounting, broadly described as ''generally accepted accounting principles,'' that has been developed in an evolutionary way over centuries of practice. It brings an independently testable discipline to the measurement process. They also note that it juxtaposes all of an entity's existing assets and liabilities on a balance sheet where they can be assessed in relation to one another and to aggregates and to changes over time. It is designed for reporting on accountability to stakeholders and decision-making by stakeholders.

A31. They argue that every liability represents a transfer of an economic burden to the future. This transfer can be deemed inter-period and/or inter-generational. The current period or generation borrows; future periods or generations repay. Sometimes the transfer is equitable, e.g., if the proceeds of borrowing are spent on something that benefits both current and future generations, e.g., a highway. However, if the spending benefits only the current period or generation, it would be judged to be inequitable. They note that inter-period or inter-generational equity judgments entail complex considerations and political judgments, and they argue that accruing and reporting the social insurance liability regularly would be a positive contribution to this process.

A32. Finally, they argue that sustainability is an important consideration for any Government program but especially for social insurance programs where the time is so long between the promise of payment and the actual payment. They believe that a rapidly rising liability would serve as a warning and precipitate analysis of sustainability that can be evaluated in relation to all other federal financial considerations and in relation to external variables such as gross domestic product and demographic trends.

A33. Others argue that social insurance participants do not substantially meet all the eligibility requirements until they attain the age when benefits may be disbursed, e.g., 62 years old - the earliest permissible retirement age for Social Security. They believe that the liability should be recognized when a participant reaches this minimum retirement age and should be the present value of benefits during retirement.

A34. Still others argue that social insurance participants do not substantially meet all the eligibility requirements until a benefit payment is due, that therefore "staying alive" or continuing to exist is a recognition criterion. This would result in liabilities essentially being recognized only for cash transfers "due and payable" at the balance sheet date. This position is the same as the result in SFFAS 17.

A35. They argue that additional commitments beyond the "due and payable" amount do not constitute liabilities under either the existing liability definition in SFFAS 5, paragraph 19, or the new definition in the *Elements* exposure draft. They argue that the Government's obligation for future scheduled social insurance payments attributable to participants who have attained 40 quarters of work in covered employment is not a "present obligation." They note the substantive differences between social insurance programs and employer-sponsored pension plans that involve a transaction where services are provided in exchange for certain compensation. They argue that social insurance programs do not involve exchange transactions or that nonexchange characteristics predominate. They note the compulsory nature of the program's dedicated payroll taxes. In their view the nonexchange or at least predominantly nonexchange nature of social insurance transactions requires the liability to be the "due and payable" amount that has applied to such nonexchange transactions.

A36. These commentators argue that "due and payable" amounts are legal obligations and that the additional amounts that would be accrued under FASAB's proposed social insurance liability are not. They cite United States Supreme Court cases affirming the right of the Congress to modify these future Federal Government benefits in any manner and at any time, in contrast to the laws governing private pension plans. These commentators apprehend that treating scheduled benefits as liabilities could be interpreted by many as "booked" and immutable, which is not the case in law.

A37. They note the susceptibility of scheduled future benefits to change. They cite Congressional authority to increase and decrease social insurance benefits and the notice to participants in their annual benefit statements that benefits might change. They note that the Trustees of the Social Security and Medicare programs emphasize the funding shortfall and resource limitations under current law in their annual reports. They fear that identifying future scheduled benefits as liabilities will afford them a stronger degree of protection from change than is warranted by law, and could limit flexibility in designing reform plans.

A38. They also note the possible effect of the proposed liability approach on the integrity of the balance sheets and other financial statements. The social insurance liability would be very large relative to other liabilities. They assert that pulling forward large, mutable and uncertain amounts of *future* social insurance benefits would compromise the integrity of the balance sheet. They believe the balance sheet is a statement of what the Government owns and what it owes as a result of *past* operations. Scheduled benefits involve extremely long-range projections that are sure to be volatile from year to year. These commentators argue that the magnitude and volatility of such amounts will distort the meaning and undermine the credibility and value of the annual statement of net cost and balance sheet, and thereby diminish their usefulness as a means to improve financial management. They believe large new balances on the U.S. balance sheet may receive a negative interpretation by the international community, as other countries generally do not record such amounts on their financial statements.

Board members supporting the Primary View

A39. The Board members supporting the Primary View believe that the liability definition is met when participants attain fully insured status. When Social Security, Medicare, and RRB participants meet the sufficient-work-in-covered-employment condition in a reporting period, the Government has a present obligation to fulfill its commitment to provide benefits in the future based on events that have occurred before the end of the reporting period even though the actual transfer of resources is not required until a later date. The Government and the participants have an agreement or understanding concerning settlement. Uncertainty regarding the amount of the individual and aggregate settlement is addressed through measurement. Identification of the specific individuals who will receive benefits is not an essential characteristic of a liability. The Government is obligated to fulfill its obligation when the timing, amount, and recipient of settlement are known.

A40. The Board members supporting the Primary View believe that work in covered employment prior to becoming fully insured is not an obligating event. Should they fail to complete sufficient work in covered employment, participants would not receive any benefits in the future.

A41. When considering the obligating event for Medicare liability and expense recognition, the Board was presented with another question. When they complete sufficient work in covered employment, Medicare participants, like Social Security participants, have met the conditions for eligibility for the program. Unlike Social Security, however, the participant's benefit will not increase after they become eligible.

A42. The Medicare participant's future benefit is calculated using the projected future costs of the coverage. The principal steps involved in projecting the future Medicare costs are:

(1) establishing the present cost of services provided to beneficiaries, by type of service, to serve as a projection base; and
(2) projecting increases in Medicare payments for
   (a) inpatient hospital services, skilled nursing, home health, and hospice services covered;
   (b) managed care plans; and
   (c) administrative costs.[45]

A43. The Medicare participant's benefit is not increased by work in covered employment after they become fully insured; nor is it related to the amount of payroll taxes paid. Participants and their employers currently are required to pay 1.45% of total earnings, each. Thus, a participant earning $2 million dollars a year and paying $29,000 a year (and whose employer pays $29,000) receives the same benefit or

[45] 2005 Medicare HI and Medicare SMI Annual Report, p. 115.

coverage as a participant earning $20,000 and paying $290. Although participants "pay for" Medicare coverage throughout their working career, the amount each one pays will be different, sometimes dramatically different.

A44. The Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, requires that an employer's obligation for postretirement benefits expected to be provided to or for an employee should be fully accrued by the date that the employee attains full eligibility for all of the benefits expected to be received by that employee (the full eligibility date). The full eligibility date is the date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits that employee is expected to receive under the plan. For example, if a plan provides a postretirement health care or life insurance benefit to an employee who renders 10 years of service, the actuarial present value of that benefit should be fully accrued at the end of 10 years of service. Similarly, if a plan provides a postretirement benefit to an employee who attains age 55 while in service, the actuarial present value of that benefit should be fully accrued when the employee attains age 55. If a plan requires both 10 years of service and 55 years of age, then actuarial present value of that benefit would be fully accrued at the longer of the two periods. Determination of the full eligibility date is not affected by the plan terms that define when the benefit payments commence.[46]

A45. SFAS 106 requires an equal amount of the obligation attributed to each year of service generally beginning at the date of hire and ending at the full eligibility date. Thus, if SFAS 106 were applied to Medicare the actuarial present value of the benefit would begin to be accrued when work began in covered employment and be fully accrued by the time the participant attains fully insured status, e.g., for Social Security and Medicare, 40 quarters or equivalent of work in covered employment. The Board notes that some argue that full eligibility occurs at 62 years of age rather than at an earlier point when participants become fully insured and, in that case, the cost presumably would be allocated over that time period.

A46. The FASB stated in SFAS 106 that it was unable to find a basis for attributing postretirement benefits that would be more appropriate than measurement of the current benefit cost and accumulated obligation based on years of service. "The [FASB] found no compelling reason to prescribe a different basis for attributing postretirement benefits than the basis used for attributing pension benefits."[47]

A47. With respect to Medicare, the FASAB considered several alternative approaches. One alternative is to recognize the present value of the entire obligation when the participant completes sufficient work in covered employment to be fully insured.

[46] See FAS 106, pars. 221-2.
[47] FAS 106, par. 210

This is what the Primary View adopted. Another alternative is to recognize – either when work begins in covered employment or when the participant is fully insured – a percentage representing the ratio of work in covered employment completed at that point versus the total such work the participant is expected to complete, and attribute the balance to the years of work in covered employment as they are completed. Another alternative is to recognize the present value of the obligation when participants attain the age when benefits may commence, and for Medicare that is 65 years of age or equivalent.

A48. The Board members supporting the Primary View believe that, unlike the private employer's cost addressed in SFAS 106, Medicare is not deferred compensation to be spread over the working life of employees. It is, however, a cost to the Government. The question is whether to recognize the present value of the full obligation when fully insured status is attained or spread it over the participants work in covered employment. Participants and their employers pay payroll taxes over that time. One might argue that they are, in a sense, paying for the future benefit.

A49. The Board members supporting the Primary View believe that the best approach is to recognize the present value of the entire obligation when fully insured status is attained. The goal is for the service cost component of expense to be the actuarial present value of benefits attributed by the social insurance benefit formula to (1) work in covered employment up to and including the date when fully insured status is attained and (2) subsequent quarters (or months or days) of work in the periods that these are attained. As explained above, the present value of a future Social Security benefit continues to increase with work in covered employment. For Medicare, however, no additional expense is attributed to subsequent quarters of work.

Obligating Event: Unemployment Insurance and Black Lung Benefits

A50. The Board members supporting the Primary View considered whether the standards for Unemployment Insurance (UI) and Black Lung benefits (BLB) established in SFFAS 17 should change. The Board believes that they should not.

A51. The UI and BLB programs are substantially different than the other SI programs. The UI program provides benefits for a short period of time since eligibility is reconfirmed weekly or bi-weekly and, normally benefits cover the shorter of a six-month period or the period of unemployment with the possibility of extensions. The UI participants are only eligible for future payments when they meet the UI conditions at each reconfirmation point.

A52. The states play a supervisory role in the UI program and conditions leading to payments vary. Thus, liability and expense are best measured at the state level. Therefore, the SFFAS 17 requirement regarding expense and liability recognition and RSI remain appropriate.

A53. The Black Lung benefits program deals with a declining beneficiary population. The Board is proposing no changes at this time but may revisit the BLB program in conjunction with another project on liability recognition. For now, the conditions for BLB are substantially met in the short-term. Thus, SFFAS 17 expense and liability and RSI required in SFFAS 17 are being preserved for BLB as well.

Measurement

A54. After satisfying the liability definition the next question is whether recognition is in order. There are two recognition criteria in the *Elements* ED: (1) meeting the liability definition and (2) measurability. If the definition for social insurance programs has been met, then recognition presumably becomes a question of measurability.

A55. The Board members supporting the Primary View believe that, for Social Security, Medicare, and RRB, a liability and expense is incurred when participants initially become fully insured and thereby become eligible for future benefits and (2) when subsequent work in covered employment increases the present value of the future benefit. The Board members supporting the Primary View believe that an expense should be recognized for the following components.

a. The <u>present value of estimated future payments</u> payable to or on behalf of current participants, based on their <u>past work</u> in covered employment, who have substantially met the eligibility conditions during the reporting period.
b. <u>Interest</u> accruing on the liability during the period due to the passage of time.
c. <u>Actuarial gains and losses, if any</u>.
d. <u>Prior service cost, if any</u>.

These four components of expense are consistent with the benefit formula expressed in these programs and the long-term nature of the obligation. The following paragraphs discuss these components.

Measurement: Present Value of Future Payments

A56. Present value is required in various FASAB standards involving long-range projections, including SFFAS 2, *Accounting for Direct Loans and Loan Guarantees,* (for loan subsidies and guarantees); SFFAS 5 (for pension, retirement healthcare, insurance, and other liabilities); SFFAS 17; SFFAS 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*; and 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees* (amendments to SFFAS 2), and others. Moreover, the Social Security Trustees use present value for the primary measurement in their Annual Report, in conjunction with sensitivity analysis and stochastic modeling (more on the Trustees' work below).

A57. A present value measurement captures, to the extent possible, the economic differences created by the passage of time between sets of future cash flows.[48] The initial step in present valuation is to project nominal dollar cash flows based on the benefit plans under current law, e.g., for Social Security, average of high indexed wages in covered employment over 35 years and assumptions about demographics, economics, and program-specifics. The laws defining the benefit a participant would receive provide the most relevant and reliable indication of how cost and present obligations are incurred. The plan's benefit formula in law indicates the agreement between the Government and the parties and accounting has generally looked to the agreement as a basis for recording pension-type[49] transactions.

Cost Recognition

A58. The Board members supporting the Primary View would attribute cost to periods based on the benefit formula in current law using a "benefits approach." As participants fulfill the conditions specified in current law for future benefits, an expense and a liability are recognized. Each accounting period is viewed as a unit and credits may accumulate, depending on the benefits formula, as participants work in covered employment and thereby fulfill conditions.

A59. Some argue that a benefits approach to attribution is inappropriate for a government. They note that a characteristic of this method is that the "normal" cost is lower as a percentage of pay in the first years of work and higher in the last years. They argue that effect may be appropriate for private pensions where plans change and funding tends to be erratic. However, they argue that, for social insurance and other government programs where funding tends to be level as a percentage of pay, an attribution that spreads cost more evenly over the working lives of participants is more appropriate. The "entry age normal" attribution method is often mentioned as an example of the latter. Such methods are knows as "cost approaches" because the total cost is calculated and then allocated to accounting periods.

A60. The Board members supporting the Primary View prefer the benefits approach because it is more reflective of the way the obligation and the cost are incurred. The recently issued *Elements* ED defines liabilities as present obligations to provide assets at a determinable date when a specified event occur or on demand. Present obligations require past transactions or events. The Government's obligation is based on the benefits promised in current law and actions taken up to that date. A level pattern of cost recognition may be desirable for funding or budgeting purposes, but it is not the best reflection of how cost is incurred or how the liability arises. The

[48] See SFAC No 7, Using Cash Flow Information and Present Value in Accounting Measurements, February 2000.

[49] Pension is defined as (a) a fixed sum paid regularly to a person: archaic : WAGE (b): a gratuity granted (as by a government) as a favor or reward (c): one paid under given conditions to a person following retirement from service or to surviving dependents. (Merriam-Webster Online Dictionary)

Board members supporting the Primary View believe that, for accrual accounting purposes, a benefits approach more faithfully represents the obligation and cost that is being incurred.

Medicare Premiums

A61. The Primary View would treat inflows of Medicare payroll taxes differently than inflows from premiums. The expense and liability for SMI, Parts B and D, would be measured at net present value (NPV). The liability amount would be the present value of further benefits less the related premiums.

A62. The Primary View standard reflects the concept that SMI differs from Medicare HI Part A, which is financed with payroll taxes paid by current workers. The members supporting the Primary View note that the effect of premiums is a sharing of the cost of benefits. The Government is obligated to cover 75% of covered care. Moreover, the SMI premiums are necessary only if the participants enroll in SMI. HI payroll tax is paid well before the coverage is in effect but not afterwards. In fact, payment of payroll taxes beyond forty quarters has no relationship to future benefits. Once fully insured, participants receive HI coverage whether additional payroll tax is paid or not. The SMI premiums are voluntary while payroll tax is compulsory. Also, the budget approach for tax revenue versus revenue "earned" by the program is similar: taxes are displayed apart from expenditures whereas revenue "earned" by the program is offset against expenditures at the program or agency level.

Uncertainty

A63. Present values and other long-range accounting estimates are inherently uncertain. This is particularly true of estimates based on current law since future changes in law could alter future benefits. The Board members supporting the Primary View believe that the uncertainty related to future changes in law should be disclosed. In addition, the estimates themselves are uncertain. Assumptions are required and the more long-range the estimate the more complex it becomes. No present value estimates are more complex than those for social insurance. The degree of precision and certainty of amounts reported on financial statements is often misunderstood.

A64. According to SFFAC 1, financial information has certain qualities, including reliability. In SFFAC 1 the FASAB stated that

> [R]eliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than

no estimate at all.[50]

A65. Another equally important characteristic of financial information is relevance. SFFAC 1 states the familiar principle that a characteristic of relevant information is its capacity to make a difference in users' assessment of and decisions about a problem, condition, or event.[51]

A66. The FASB has noted the need for trade-offs between reliability and relevance. In Statement of Financial Accounting Concepts (SFAC) 2, *Characteristics of Accounting Information*, FASB identifies reliability and relevance as the qualities that make accounting information useful. SFAC 1, *Objectives of Financial Reporting by Business Enterprises,* notes gradations of reliability and relevance and the possibility of trade-offs between them.[52] According to SFAC 2, the principal components of reliability are representational faithfulness and verifiability.[53]

A67. Relevant information frequently involves estimates, which necessitate some tolerance of uncertainty. Uncertainty can be tolerated if it is clearly explained and illustrated in the entity's financial statements, and there are many ways to do this. Uncertainty can be discussed and illustrated in the notes to the financial statements, in supplementary information, or even in the measurement of the liability and expense.

A68. Sensitivity analysis pursuant to the Primary View would be a change from that required in SFFAS 17. SFFAS 17 requires all component entities except UI to illustrate the sensitivity of both cash flow projections and the SOSI present values to changes in the most significant assumptions.[54] This Primary View proposes, first, that the component and governmentwide entities state in the notes to the financial statements that the amounts reported in the balance sheet, statement of net cost, and the SOSI are estimates based on assumptions and actual results will be different, sometimes substantially different.

A69. Secondly, the Primary View also proposes entities to illustrate the sensitivity of amounts presented in the principal financial statements. For SFFAS 17, the liability represents the amount "due and payable" at the end of the accounting period and the expense represents the cash benefits paid during the accounting period, plus or minus the change in the liability. Thus, under SFFAS 17, uncertainty with respect to the amounts in the principal financial statements is minimal. However, SFFAS 17 required long-range projections as supplementary stewardship information" (RSSI)

[50] SFFAC 1, par. 160
[51] SFFAC 1, par. 161
[52] SFAC 1, par. 55. Also see FASB SFAC 2, par. 15, and FASAC's white paper "The FASB's Conceptual Framework: Relevance and Reliability," September 2004.
[53] SFAC 2, Glossary
[54] See SFFAS 17, par. 27(4)(a).

and appropriately focused the sensitivity analysis there.

A70. The Board members supporting the Primary View believe that the sensitivity analysis should now focus on the amounts reported in principal financial statements. There will be uncertainty regarding the liability and expense estimates as well as the present values displayed on the SOSI, which SFFAS 25 and 26 made a principal financial statement. This is a change in emphasis rather than in kind since the same assumptions are used for present values as for cash flow projections.

A71. Unlike SFFAS 17, the Primary View does not specify a method or approach for illustrating uncertainty. Entities will decide what is appropriate based on trends, the utility of the information to the users and policy-makers, and the relative burden of producing it. The entities are encouraged to explore areas of analysis. This will afford flexibility and allow best practices to develop. Entities may continue to vary key assumptions as required by SFFAS 17 or pursue other methods. For example, this standard allows stochastic modeling. The Board, including members supporting the Primary View, believes that a graph like figure "VI.E2" from the Trustees' Annual Report shown below is a promising method for illustrating uncertainty. The Board, including members supporting the Primary View, believes that a stochastic presentation of the ranges of possible outcomes with respect to the present value estimates in the basic financial statements will provide useful information for users to consider.

A72. Each year the Social Security Trustees report on the financial condition of the system. The principal results from their report are generated by a **deterministic model** of the annual income and expenses of the system over a 75-year projection period. The Social Security Trustees carefully review and update assumptions used for projections on an annual basis. This helps ensure that they represent the Trustees' best estimate of future possibilities.

A73. The Social Security Trustees illustrate uncertainty throughout their Annual Report. The results of their "best estimate" or intermediate cost assumptions are contrasted in narratives, tables, and charts with estimates based on low- and high-cost assumptions.[55] The latter vary all assumptions either low or high. This approach is characterized as "deterministic."[56]

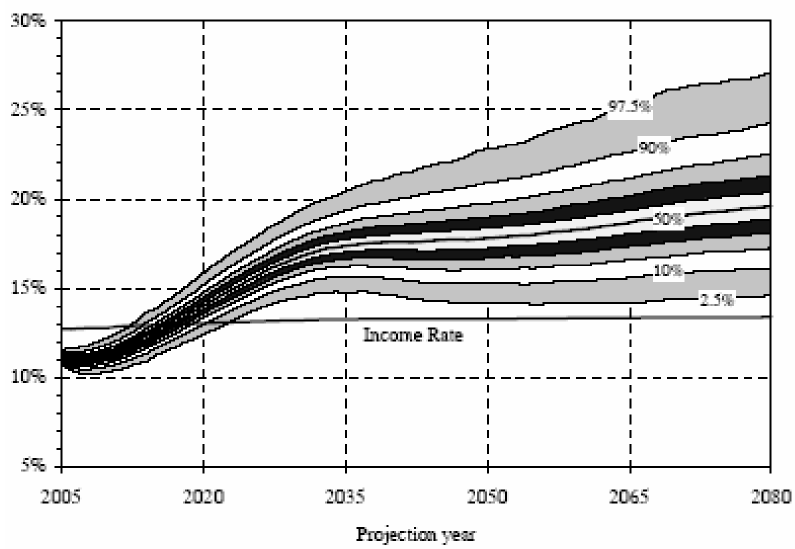
A74. The Trustees also present sensitivity analysis. Key assumptions are varied from the intermediate cost assumptions to illustrate how changes therein affect the estimates.

A75. In addition to this sensitivity analysis, starting in 2003 the Social Security Trustees' Report began to illustrate uncertainty via a stochastic model that attempts to capture

[55] See Appendix 5 containing the table of contents from the 2005 Trustees' Annual Report to illustrate the extensive nature of the information provided there.
[56] The Trustees' Annual Report, p. 158-9.

uncertainty by displaying ranges rather than point estimates.[57] It represents a probability distribution of possible future outcomes centered on the Trustees' intermediate assumptions. For example, the following figure (VI.E2) shows the probability distribution of the year-by-year Social Security cost rates (i.e., cost as a percentage of taxable payroll). The range of the cost rates widens as the projections move further into the future reflecting increasing uncertainty. The lines in the figure display different confidence intervals expected for future annual cost rates. For each given year, these lines represent the percentile distribution of cost rates based on all stochastic simulations for that year.[58] The 50 percent confidence level aligns closely with the Trustees' best estimate using the intermediate cost assumptions.

Figure VI.E2.—Annual Cost Rates



Assumptions

A76. With respect to assumptions, the Board is cognizant of the extensive formulation process employed by the Social Security and Medicare Trustees and believes that a general requirement for prudence should be established for selecting assumptions with a reference to actuarial standards of practice. The requirement is a pragmatic approach to this very difficult subject and has been effective for past FASAB standards.

Actuarial Gains and Losses

A77. Actuarial gains and losses result from (1) deviations between actual experience and the actuarial assumptions used and (2) changes in the assumptions. Gains and

[57] 2005 Trustees' Annual Report, pp. 158, 202-3
[58] 2005 Social Security Trustees' Report, p. 161.

losses include amounts that have been realized, for example, by the redemption of a security, as well as amounts that are unrealized. The Primary View does not distinguish between those sources of gains and losses. The Primary View proposes recognition of gains and losses as a component of expense in the period in which they arise.

A78. FASB in SFAS 87, *Employers' Accounting for Pensions*, did not require recognition of gains and losses as components of net pension cost of the period in which they arise because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa. SFAS 87 requires amortizing such costs over the future service of those employees active at the date of the amendment that are expected to receive benefits under the plan. The resulting ability of an entity to "smooth" and/or manage operating results has been a concern. The FASB has recently added a pension project to its agenda; a key objective of which is to re-consider this approach.

A79. In SFFAS 5, FASAB concluded that actuarial gains and losses and prior service costs are expenses that should be recognized immediately, without amortization. The FASAB continues to believe nothing is gained by delaying recognition of a cost and a liability or to reducing volatility. Others have commented that smoothing has negative effects in a governmental context.[59] However, the Primary View would require that actuarial gains and losses be displayed separately on the statement of net cost.

Prior Service Cost

A80. Prior service cost is the cost of retroactive benefits (including benefits that are granted to retirees) granted in the reporting period. It is the increase in the obligation at the date of the amendment. The FASB in SFAS 87 did not require the cost of providing such retroactive benefits to be included in net periodic pension cost entirely in the year of the amendment because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods. The SFAS 87 requires amortizing such costs over the future service of those employees active at the date of the amendment that are expected to receive benefits under the plan. A plan amendment can also reduce, rather than increase, the projected benefit obligation.

A81. In SFFAS 5, FASAB concluded, as it did for actuarial gains and losses, that prior service costs are expenses that should be recognized immediately, without

[59] Holtz-Eakin, Douglas, Defined-Benefit Pension Plans: Current Problems and Future Challenges, CBO Testimony before the Committee on Finance, US Senate, June 7, 2005pp. 7-8: "Funding requirements that allow for the long-term smoothing of both asset values and discount rates are among the funding rules that have contributed to widespread underfunding."

amortization. The Board explained that it saw no benefit to delaying recognition of a cost and a liability or to reducing volatility. Although some argued that future periods could benefit from the amendments, e.g., from increased employee productivity, the Board did not regard that possibility as sufficiently tangible in the Federal Government to warrant delayed recognition.

A82. The Primary View proposes that prior service costs be displayed separately on the statement of net cost.

Display

Balance Sheet

A83. The Board members supporting the Primary View believe that the balance sheet should display a single liability line item for social insurance. The line item should reference a revised SOSI display, as shown in Appendix B, page 100, wherein an amount for the liability is shown. The liability represents the obligation for those who have completed sufficient work in covered employment to be fully insured, e.g., for Social Security and Medicare, 40 quarters or equivalent of work in covered employment. The Board members supporting the Primary View also believe that certain note disclosures (e.g., assumptions, cost components) and RSI (see below) should accompany the financial statements. This display is concise while providing additional information in notes and RSI.

Statement of Net Cost

A84. The Board members supporting the Primary View believe that the statement of net cost should display present value of amounts payable based on work completed in the period and interest on the obligation as separate components of "operating cost." Actuarial gains or losses and prior service costs, if any, should be presented as a separate component after operating cost, but as part of the total cost on the statement of net cost, as in the pro forma illustration in Appendix B.

A85. This display therefore categorizes the present value of benefits attributed to the current reporting period and interest on the liability as operating expense and gains or losses from actuarial changes and prior service costs, if any, as "non-operating expense." It highlights the effects of actuarial changes, which are significant, and includes them as a component of aggregate "net cost."

Statement of Social Insurance

A86. As explained above, the Primary View is requiring an amended format for the SOSI, including a new line item for the liability component of the set of present values presented.

Disclosure

A87. The component entities would be required to disclose the following:

a. A statement about the uncertainty of estimates,
b. Assumptions used to estimate the expense, liability, and SOSI amount;
c. Components of the change in the liability account, i.e., present value of future payments, interest on the liability, actuarial gains or losses, if any, and prior service cost, if any;
d. Benefits accrued by participants who have not completed sufficient work in covered employment, for example, for Social Security and Medicare, 40 quarters or equivalent of work in covered employment; and
e. For the same time period as used for the SOSI, the total future outlays in excess of statutorily provided future resources for all who will be participating in the program over that period, if any.

A88. Items "a.", "b.," and "c.," have been discussed above. Items "d" and "e" are discussed below.

A89. The Primary View proposes recognition of expense and liability when Social Security and Medicare participants complete sufficient work in covered employment for fully insured status. Amounts accruing before that point are not recognized. The note disclosure will inform the reader about the amount accruing to those who have not yet fulfilled all the conditions to be eligible for future benefits.

A90. The Primary View proposes a brief discussion in the notes of the excess of future outlays over the statutory "cap" on resources, if any, using the **open group** population and a time period consistent with the SOSI presentation. The open group population includes everyone who is or will be participating in the program over the projection period. For this group projections indicate that by the mid-2040s accumulated assets would be exhausted and payroll taxes and other taxes from all sources would cover less than 100% of the benefit payments. This information should be disclosed in the notes to the financial statements.

A91. The present value amount for the open group population is unlike the liability on the balance sheet, which for Social Security and Medicare Hospital Insurance represents the gross cost of benefits for a specific, limited population group. No payroll taxes to be paid in the future or benefits to be credited in the future would be included in the liability. Assets (i.e., Treasury securities), which represent accumulated excess revenue received as of the reporting date, would be accounted for separately under the Primary View.

A92. The Board members supporting the Primary View note that the statutory limitation may affect the Medicare program sooner than Social Security. The statutory resources currently provided for Medicare are projected to be insufficient to pay 100 percent of claims much sooner than for Social Security. By 2020 the Medicare trust fund is projected to become exhausted and expenditures would exceed tax revenues.[60] On the other hand, Medicare SMI (Part B), which covers doctor bills, has access to the General Fund and therefore has no such statutory limitation.

The Objective of the Information

A93. This Primary View represents an improvement over SFFAS 17. It will produce information that addresses the dual objectives of FASAB Objectives 2 and 3, operating performance and stewardship. Although they are all important, objectives 2 and 3 directly impact the social insurance standards.

A94. Objective 2 provides:

> **Operating Performance**—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. Federal financial reporting should provide information that helps the reader to determine
>
> - The costs of providing specific programs and activities and the composition of, and changes in, these costs;
> - The efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
> - The efficiency and effectiveness of the government's management of its assets and liabilities.

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.

A95. Recognizing cost of social insurance as it is being incurred is relevant to the operating performance objective. Estimates of current costs and accumulated obligations 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.

A96. Meeting Objective 3 is the other focus for this statement. Objective 3 provides as follows:

> **Stewardship**—Federal financial reporting should assist report users in assessing the

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[60] 2005 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, page 61. (2005 Medicare HI and Medicare SMI Annual Report)

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. Federal financial reporting should provide information that helps the reader to determine whether

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

A97. 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 on the broad outcomes of its actions.

A98. The terms "sustainability" or "sustainable solvency" are used frequently with respect to social insurance programs. The dictionary definition of "sustain" that is closest to the financial accounting usage is "to keep up;" and "solvent" means to be able to pay all legal debts. The Government Accountability Office has defined "solvency" and "sustainable solvency" for Social Security as essentially being able to pay full benefits as they come due, permanently.[61] Thus, "sustainability" is a compound concept involving several perspectives.

A99. In light of Objectives 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 that would be required by the Primary View will help users assess (1) accrued costs and present obligations; and (2) whether the programs are forecasted to achieve sustainable solvency.

A100. The balance sheet and statement of net cost are primary means of communication. Recognizing an expense for the Federal Government on the statement of net cost and accumulating a liability on the Federal balance sheet as workers complete sufficient work in covered employment arguably will permit users access to information that will help them understand the economic cost attributable to events of the period rather than merely the cash outlays for the period.

A101. At the same time the array of information that would be required by the Primary View continues to illustrate the complexity of the programs and the uncertainty of long-

[61] Social Security Reform: Answers to Key Questions, Glossary of Key Terms, "Solvency, Sustainable."

term projections. Estimates of future costs disaggregated by age cohort as required in the SOSI and elsewhere highlight the long-range impact of social insurance programs and also of changes in benefit levels as well as economic and demographic changes.

A102. The Board members supporting the Primary View believe that their proposal will focus attention on the costs being incurred and claims being accumulated from current activity that are being passed on to future periods. These are claims that current law requires to be paid in future periods.

A103. Moreover, the SOSI will present additional information about intergenerational equity. The total for the SOSI represents an estimate for the "open group" population over a 75-year horizon that is important for assessing sustainability, and the subtotals provide an inter-generational perspective: estimates for the "**closed group**" population for three cohorts – participants 62 and over, participants 15-61, and **future participants** – over a 75-year horizon. The subtotals indicate by cohort the extent to which Social Security resources on hand and to be provided are sufficient to pay the benefits payable in the future under current law. Assuming the status quo, it provides a measure of the payroll taxes needed from future participants to fund benefits at current levels to current participants.

A104. However, the Board, including members supporting the Primary View, recognizes that the SOSI is not a complete measure of the intergenerational transfer. It does not include all taxes and premiums paid by and on behalf of participants, or benefits received by participants before the measurement date.[62]

A105. Some might argue that either the present values related to the "closed group" or other populations imply a greater intergenerational equity deficiency than actually exists. They argue that such present values would not reflect the amount of taxes and premiums paid by and on behalf of current participants, or benefits received by them, before the measurement date.

A106. The Primary View's principal focus is on the economic cost being incurred for social insurance programs and the accumulation thereof. The Board members supporting the Primary View believe that the objective of the primary financial statements should be to report the estimated costs incurred during the reporting period and the amount of those costs that will have to be financed in future periods. Such costs

[62] Laurence J. Kotlikoff has written extensively on inter-generational accounting. His latest book is *The Coming Generational Storm: What You Need to Know About America's Economic Future*, (Cambridge: The MIT Press, 2004).

represent the accrued liability portion of long-term actuarial projections. In addition, the Primary View is specifying the note disclosure and supplementary information that must accompany the principal financial statements to provide perspective for these complex programs.

Appendix A: Alternative View – Basis for Conclusions

Please note: Paragraphs A107-A185 contain the basis for conclusions for the Alternative View.

Alternative View Basis for Conclusions

A107. This appendix discusses factors considered significant by Board members that support the Alternative View in reaching the conclusions in that view. It includes the reasons for accepting certain approaches and rejecting others. Individual members supporting the Alternative View gave greater weight to some factors than to others. The proposed standards enunciated in this view---not the material in this Basis for Conclusions---should govern the accounting for specific transactions, events or conditions.

Scope

A108. Although the Board discussed certain characteristics that most social insurance programs have,[63] the Board decided, for the purposes of SFFAS 17, *Accounting for Social Insurance,* to identify the five specific programs that were subject to its provisions. The Board, including the Board members supporting the Alternative View continues to believe that definitive criteria would be unworkable. As the Board stated in SFFAS 17:

> 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 individual 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.[64]

The Board, including the Board members supporting the Alternative View, believes that no other programs should be included in the standard at this time.

Background

A109. Public-sector accounting standard setters and users have expressed opinions on accounting for social insurance benefits, specifically, and nonexchange benefit programs, generally, that are consistent with the Alternative View. As indicated

[63] SFFAS 17, pars. 15-21
[64] SFFAS 17, par. 45

below, some of these views were expressed in responses to FASAB's Exposure Draft (ED) entitled *Definition and Recognition of Elements of Accrual-Basis Financial Statements*.

A110. The International Public Sector Accounting Standards Board (IPSASB) is finalizing an exposure draft on reporting for all social benefits (which would include the equivalent of social insurance programs as well as other nonexchange benefits programs). For the exposure draft, the IPSASB has agreed that a liability for all social benefits should be recognized only when all eligibility criteria have been satisfied, which means that the liability would be generally equal to the amount of the next payment. This position is consistent with the Alternative View. Also, in connection with deliberations on the social benefits exposure draft, the IPSASB has expressed their views on the importance of reporting information concerning the sustainability of all government programs, recognizing that social policy obligations are a significant factor affecting sustainability in most countries.

A111. Governmental Accounting Standards Board (GASB) Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions, par. 21,* states that "providers [of nonexchange benefits] should recognize liabilities (or a decrease in assets) and expenses from government-mandated or voluntary nonexchange transactions, and recipients should recognize receivables (or a decrease in liabilities) and revenues (net of estimated uncollectible amounts), when all applicable eligibility requirements, including time requirements, are met." Also, in its recent exposure draft of a concepts statement, entitled "Elements of Financial Statements", the GASB stated its view that "a present obligation that is a liability is a duty or responsibility to sacrifice resources or future resources that the entity has little or no discretion to avoid. Nothing that is within the control of the entity can prevent the sacrifice of resources."

A112. Dean Baker, Co-Director for the Center for Economic and Policy Research wrote (on August 3, 2006) that "the decision to treat long-term obligations of Social Security and Medicare as current liabilities of the U.S. government is a political one. It does not have a solid foundation in economics or accounting." In reaching this conclusion, Mr. Baker noted that "FASAB does not propose including projections of future transportation or education spending [in] its accounting of government liabilities" and asked "[o]n what basis does [FASAB] therefore include government commitments for Social Security and Medicare for which there is no current legal obligation?" Regarding the uncertainty inherent in long-term social insurance obligation estimates, Mr. Baker remarked: "it is one thing to make projections that are based on uncertain events. It is quite another to make projections based on a set of future events that is almost unimaginable. It is certainly difficult to understand what would be the meaning of liabilities of this nature."

A113. Barry Anderson, Head of the Budgeting and Public Expenditure Division of the Organization for Economic Co-operation and Development (OECD) stated (on August 3, 2006): "The nature of the federal government is truly unique, with characteristics and power that no other entity – individual, corporation, or sub-national government – possesses." Mr. Anderson went on to say that "the federal government -- and the federal government alone -- has the power to … change unilaterally a present obligation." Yet, as noted by Mr. Anderson, FASAB is proposing to "use the same concept – a 'liability' -- to describe these transactions as are used to describe much different kinds of transactions made by other entities that do not have the powers of the federal government." As Mr. Anderson stated, "[c]lassifying these transactions the same as private sector liabilities is **wrong:** they are different and deserve special classification – perhaps as 'social obligations' or some other name, and perhaps as supplementary information to the financial statements, but not as 'liabilities.'" He suggests that recording such a liability would "confuse users of financial statements by leading them to believe that the liabilities reported for certain federal transactions have the same status as liabilities reported for private entities." Mr. Anderson went on to say that "all federal governments that we [OECD] are aware of have *explicitly* decided not to call federal 'social obligations' liabilities." (emphasis in original)

A114. At a recent FASAB public hearing on September 27, 2006, Steve Goss, Chief Actuary of the Social Security Administration, also highlighted the significance of the Government's unique power to alter unilaterally the amount of its future commitments. Specifically, Mr. Goss noted: "If through law, or other administrative means, the federal government can unilaterally alter or eliminate the obligation to the other entity, then it cannot exist as an asset for that entity, or as a liability for the federal government." He also added that, in the history of the Social Security program, the Government has, on a number of occasions, changed the level of benefits, including those for participants receiving benefits.

A115. Financial reporting for social insurance should be designed to meet the unique nature of the social insurance programs. This Alternative View proposes to supplement current reporting requirements under SFFAS 17 and SFFAS 26 with additional disclosures that would assist the reader in understanding (1) the nature of changes in social insurance responsibilities during the period, and (2) the fiscal sustainability of social insurance and other Federal programs. Some of the additional disclosures are proposed as required supplementary information. As additional experience is gained with these additional disclosures, the Board should consider whether to require some of this information as basic financial information.

A116. The fiscal sustainability of Federal programs, particularly social insurance programs like Social Security and Medicare, is important to the well being of individual Americans and to the overall economic condition of the United States. The Trustees of Social Security and Medicare have concluded that they "do not believe the currently projected long run growth rates of Social Security and Medicare are sustainable under current financing arrangements." The Office of Management and Budget, the Department of the Treasury, the Congressional Budget Office, and the Government Accountability Office have made similar observations of the unsustainable nature of the Medicare and Social Security programs as currently structured. Financial reporting should help the American public, the Congress and other users of the financial statements understand and evaluate the current status and longer-term fiscal sustainability of social insurance and other Federal programs. Federal financial reporting should illuminate the effect of social insurance program financing on intergenerational equity within the United States and the potential effect of such financing on individuals' retirement planning. Thus, it is crucial that accurate and transparent information be provided to the American public so that individuals can make well-informed decisions for themselves and for their Government.

A117. Such information should assist financial statement users, as outlined in SFFAC 1, 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." As noted in SFFAC 1, financial condition is a broader and more forward-looking concept than that of financial position. SFFAC 1 specifically discusses that Federal financial reporting should provide information that helps the reader to determine whether:

- the Government's financial condition improved or deteriorated over the period, and
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

A118. Federal financial reporting should communicate important information to users, in a transparent manner, about the long-term financial condition of the U.S. Government and annual changes therein. In particular, the Government's financial statements should communicate clearly to the user the long term sustainability of Federal Government programs, including such items as:

- the Government's current unfunded commitments for social insurance programs;
- the Government's current commitments for all other programs;
- a comprehensive presentation of the Government's long-term fiscal imbalance in relation to appropriate measures, such as GDP; and
- intergenerational equity issues, e.g., the extent to which different age groups may be required to assume unequal financial burdens to sustain Federal responsibilities.

A119. Such reporting should consider, among other things:

- indicators of fiscal sustainability and intergenerational equity for the current period, sufficient prior periods to show trends, as well as projections to future periods;
- factors affecting the cost of the Federal Government's current law responsibilities (e.g., demographics, health care cost growth),
- the sensitivity of estimates to changes in significant assumptions and the possible impact of uncertainty,

- factors that significantly affected the change in Federal responsibilities during the reporting period (e.g., legislation, program changes, assumption changes),
- a description of major Federal responsibilities under current law, other than social insurance, that are not shown (e.g., because they are not readily quantifiable),
- the intergenerational burden and implications presented by current program financing levels and approaches, and
- a fair and accurate presentation of costs and the services or transfers provided by these costs, including for social insurance programs.

A120. The more complex nature of Government requires an expanded reporting model. FASAB has provided one with additional statements that can be articulated, bridged, or aligned into an integrated framework. The balance sheet is just the beginning of the analysis of social insurance. The SOSI shows benefits and taxes projected for 75 years, separately for current beneficiaries, current participants, and future participants. The SOSI will be fully audited for the first time for fiscal year 2006. The Trustees publish similar projections in perpetuity. They also show how the projections are affected by different demographic and economic assumptions. Members who support the Alternative View see great value in this presentation and do not believe that the format for the statement of social insurance should be changed. With all future benefits in one place, it can be readily analyzed to assess the effects of different assumptions and policies, for different cohorts of participants.

The Unique Nature of Social Insurance

A121. Social insurance programs have been enacted by sovereign governments to provide assistance to those in need due to unemployment, retirement, disability, or death, or due to high health costs. Social Security and Medicare HI coverage is broad, and is financed by compulsory payroll and income taxes earmarked for program accounts. These two programs are pay-as-you-go; benefits were paid very shortly after the programs were begun in a deliberate transfer between those with jobs and those without.

A122. Social insurance is a category of program unique to government, usually at the national level. Begun in Germany in the 1880s, by the mid-1930s social insurance programs had spread to more than 50 countries in Europe, Latin America, and elsewhere. They were designed to provide some protection against hazards that might produce large dependency problems on a societal scale if not guarded against through organized means. In early years, the hazards were loss of wages through unemployment, old age, disability, and death of the family wage-earner; later the cost of health care for older people was deemed to be a comparable social hazard.

A123. "Directed against a dependency problem, social insurance is generally compulsory – not voluntary – giving the individual for whom it is intended no choice as to membership. Nor can he as a rule select the kind and amount of protection or the price to be paid for it. All this is specified in the plan, and little, if any, latitude is left for individual treatment."[65]

A124. "Social insurance…is molded to society's need for a minimum protection against one or more of a limited number of recognized social hazards. The minimum may be considered as that income which society feels is necessary and economically practicable for the subsistence of individuals comprising it. These payments, it is held, must be met in one form or another anyway, and social insurance endeavors to organize the budgeting therefore and dispensing thereof through systematic governmental processes."[66]

A125. Social insurance programs are financed by mandatory payroll taxes, other taxes, and premiums. These are levied by the sovereign power of government, and can be changed at any time by the same government that receives them. The programs were established in the United States on a pay-as-you-go basis. Soon after the programs started, benefits began to be paid to people who were without work, notwithstanding the fact that they had paid little into the programs in the form of taxes. The payroll taxes were earmarked and placed in accounts for the specific social insurance programs they funded, but the total amounts in these accounts were not built up or designated for specific beneficiaries. Based on current law, scheduled benefits are unsustainable.

A126. Social Security and Medicare were deliberately designed as intergenerational transfers. Earlier cohorts received substantial benefits relative to their taxes. There is little correlation between the taxes paid by an individual and the benefits received by that same individual. The replacement rates under Social Security are higher for low wage earners than for those with high wages. In Medicare, the scheduled benefits are the same at all wage levels, but the tax payments are higher for high-wage earners. The presence of multiple family earners affects the relationship between benefits and taxes, and the insured risks for unemployment, health costs, disability, and survivors also affect the relationship between benefits and taxes.

A127. Social insurance is *not like private insurance*. "Because of its voluntary nature, then, private insurance must be built on principles which assure the greatest practicable degree of equity between the various classes insured. Not only would the very nature of the case make it basically unfair to have one homogeneous group of insured designedly pay for part of the costs of providing insurance for another group for which the actuarial measure of the risk is quite different, but such a practice would lead to a cessation of insurance soon after the former group came to understand that it could save money by being treated as an independent, financially

[65] From Reinhard A. Hohaus, "Equity, Adequacy, and Related Factors in Old Age Security," *Record*, American Institute of Actuaries, vol. 37, 1938, printed as Appendix B in *Social Security,* Robert J. Meyers, Pension Research Council Publications, 1993.
[66] Ibid.

self-contained unit." "Private insurance, then, is adapted to the individual's need for, and his ability to afford, protection against one or more of a large variety of risks."[67]

A128. Social insurance is not *an employee benefit*. Business and government hire employees through exchange transactions in competitive labor markets. Through individual choice and bargaining, some employee compensation is received in wages, some in current benefits, and some in deferred benefits such as pensions and retiree health care. Larger costs for deferred benefits, whether by design or, for example, from rising health costs, detract from the amount paid in wages. The accounting methods for employee retirement benefits reflect the fact that the employees voluntarily exchange lower wages during their working years in order to receive certain future benefits. Such an exchange does not occur in connection with social insurance benefits.

A129. In business, as income is earned, the full cost of the goods and services sold is subtracted to calculate net income. The full cost of the goods and services includes the accruing cost of employee pensions and retiree health benefits. In the Federal Government, SFFAC 1 states that the full cost of goods and services delivered to the public should be matched in timing with that delivery. SFFAS 5 established rules for calculating the expense and the liabilities to be recorded. For Federal employee pensions and retiree health, the full normal cost accrues and is recorded by the employing agency during the employee's working years, and the full liability is recorded by the benefit-paying account and in the consolidated Financial Report during the same period. For social insurance and other transfer programs, in contrast, the service is delivered and the cost accrues when the benefit is due and payable, not while the individual is working and paying compulsory taxes earmarked for a particular program.

A130. Social insurance programs are *not pre-funded*. Social Security and Medicare--HI, are funded on a pay-as-you-go basis. Rather than being set aside for a particular individual's future benefits, current payroll taxes from current workers are used to pay benefits to current beneficiaries. For most of Social Security and Medicare's history, the Trust Fund balances were just high enough to maintain benefits despite variations in income and outgo over an economic cycle. Social insurance in effect is a social compact between generations

A131. In short, Social Security and Medicare—HI are compulsory programs financed by compulsory taxes on payrolls and other income. They are designed to deter dependency and to provide an adequate base on which employer-sponsored benefits, personal saving and personal insurance can build. The employee benefits are the result of voluntary exchange transactions. The personal savings and personal insurance are the result of voluntary exchange transactions and personal

[67] Op. cit.

choice. Total compensation is determined in competitive labor markets, and divided among wages and various employee benefits.

Benefit Liability Recognition

A132. Consistent with existing Standards (SFFAS 17), except for UI, the entity should recognize a liability and a related expense when social insurance benefits become due and payable to or on behalf of beneficiaries at the end of the reporting period, including IBNR claims. For 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 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.

A133. The liability and related expense for social insurance benefits, except for UI, should continue to be recognized when such benefits become due and payable for several reasons, including (1) future scheduled social insurance benefits are not present obligations, (2) recognition of future social insurance benefits would result in a substantial mismatch of costs and the transfers or services provided by such costs, and (3) given the ability of the Federal Government to change the laws relating to social insurance programs and the unsustainability of current benefit payments with current financing, amounts of benefit payments are uncertain and not reliably estimable.

Future Scheduled Social Insurance Benefits Are Not Present Obligations

A134. Any additional amounts beyond the "due and payable" amount do not constitute liabilities under the current liability definition.

A135. As noted in SFFAS 5, the distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in Federal accounting. An exchange transaction arises when each party to the transaction sacrifices value and receives value in return. There is a voluntary two-way flow of resources or of commitments to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for money or other resources or a commitment to provide money or other resources in the future. An example of an exchange transaction occurs when a Federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) voluntarily receive and sacrifice value. The expense is recognized in the period that the exchange occurs. The compensation expense and liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.

A136. A nonexchange transaction arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. Consistent with existing SFFAS 5, a liability for Federal nonexchange transactions should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the Federal entity to pay for benefits, goods, or services provided under the terms of the program, as of the Federal entity's reporting date, whether or not such amounts have been reported to the Federal entity. (e.g., estimated Medicaid payments due to health providers for services rendered that will be financed by the Federal entity, but that have not yet been reported to the entity). Social insurance benefits are a form of nonexchange transaction, similar to other eligibility-based benefit programs. The Government finances these programs through nonexchange, compulsory taxes, including earmarked payroll and beneficiary income taxes. Although financed by earmarked taxes, the benefits paid are nonexchange; the Government gives value to beneficiaries without receiving value in return. The fact that benefits paid are not based on the amount of taxes paid confirms the nonexchange nature of the social insurance transactions.

A137. Another important distinction between exchange and nonexchange transactions is the type of obligations that are recognized. In contrast to the laws governing private pension plans, which are typically contractual in nature, the United States Supreme Court has affirmed the right of the Congress to modify future Federal Government benefits in any manner and at any time. Therefore, because these future benefits can be modified or eliminated unilaterally by the entity which would pay them, there is no legal obligation for future social insurance benefits beyond amounts that are due and payable. The Government is not bound in its policy decisions by its previous actions; one Congress cannot bind a subsequent Congress.

A138. As noted earlier, the IPSASB is finalizing an exposure draft on reporting for all social benefits (which would include the equivalent of social insurance programs as well as other nonexchange benefits programs). For the exposure draft, the IPSASB has agreed that a liability for all social benefits should be recognized only when all eligibility criteria have been satisfied, which means that the liability would be generally equal to the amount of the next payment. This position is consistent with the Alternative View. Also, in connection with deliberations on the social benefits exposure draft, the IPSASB has expressed its views on the importance of reporting information concerning the sustainability of all government programs, recognizing that social policy obligations are a significant factor affecting sustainability in most countries.

A139. The Alternative View holds that the liability recognition point would be the same even if the proposed liability definition in FASAB's exposure draft on concepts entitled *Definition and Recognition of Elements of Financial Statements* ("*Elements* ED") were applied. The *Elements* ED proposes to establish, at a concept statement level, a new definition of a liability that is different from the definitions found in SFFAS 5. The proposed definition is as follows:

> A liability is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

A140. Pursuant to the liability definition in the *Elements* ED, a liability of the Federal Government has two essential characteristics: (1) it constitutes a present obligation to provide assets or services to another entity; and (2) the Federal Government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur. The rationale for the definition is explained in the *Elements* ED.

A141. The ED is part of a conceptual framework designed to assist the Board in deliberating new standards and does not amend existing standards. According to the ED, a "present" obligation is incurred when the Government takes a specific action that commits or binds the Government and affects another entity. Consistent with other benefit programs, the Federal Government establishes eligibility criteria for determining whether and when an individual is entitled to receive a benefit. The Alternative View holds that the Federal Government is not committed or bound to make social insurance or other benefit payments until all eligibility criteria are met. Even if the proposed definition were adopted as part of the Board's conceptual framework and applied to social insurance, a present obligation or a liability for social insurance would not be incurred until all eligibility requirements are met and benefits are due and payable.

Recognition of Future Social Insurance Benefits as a Liability Would Result in a Substantial Mismatch between Federal Costs and the Delivery of Services to the Public

A142. Recognition of future social insurance benefits as a liability would result in a substantial mismatch between program costs and the transfers or services provided. SFFAC 1 established the principle that, since government had little earned revenue and no profit motive, but had instead the goal of providing services that are collectively chosen to improve the well-being of citizens, Government costs should be matched year-by-year with the delivery of such services. Thus, cost could be matched with program delivery, and analyzed in relation to outputs, outcomes, and other relevant performance measures. These measures would improve resource allocation and program management, improving the effectiveness and efficiency with which services are delivered and permitting accountability to citizens for service delivery. This principle has been successfully applied in the development of FASAB standards over the past fifteen years. This orientation of the statement of net cost and the articulated balance sheet marked the beginning of substantial improvement in Federal financial management.

A143. The Federal Government conducts its programs on an ongoing basis. For example, the Federal Government has responsibilities to provide for such programs as defense and public education, which it ultimately finances through future taxes. Although these and other Federal programs are likely to continue and future costs for these programs are highly likely to be incurred, Federal financial statements properly do not recognize these future costs in the current period. Although these programs are ongoing, the Federal Government clearly has no present obligation and therefore no liability for these long-term future responsibilities, other than for specific transactions that have already been incurred. Rather, the costs of these responsibilities generally are recognized in future periods in which the Federal Government engages in the related activities to deliver services. The Federal Government has ongoing responsibilities with respect to social insurance programs, and should properly recognize these costs, like other ongoing costs, in the future periods when they occur. It is important to clearly distinguish between those costs that relate to the current period and those costs that relate to future periods. Further, showing expenses on a due and payable basis provides important information about the relationship between costs and the delivery of services during the period.

A144. The enormity of a social insurance "liability" based on 40 quarters or equivalent of work in covered employment (which would triple or quadruple the Government's total liabilities) and the annual changes therein would distort the amounts related to other activities of Government and render them insignificant. Currently, materiality considerations for the SOSI are generally perceived to be different from the balance sheet and statement of net cost. Inclusion of such an enormous "liability" for social insurance would substantially diminish the materiality of other items currently on these statements and would reduce the attention paid to non-social insurance programs.

Likely Benefit Payments Are Uncertain and Not Reliably Estimable

A145. The scheduled benefits reported in the SOSI represent the present value of benefits that would be paid if current laws remained in force. However, The annual Trustees Reports of the Social Security and Medicare programs clearly note that Social Security and Medicare are not sustainable under current financing arrangements and that the law concerning these programs can be changed at any time by Congress. The benefit statements that are sent to individuals contain similar statements. Hence, the social insurance benefits that are likely to be paid are uncertain and not reliably estimable (as defined under SFFAS 5). The following paragraphs illustrate the unsustainability of the Social Security and Medicare programs as currently structured.

- *Social Security* – In the latest Trustee Report, as of January 1, 2006, the present value of OASDI scheduled benefits over the valuation period ($38.6 trillion) is estimated to exceed the present value of estimated revenues ($32.1 trillion) by $6.5 trillion. The payment of benefits is limited, by law, to the balances in the OASDI trust funds. As of January 1, 2006, such trust fund balances were $1.9 trillion, or $4.6 trillion less than the estimated fiscal imbalance in the OASDI program. The OASDI trust funds are expected to be exhausted in 2040, at which time they will be insufficient to pay all scheduled benefits.

- *Medicare Hospital Insurance* – In the latest Trustee Report, as of January 1, 2006, the present value of Medicare-- HI scheduled benefits over the valuation period ($21.9 trillion) is estimated to exceed the present value of estimated revenues ($10.6 trillion) by $11.3 trillion. The payment of benefits is limited, by law, to the balances in the HI trust fund. As of January 1, 2006, such trust fund balances were $0.3 trillion, or $11 trillion less than the estimated fiscal imbalance in the HI program. The HI trust fund is expected to be exhausted in 2018, at which time they will be insufficient to pay all scheduled benefits.

- *Medicare Supplementary Medical Insurance* -- In the latest Trustee Report, as of January 1, 2006, the present value of Medicare—SMI scheduled benefits over the valuation period ($28 trillion) is estimated to exceed the present value of estimated revenues ($7 trillion) by $21 trillion. In addition to premiums and other revenue, the SMI program is funded by substantial general fund transfers (about 75% of scheduled benefits). The fiscal imbalance in SMI of $21 trillion represents approximately 3% of the present value of GDP. Given the magnitude of the imbalance and the overall long-term fiscal imbalance of the Federal Government, the SMI program is unsustainable as currently structured. Further, SMI is elective and coverage is dependent upon continued payment of premiums by participants, an eligibility requirement.

A146. Further, over the next 75 years, the estimated Social Security and Medicare annual expenditures are expected to grow from about 7% of GDP to about 17% of GDP. Over the same period, other government costs are expected to grow to about 19% of GDP, while total tax revenues, including Social Security and Medicare payroll taxes, have historically averaged about 18% of GDP, Also, based on the requirements of the Medicare Modernization Act of 2003, the 2006 Medicare Trustees report issued a determination of “excess general revenue Medicare funding.” A similar determination in next year's report would trigger the Medicare funding warning in response to which the President must submit a proposal and Congress could consider it under expedited procedures.

A147. As noted above, the OASDI and Medicare programs are not sustainable as currently structured and can, and almost certainly will, be modified by Congress at some point in the future. It is not possible, however, to predict what specific actions Congress will undertake to increase or reduce benefits in the future. During the 1980s, Congress enacted a number of reforms in Social Security to put the program on a more fiscally sustainable path. These reforms included not only increases in payroll tax contributions, but also reductions in scheduled benefit payments resulting from reduced or delayed cost-of-living adjustments, changes to the formula used to compute initial benefits, increases in the retirement age, and reductions in benefits for certain classes of beneficiaries. Given the current fiscal outlook for Social

Security and Medicare, it is not unreasonable to anticipate future reforms involving similar reductions in scheduled benefits. Consequently, due to this uncertainty, recording a liability for these future payments would potentially provide the public with a false sense of the certainty regarding the likely amount or existence of such payments.

Deferral of Earmarked Revenues

A148. Social insurance programs are funded in part by earmarked revenues and by other financing sources (such as appropriations). When earmarked funds exceed current benefits, they are invested in special U.S. Treasury securities and reported as an asset by the program agency (e.g., SSA and CMS) and as a liability by Treasury. Such funds are held for the payment of future benefits. Consistent with this concept, an argument can be raised that earmarked revenues received in excess of benefits incurred should not be recorded as revenue in the current period because (1) they should not offset non-earmarked costs in determining net operating cost, and (2) consistent with the Alternative View that social insurance benefit expense should be recorded in the period in which services are provided, such earmarked revenues should be recognized in the period in which they are used. Instead, such excess earmarked revenues should be recorded and reported as deferred earmarked revenues. In periods where earmarked revenues exceed benefits incurred, deferred earmarked revenue would increase. In periods when previously deferred earmarked revenues are used to finance programs costs, deferred earmarked revenue would decrease. Generally, the cumulative amounts of such deferred earmarked revenues would represent the amounts that are currently reported as the net position of the funds (assets less liabilities). Recognizing deferred earmarked revenue would not modify or be inconsistent with the requirements of SFFAS 27. Earmarked revenues would be recognized and reported to the extent of current benefit expenses incurred. In addition, deferred earmarked revenues would be reported as part of earmarked funds. Deferred earmarked revenues would be classified as a liability on the balance sheet.

A149. As noted in SFFAS 27, earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. The deferred earmarked revenue concept discussed above in relation to social insurance could also be applied to other earmarked funds. Certain other earmarked funds receive funds in advance of incurring program expenses. Such excess earmarked revenues currently offset non-earmarked costs and reduce the net operating cost, and such earmarked revenues are not currently recognized as revenue in the period when program expenses are incurred. Because this concept would require revising provisions of SFFAS 7 and the supporting arguments may also apply to other programs with earmarked revenues, it should be considered by the Board as a separate project. For example, the arguments supporting recognition of deferred earmarked revenue could be applied to certain other earmarked funds (e.g., Highway and Airport and Airways Trust Funds).

Statement of Social Insurance

A150. As noted in SFFAS 25, the SOSI is treated as a basic financial statement because it is essential to fair presentation and is important to achieve the objectives of Federal financial reporting. The information required by SFFAS 17 reports on the financial effects of existing law under actuarial demographic and economic assumptions.

A151. The SOSI and supporting information provide information that assists users in understanding the projected revenues and scheduled benefits of social insurance programs. The SOSI provides the present value of revenues and benefits for three classes of participants (1) participants who have attained retirement age, (2) participants who have not yet attained retirement age, and (3) future participants. The use of these three classes is important to assist the user in understanding the extent to which benefits exceed revenues for a particular class, which will have to be paid by another generation. One such measure of intergenerational equity, referred to as the "closed group" is the amount of benefits for current participants that are expected to be paid by future participants. The SOSI also provides information for four prior years to assist the user in understanding the changes in such classes over time.

A152. As noted above, because Social Security and Medicare are not sustainable under current law, future benefits likely to be paid will depend upon the actions taken by the Congress and the President. Therefore, unlike scheduled benefits presented in the SOSI based on current law, social insurance benefits that are likely to be paid are uncertain and not reliably estimable.

A153. Information on cumulative balances (e.g., OASDI and Medicare trust fund balances) provides information on earmarked resources available to fund social insurance benefits and the relationship between such balances and the net present value of future revenues and benefits. Additional information on OASDI and Medicare—HI provides information about the potential magnitude of changes in program revenues and benefits that would be necessary to bring them into balance.

A154. Information concerning the significant assumptions allows users to understand the basis for the projections and the sensitivity of the projections to changes in such assumptions.

A155. State by state UI information illustrates the solvency of individual state programs.

Statement of Changes in Social Insurance

A156. The Alternative View proposes to provide additional information on sustainability in two parts at this time: (1) A statement of changes in social insurance, and (2) required supplementary information related to the overall fiscal sustainability of all Federal programs, including social insurance programs. Consistent with many other countries around the world, the increasing costs of social insurance are one of the largest factors affecting sustainability of governments.

A157. The statement of changes in social insurance presents the full extent of changes in the net present value of projected revenues and scheduled benefits. This statement would identify and analyze the changes, such as those due to legislation or changes in assumptions during the period. Narrative information on the nature of changes in social insurance responsibilities provides information regarding the reasons for any improvement or deterioration in the financial condition of these programs during the period. For example, the effect of legislative and other changes that affected participants with fewer than 40 quarters or equivalent of work in covered employment would be reflected in the statement of changes in social insurance.

A158. Footnote disclosures provide additional information to assist the user in analyzing the statement of changes in social insurance responsibilities, including further discussion of the significant changes and information on key drivers affecting the projections.

Statement of Fiscal Sustainability

A159. In addition to the SOSI and the statement of changes in social insurance, members who favor the Alternative View favor a governmentwide statement of fiscal sustainability that would project costs for all Federal programs and all revenues over the same 75 year period that is used for Social Security and Medicare, and in perpetuity. These projections would be done under a variety of economic, demographic, and policy assumptions and would provide a broad array of information. The objective would be to provide a broad range of users with information to assess the likely sustainability of Government services under a range of possible conditions, to understand the sources of risk, and to encourage fiscal prudence.

A160. The fundamental question of fiscal sustainability is whether the Government can pay its bills as they come due, reflecting whether the Government is solvent. Answering this question requires analyzing current and projected levels of Federal spending, Federal revenue and Federal debt in relation to the economy. In other words, it requires analyzing whether the Government's debt to the public is falling, rising or remaining constant as a percent of GDP. If the debt-to-GDP ratio is rising uncontrollably then there will come a time when the Government cannot pay its bills.

This is because there is a limit on the amount of the economy's output that the Government can claim through taxation to service its debt and if the debt burden rises uncontrollably, then that limit will be exceeded. From a long-term perspective, total Government spending must be on a sustainable path in relation to the growth of the economy. Too rapid a trajectory of spending will require either an increase in taxes or an increase in borrowing, both of which will take resources from other sectors of the economy, thus undermining or stifling the economic growth needed to keep revenue growth in line with spending.

A161. The Government has no stockholders. Its assets and liabilities (e.g., loan guarantees) are used to provide services rather than to earn a return on investment. Its credit is based on a healthy economy underlying tax revenue and a sustainable path of spending under a range of conditions. The Federal Government is charged with shouldering its responsibilities in perpetuity, so assessing its sustainability is important.

A162. Information on the trajectory and present value of key components of revenues and outlays under a range of assumptions can be very useful. Such information can assist in understanding the magnitude of policy changes (e.g., reductions in outlays, or increases in tax revenues) that would be required to sustain Federal operations. For example:

- The excess of outlays over revenues, expressed both in current dollars and as a percentage of GDP, shows the Government's basic drain on financial markets.
- The fiscal imbalance, defined as the present value of the projected difference between future outlays and receipts plus public debt, is a summary measure of shortfall that must be addressed by future fiscal policy changes.
- The fiscal gap illustrates the amount of budgetary resources needed to maintain public debt as a constant percentage of GDP.
- The net outlays for the rest of government illustrates general fund amounts that would be available to fund all other Government spending, including social insurance benefits that exceed earmarked revenues, such as for Medicare—SMI.

Measures of fiscal imbalance place no constraint on the future level of debt. However, excessively high levels of debt, as reflected in large measures of imbalance, can have serious negative consequences for the Government and on the economy and be unsustainable.

A163. The statement of fiscal sustainability will provide information that will assist in understanding the intergenerational equity of social insurance programs. Such information illustrates the cost burden that would be shifted to other generations.

Also, the statement will provide several other key measures relevant to sustainability, such as fiscal imbalance per capita information.

A164. While the SOSI presents information over a 75 year horizon, additional information over the infinite horizon adds perspective on sustainability. Also, information about future periods provides information about the increase in costs to resolve the fiscal imbalance if actions to modify the programs are not taken.

A165. Information showing the projected net results, including significant components, on an annual basis over the projection period shows the relationship between the components over the valuation period, the timing of key events, and related changes therein.

A166. Because the fiscal imbalance and projected net results can be affected by changes in significant assumptions, the sensitivity analysis will show the impact of changes in significant assumptions.

A167. Other disclosures will provide a narrative analysis of the information presented in the statement of fiscal sustainability and other useful information about trends. In addition, the footnotes should assist the user in understanding the nature of other federal responsibilities that are not reflected in the financial statements.

A168. The statement of fiscal sustainability presented in the Alternative View is meant to be illustrative. It is provided as a starting point for a larger dialogue with interested stakeholders (including the Sustainability Taskforce that FASAB plans to assemble) on the most appropriate form and content of the proposed statement. In addition to the items provided in the proposed statement of fiscal sustainability in this view, there are a variety of other measures and indicators of sustainability that should be reviewed and considered as the discussion on sustainability presentation moves forward. Other possible disclosures include (among others):

- Providing a time series projection of the expected cost of fulfilling obligations in the future, expressed as a percentage of GDP. For SOSI programs, this would be the projected cost of “scheduled” benefits under the programs divided by projected GDP. For other Government programs, this would be the projected cost of maintaining the current level of effort in these programs in the future, regardless of the anticipated financing available to meet this level of effort.

- Illustrating the “gap” in current law for financing these intended expenditures by presenting a “trust fund ratio,” which is the ratio of trust fund assets [for those programs financed with largely dedicated tax revenues (OASDI and HI)] to the annual cost of the program. This disclosure can be extended beyond the date of projected trust fund exhaustion by labeling the negative values as the “unfunded obligation” of the program through the given date as a percent of the annual cost of the program. For other social insurance programs and other Government programs, a single representation of the projected publicly-held debt as a percent of GDP could be the appropriate presentation.]

A169. These presentations would help clarify the trend in the overall cost of these programs, relative to GDP, and highlight the trend in the solvency or debt load associated with meeting these obligations.

Uncertainty

A170. Present values and other long-range accounting estimates are inherently uncertain. This is particularly true of estimates based on current law since future changes in law could alter future benefits. In addition, the estimates themselves are uncertain. Assumptions are required and the more long-range the estimate the more uncertain it becomes. The degree of precision and certainty of amounts reported on financial statements is often misunderstood.

A171. According to SFFAC 1, financial information has certain qualities, including reliability. In SFFAC 1 the FASAB stated that

> [R]eliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.[68]

A172. Another equally important characteristic of financial information is relevance. SFFAC 1 states the familiar principle that a characteristic of relevant information is its capacity to make a difference in users' assessment of and decisions about a problem, condition, or event.[69]

A173. The FASB has noted the need for trade-offs between reliability and relevance. In Statement of Financial Accounting Concepts (SFAC) 2, *Characteristics of Accounting Information*, FASB identifies reliability and relevance as the qualities that make accounting information useful. SFAC 1, *Objectives of Financial Reporting by Business Enterprises,* notes gradations of reliability and relevance and the possibility of trade-offs between them.[70] According to SFAC 2, the principal components of reliability are representational faithfulness and verifiability.[71]

[68] SFFAC 1, par. 160
[69] SFFAC 1, par. 161
[70] SFAC 1, par. 55. Also see FASB SFAC 2, par. 15, and FASAC's white paper "The FASB's Conceptual Framework: Relevance and Reliability," September 2004.
[71] SFAC 2, Glossary

A174. Relevant information frequently involves estimates, which necessitate some tolerance of uncertainty. Uncertainty can be tolerated if it is clearly explained and illustrated in the entity's financial statements, and there are many ways to do this. Uncertainty can be discussed and illustrated in the notes to the financial statements, in supplementary information, or even in the measurement of the liability and expense.

A175. Sensitivity analysis pursuant to the Alternative View would be a change from that required in SFFAS 17. SFFAS 17 required all component entities except UI to illustrate the sensitivity of both cash flow projections and the SOSI present values to changes in the most significant assumptions.[72]

A176. The Alternative View would require, first, that the component and governmentwide entities state in the notes to the financial statements that the amounts reported in the SOSI, the statement of changes in social insurance, and the statement of fiscal sustainability are estimates that are based on assumptions and that actual results would be different, sometimes substantially different, from the estimated results. Secondly, the Alternative View also requires entities to illustrate the sensitivity of amounts presented in the principal financial statements and in the statement of fiscal sustainability.

A177. Unlike SFFAS 17, the Alternative View does not specify a method or approach for illustrating uncertainty. Entities will decide what is appropriate based on trends, the utility of the information to the users and policy-makers, and the relative burden of producing it. The entities are encouraged to explore areas of analysis. This will afford flexibility and allow best practices to develop. Entities may continue to vary key assumptions as required by SFFAS 17 or pursue other methods. For example, the Alternative View would allow stochastic modeling. The Board believes and the Board members supporting the Alternative View believe that a graph like figure "VI.E2" from the Trustees' Annual Report shown below is a promising method for illustrating uncertainty. The Board believes and the Board members supporting the Alternative View believe that a stochastic presentation of the ranges of possible outcomes with respect to the present value estimates in the basic financial statements will provide useful information for users to consider.

A178. Each year the Social Security Trustees report on the financial condition of the system. The principal results from their report are generated by a **deterministic model** of the annual income and expenses of the system over a 75-year projection period. The Social Security Trustees carefully review and update assumptions used for projections on an annual basis. This helps ensure that they represent the Trustees' best estimate of future possibilities.

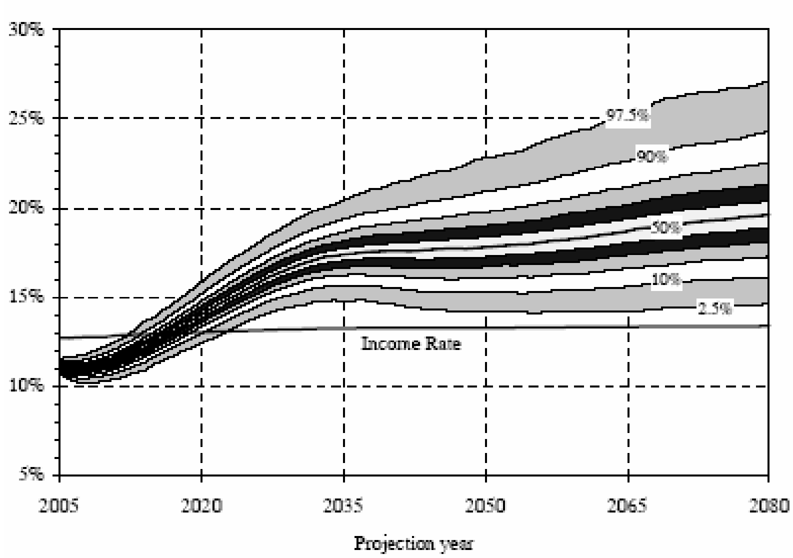
[72] See SFFAS 17, par. 27(4)(a).

A179. The Social Security Trustees illustrate uncertainty throughout their Annual Report. The results of their "best estimate" or intermediate cost assumptions are contrasted in narratives, tables, and charts with estimates based on low- and high-cost assumptions.[73] The latter vary all assumptions either low or high. This approach is characterized as "deterministic."[74]

A180. The Trustees also present sensitivity analysis. Key assumptions are varied from the intermediate cost assumptions to illustrate how changes therein affect the estimates.

A181. In addition to this sensitivity analysis, starting in 2003 the Social Security Trustees' Report began to illustrate uncertainty via a stochastic model that attempts to capture uncertainty by displaying ranges rather than point estimates.[75] It represents a probability distribution of possible future outcomes centered on the Trustees' intermediate assumptions. For example, the following figure (VI.E2) shows the probability distribution of the year-by-year Social Security cost rates (i.e., cost as a percentage of taxable payroll). The range of the cost rates widens as the projections move further into the future reflecting increasing uncertainty. The lines in the figure display different confidence intervals expected for future annual cost rates. For each given year, these lines represent the percentile distribution of cost rates based on all stochastic simulations for that year.[76] The 50 percent confidence level aligns closely with the Trustees' best estimate using the intermediate cost assumptions.

Figure VI.E2.—Annual Cost Rates



[73] See Appendix 5 containing the table of contents from the 2005 Trustees' Annual Report to illustrate the extensive nature of the information provided there.
[74] The Trustees' Annual Report, p. 158-9.
[75] 2005 Trustees' Annual Report, pp. 158, 202-3
[76] 2005 Social Security Trustees' Report, p. 161.

Assumptions

A182. With respect to assumptions, the Board is and the Board members supporting the Alternative View are cognizant of the extensive formulation process employed by the Social Security and Medicare Trustees and believes that a general requirement for prudence should be established for selecting assumptions with a reference to actuarial standards of practice. The recommendation is a pragmatic approach to this very difficult subject and has been effective for past FASAB standards. In addition, similar prudence should be exercised in the formulation of assumptions in the statement of fiscal sustainability.

A183. The array of information required by the Alternative View would continue to illustrate the size and diversity among the programs and the uncertainty of long-term projections. Estimates of future costs disaggregated by age cohort as required in the SOSI highlight the long-range intergenerational impact of social insurance programs.

A184. The new governmentwide statement of fiscal sustainability is not aimed at predicting a single outcome, but rather at assessing the fiscal risks faced by the nation and thus illuminating the actions necessary to chart a prudent course.

Valuation Date

A185. Members supporting the Alternative View believe that it is appropriate to retain the existing requirements for valuation date, allowing some flexibility for the timely preparation and audit of the information. Trustees reports for the Social Security and Medicare programs are prepared annually as of January 1. These members are concerned that the cost to project the valuation through September 30, as proposed by the Primary View, would exceed the benefits and that having multiple valuations within the year could be confusing. Also, the financial statements should disclose the nature of any events, after the valuation date but before financial statements are issued, that could materially affect the estimates and, if available, an estimate of the potential impact.

Appendix B: Primary View - Pro Forma Financial Statements

The following table contains a pro forma illustration of the statement of social insurance (SOSI). **The amounts shown in the table are for illustration only. Some of the amounts are derived from the SOSI in the 2005 Financial Report of the United States Government while others are developed arbitrarily for the purposes of illustration. They do not represent actual estimates.**

Line g on the SOSI below represents the amount that would be reported on the balance sheet by Social Security and Medicare. **Line r** represents the total net expense that would be reported by those agencies on the statement of net cost.

Line m in the SOSI represents the net "open group" obligation (see Glossary at Appendix F). With respect to Social Security, subtracting $1,687 billion of assets held by the Social Security Trust Fund (SSTF) in 2005 from line m yields the "open group unfunded obligation" of $4 trillion. This is the same amount as reported in *The 2005 Annual Report of the Board of Trustees of the Federal Old-age and Survivors Insurance and Disability Insurance Trust Funds*, (*2005 Annual Report of OASDI TF*). [See Table IV.B5, "Components of 75-Year Actuarial Balance under Intermediate Assumptions (2005-79)", p. 57.] The Social Security Trustees define the "open group unfunded obligation" as the excess of the present value of the projected cost of the program over a specified time period (for example the next 75 years) over the sum of (1) the value of trust fund assets at the beginning of the period and (2) the present value of the projected tax income of the program, assuming scheduled tax rates and benefit levels. [See the *2005 Annual Report of OASDI TF,* Glossary, p. 199.] The Trustees characterize the open group unfunded obligation as indicative of the adequacy of financing over the period as a whole for a program financed on a pay-as-you-go basis. [See the *2005 Annual Report of OASDI TF, p. 57*.]

Lines i and j in the SOSI less **lines a and b** represents the net "closed group" obligation (see Glossary). With respect to Social Security, subtracting $1,687 billion of assets held by the SSTF from the sum of line i and j less lines a and b yields the closed group unfunded obligation. [See *2005 Annual Report of OASDI TF* Table IV.B7, "Present Values of OASDI Cost Less Tax Revenue and Unfunded Obligations for Program Participants," p. 60.] The 2005 Social Security Trustees' Report defines "closed group unfunded obligation" as a measure like the open group unfunded obligation except that individuals under the age of 15 (or not yet born) are excluded. In other words, only persons who are 15 years or older as of the valuation date are included in the calculations. [See the *2005 Annual Report of OASDI TF,* Glossary, p. 199.]

Another measure available from the Social Security Administration is the "maximum transition cost." The SSA defines the maximum transition cost as the cost of meeting the accrued benefit obligations of the old form while continuing the

Social Security program in a completely different form, with all payroll taxes for work after the valuation date credited to the new benefit form. [See SSA Actuarial Note 2004.1.] The maximum transition cost is determined as of the valuation date for current and past participants only. It is computed as the difference between

a. The present value of [the] accrued benefit obligations payable on the old form; and
b. The value of the assets on the valuation date plus the present value of revenue from income taxation of future benefits.

Line i in the SOSI represents component (a) immediately above. Actuarial Note 2004.1 defines the accrued benefit obligation (ABO) as the present value of future benefit obligations based on past earnings as of the valuation date. The ABO includes the benefits scheduled for current retired-workers and disabled workers. Benefits are calculated on a proportional past-service-credit basis determined as of the valuation date for current active participants under age 62, which requires a computation as if the worker had just become eligible to receive a disabled-worker benefit and adjusted to make them equivalent to a worker aged 62.

[See Goss, Steve, Alice Wade and Jason Sch, SSA Actuarial Note No. 2004.1, "Unfunded Obligations and Transition Cost for the OASDI Program," (Actuarial Note 2004.1), pp. 24-6.]

The SOSI uses a 75-year projection period. The Social Security Trustees note limitations involved in using projection periods of only 75 years.

a. First, overemphasis of summary measures (such as the actuarial balance and open group unfunded obligation) that are limited to the 75-year period can lead to incorrect perceptions and policy that fail to address sustainability for the more distant future. …
b. A second limitation is that continued, and possibly increasing annual shortfalls after the period are not reflected in the 75-year summarized measures. In order to provide a fuller description of long-run unfunded obligations of the OASDI program, [the Trustees' Annual Report also] presents estimates of obligations that extend to the infinite horizon. The extension assumes that the current-law OASDI program and the demographic and most economic trends used for the 75-year projection continue indefinitely. Extending the calculations beyond 2079 adds $7.1 trillion in unfunded obligations to the amount estimated through 2079. That is, over the infinite horizon, the OASDI open group unfunded obligations are projected to be $11.1 trillion. The $7.1 trillion increment reflects a significant financing gap for OASDI after 2079.

Federal Old-Age, Survivors and Disability Insurance (Social Security) Statement of Social Insurance

Federal Old-Age, Survivors and Disability Insurance (Social Security)	2005	2004	2003	2002	2001
Present value of future payroll taxes and income taxes[77] to be paid by:					
a. Current participants who have attained fully insured status and retirement age or disability status……	464	411	359	348	309
b. Current participants who have not yet attained retirement age or disability status……	15,290	14,388	13,576	13,048	12,349
c. Future participants expected during the projection period ……	13,696	12,900	12,213	11,893	11,035
d. Subtotal – All Current and future participants (lines a, b, and c)……	29,450	27,699	26,147	25,289	23,693
Present value of future benefits attributable to current participant's past work in covered employment to be paid to:					
e. Current participants who have attained fully insured status and retirement age or disability status……	5,395	4,933	4,662	4,401	4,256
f. Current participants who have attained fully insured status but have not yet attained retirement age or disability status……	8,979	8,407	7,881	7,579	7,104
g. Subtotal – accrued liability for current participants (line e plus f above)……	14,374	13,340	12,543	11,980	11,360
h. Current participants who have not yet attained fully insured status……	2,992	,802	2,627	2,526	2,368
i. Subtotal – "accrued benefit obligation" (line g plus h)……	17,366	16,142	15,170	14,506	13,728
Present value of future benefits attributable to current and future participant's future work in covered employment to be paid to:					
j. All current participants (i.e., same group as in lines e, f, and h above)……	11,971	11,209	10,508	10,105	9,472
k. All future participants expected during the projection period ……	5,816	5,578	5,398	5,240	4,700
l. Total present value of future benefits payable (lines i, j and k)……	35,154	32,928	31,075	29,851	27,900
Excess of the present value of future benefit payments over future payroll and income tax					
m. Excess of the present value of future benefit payments over future payroll and income tax (or taxes paid over benefits) (line l minus d) ……	(5,704)	(5,229)	(4,927)	(4,562)	(4,207)

[77] The phrase "income taxes" in this table refers to income tax on social insurance benefits received by participants.

Federal Old-Age, Survivors and Disability Insurance (Social Security)	2005	2004	2003	2002	2001
Change in the Liability					
For Fully Insured Current Participants, the Change in the Present Value of Estimated Future payments during the reporting period attributable to:					
n. Current participants becoming fully insured during the reporting period and fully insured current participants' increased benefits from work completed in covered employment.	520	429	345	359	438
o. Interest on the liability during the period due to the passage of time.	520	430	345	359	439
p. Prior service cost attributable to changes in law or policy, if any.	0	0	0	0	0
q. Actuarial losses or gains, if any	521	430	45	359	439
r. Net cost for the period (subtotal of lines n through q) [This amount is the expense to be reported on the statement of net cost.]..	1,561	1,289	1,035	1,077	1,316
s. The change in the present value of estimated future payments attributable to net benefit payments. [Benefit payments reduce the liability.]..	527	492	472	457	432
t. Net change in the liability for the period (subtotal of line r minus s)..........	1,034	797	563	620	884
Change in the obligation to those not-fully-insured yet					
For not-fully-insured current participants, the change in the present value of estimated future payments during the reporting period attributable to:					
u. Not-fully-insured current participants' increased potential benefits from work completed in covered employment.	63	58	33	52	72
v. Interest on the potential benefits during the period due to the passage of time.	63	58	34	53	72
w. Prior service cost attributable to changes in law or policy, if any.	0	0	0	0	0
x. Actuarial losses or gains, if any..	64	59	34	53	72
y. Net of lines u through x for the period	190	175	101	158	216
Change attributable to future work					
All participants during the projection period, the change in the present value of estimated future payments during the reporting period attributable to:					
z. Changes in law or policy	500	440	280	586	633
aa. Actuarial losses or gains related to future work in covered employment............................	500	441	281	587	633
bb. Total changes in net present value...	1,000	881	561	1,173	1,266

Medicare, Hospital Insurance, Part A
Statement of Social Insurance

Medicare, Hospital Insurance, Part A	2005	2004	2003	2002	2001
Present value of future payroll taxes to be paid by:					
a. Current participants who have attained fully insured status and retirement age or disability status …………	162	148	128	125	113
b. Current participants who have not attained retirement age or disability status…………	5,064	4,820	4,510	4,408	4,136
c. Future participants …………	4,209	4,009	3,773	3,753	3,507
d. Subtotal – All Current and future participants (lines a, b, and c)…………	9,435	8,976	8,411	8,286	7,756
Present value of future benefits attributable to past work in covered employment to be paid to:					
e. Current participants who have attained fully insured status and retirement age or disability status …………	2,179	2,168	1,897	1,747	1,693
f. Current participants who have attained fully insured status but have not attained retirement age or disability status …………	9,501	9,041	7,521	6,896	6,426
g. Subtotal – accrued liability for current participants (line e. plus f. above)…………	11,680	11,209	9,418	8,643	8,119
h. Current participants who have yet not attained fully insured status…………	3,167	3,013	2,507	2,298	2,142
i. Subtotal – accrued benefit obligation (line g plus h.)…………	14,847	14,222	11,926	10,941	10,261
Present value of future benefits attributable to future work in covered employment to be paid to:					
j. Current participants (see lines e, f, and h above) …………	0	0	0	0	0
k. All future participants expected during the projection period (that is, those less than 15 years old, plus those to be born over the projection period, plus immigrants during the period) …….	3,417	3,246	2,653	2,470	2,225
l. Total present value of future benefits payable (lines i, j and k) …………	18,264	17,468	14,577	13,412	12,487
Excess of the present value of future benefit payments over future payroll and income tax					
m. Excess of the present value of future benefit payments over future payroll taxes (or payroll taxes over benefits) (line l minus line d) …………	8,829	8,492	6,166	5,126	4,730
Change in the Liability					
For fully insured current participants, the change in the present value of estimated future payments during the reporting period attributable to:					
n. Current participants becoming fully insured during the reporting period and fully insured current participants' increased benefits from work completed in covered employment. ………	216	652	309	224	194

Medicare, Hospital Insurance, Part A	2005	2004	2003	2002	2001
o. Interest on the liability during the period due to the passage of time.	216	652	309	223	194
p. Prior service cost attributable to changes in law or policy, if any.	0	0	0	0	0
q. Actuarial losses or gains related to the liability as of the reporting date, if any.	216	651	308	223	194
r. Net cost for the period (subtotal of lines n through q) [This amount is the expense to be reported on the statement of net cost.]	648	1,955	926	670	358
s. The change in the present value of estimated future payments attributable to benefit payments. [Benefit payments reduce the liability.]	177	164	151	146	128
t. Net change in the liability for the period (line r minus s).	471	1,791	775	524	712
Change in the obligation to those not-fully-insured yet					
For not-fully-insured current participants, the change in the present value of estimated future payments during the reporting period attributable to (the same information as required above lines n through r):					
u. The increased potential benefits attributable to work completed in covered employment.	26	84	34	26	77
v. Interest on the potential benefits during the period due to the passage of time.	26	84	35	26	78
w. Prior service cost attributable to changes in law or policy, if any.	0	0	0	0	0
x. Actuarial losses or gains on the present value of potential benefits, if any.	26	85	35	26	78
y. Net of lines u. through x for the period.	78	253	104	78	233
Change attributable to future work					
All Participants during the Projection Period					
z. The change in the present value attributable to future work in covered employment during the period from changes in law or policy.	239	803	299	279	738
aa. The change in the present value of estimated future payments attributable to actuarial losses or gains related to benefits attributable to future work in covered employment.	239	804	299	280	739
bb. Total changes in net present value [line l above for the current reporting period less line l for the prior reporting period].	478	1,607	598	559	1,477

Medicare, Supplementary Medical Insurance, Part B
Statement of Social Insurance

Medicare Supplementary Medical Insurance, Part B	2005	2004	2003	2002	2001
Present Value of Future Benefits Attributable to Past Work in Covered Employment Payable to: [78]					
e. Current participants who have attained fully insured status and retirement age or disability status…………	1,259	1,143	1,023	880	901
f. Current participants who have attained fully insured status but have not attained retirement age or disability status…………	6,481	5,934	5,023	4,205	4,178
g. Subtotal – accrued liability for current participants (line e. plus f. above)…………	7,740	7,077	6,046	5,085	5,079
h. Current participants who have yet not attained fully insured status …………	2,160	1,978	1,674	1,402	1,393
i. Subtotal – accrued benefit obligation (line g plus h) …………	9,900	9,055	7,720	6,487	6,472
Present Value of Future Benefits Attributable to Future Work in Covered Employment Payable to:					
j. All current participants (see lines e, f, and h above) …………	0	0	0	0	0
k. All future participants expected during the projection period (those less than 15 years old, plus those to be born over the projection period, plus immigrants during the periods) …………	2,484	2,386	1,934	1,638	1,613
l. Total present value of future benefits payable (lines i, j and k) …………	12,384	11,441	9,654	8,125	8,085
Excess of the present value of future benefit payments over future preimums					
m. Excess of the present value of future benefit payments over future premium (or premiums over benefits) …………	12,384	11,441	9,654	8,125	8,085

[78] Alpha characters for Medicare Parts B and D will start with "e" for the purposes of this pro forma illustration to show the linkage to paragraph 17 and its sub-paragraphs. Medicare Parts B and D are net present values where the "insurance premiums" to be paid in the future are subtracted from the present value of the future benefit payments. The NPV approach used for Parts B and D contrasts with the "gross" approach used for Medicare Part A and for Social Security because the inflows for the latter programs are compulsory taxes rather than premiums. The different approaches are explained further in the text.

Medicare Supplementary Medical Insurance, Part B	2005	2004	2003	2002	2001
Change in the PV attributable to past work in covered employment					
For fully insured current participants, ***the change*** *in the present value of estimated future payments during the reporting period attributable to:*					
n. Current participants becoming fully insured during the reporting period and fully insured current participants' increased benefits from work completed in covered employment. ………	219	316	271	32	234
o. Interest on the liability during the period due to the passage of time. ……………………………	219	317	271	33	234
p. Prior service cost attributable to changes in law or policy, if any. ………………………………	0	0	0	0	0
q. Actuarial losses or gains related to the liability as of the reporting date, if any. ………………	220	317	272	33	234
r. Net increase for the period (subtotal of lines n through q)………………………………………	658	950	814	98	702
s. The change in the present value of estimated future benefit payments ………………………..	149	132	122	107	98
t. Net change in the present value for the period (subtotal of line r minus s)...……………………	509	818	692	(9)	604
Change in the PV for not-fully-insured participants attributable to past work in covered employment					
For not-fully-insured current participants, the change in the present value of estimated future payments during the reporting period attributable to (the same information as required above lines n through r):					
u. The increased potential benefits attributable to work completed in covered employment. ……	40	72	57	6	55
v. Interest on the potential benefits during the period due to the passage of time. ………………	40	72	58	3	55
w. Prior service cost attributable to changes in law or policy, if any. ………………………………..	0	0	0	0	0
x. Actuarial losses or gains on the present value of potential benefits, if any. …………………….	41	72	58	0	55
y. Net of lines u through x for the period………………………………………………………….	121	216	173	6	165
Change attributable to future work					
All Participants during the Projection Period					
z. The change in the present value attributable to future work in covered employment during the period from changes in law or policy…………………………………………………………	306	761			
aa. The change in the present value of estimated future payments attributable to actuarial losses or gains related to benefits attributable to future work in covered employment. ………………	306	761			
bb. Total changes in net present value [line l above for the current reporting period less line l for the prior reporting period]……………………………………………… ……………………	612	1,522			

Medicare, Supplementary Medical Insurance, Part D
Statement of Social Insurance

Medicare Supplementary Medical Insurance, Part D	2005	2004	2003	2002	2001
Present Value of Future Benefits Attributable to Past Work in Covered Employment Payable to: [79]					
e. Current participants who have attained fully insured status and retirement age or disability status……	695	597			
f. Current participants who have attained fully insured status but have not attained retirement age or disability status……	4,592	4,282			
g. Subtotal – accrued liability for current participants (line e plus f above)……	5,287	4,879			
h. Current participants who have yet not attained fully insured status ……	1,531	1,427			
i. Subtotal – accrued benefit obligation (line g plus h)……	6,818	6,306			
Present Value of Future Benefits Attributable to Future Work in Covered Employment Payable to:					
j. All current participants (see lines e, f, and h above) ……	0	0			
k. All future participants expected during the projection period (those less than 15 years old, plus those to be born over the projection period, plus immigrants during the periods) ……	1,868	1,813			
l. Total present value of future benefits payable (lines i., j. and k.) ……	8,686	8,119			
Excess of the present value of future benefit payments over future payroll and income tax					
m. Excess of the present value of future benefit payments over future premiums (or premiums over benefits) ……	8,686	8,119			

[79] Alpha characters for Medicare Parts B and D will start with "e" for the purposes of this pro forma illustration to show the linkage to paragraph 17 and its sub-paragraphs. Medicare Parts B and D are net present values where the "insurance premiums" to be paid in the future are subtracted from the present value of the future benefit payments. The NPV approach used for Parts B and D contrasts with the "gross" approach used for Medicare Part A and for Social Security because the inflows for the latter programs are compulsory taxes rather than premiums. The different approaches are explained further in the text.

Medicare Supplementary Medical Insurance, Part D	2005	2004	2003	2002	2001
Change in the PV attributable to past work in covered employment					
For fully insured current participants, the change in the present value of estimated future payments during the reporting period attributable to:					
n. Current participants becoming fully insured during the reporting period and fully insured current participants' increased benefits from work completed in covered employment. ………	79	3,610			
o. Interest on the liability during the period due to the passage of time. ……………………………	79	0			
p. Prior service cost attributable to changes in law or policy, if any. ………………………………..	0	0			
q. Actuarial losses or gains related to the liability as of the reporting date, if any…………………	79	0			
r. Net cost for the period (subtotal of lines n through q)……………………………………………	237	3,610			
s. The change in the present value of estimated future payments attributable to benefit payments. [Benefit payments reduce the liability.] …………………………………………………	0	0			
t. Net change in the liability for the period (subtotal of line r minus s)…………. …………………	237	3,610			
Change in the PV for not-fully-insured participants attributable to past work in covered employment					
For not-fully-insured current participants, the change in the present value of estimated future payments during the reporting period attributable to (the same information as required above lines n. through r.):					
u. The increased potential benefits attributable to work completed in covered employment. ……	14	946			
v. Interest on the potential benefits during the period due to the passage of time. ………………	14	0			
w. Prior service cost attributable to changes in law or policy, if any. ………………………………..	0				
x. Actuarial losses or gains on the present value of potential benefits, if any. ……………………	15	0			
y. Net of lines u through x for the period…………………………………………………………..	43	946			
Change attributable to future work					
All Participants during the Projection Period					
z. The change in the present value attributable to future work in covered employment during the period from changes in law or policy…………………………………………………………	231	10,770			
aa. The change in the present value of estimated future payments attributable to actuarial losses or gains related to benefits attributable to future work in covered employment. ………………	232	0			
bb. Total changes in net present value [line l above for the current reporting period less line l for the prior reporting period]…………………………………………………………………………..	463	10,770			

Appendix B: Pro Forma Financial Statements and Entries

Note: Hypothetical numbers used for the examples were derived starting with the Social Security Administration's (SSA) FY 2005 financial statements for the Old-Age, Survivors, and Disability Insurance (OASDI or "Social Security") program.

Next, the liability and expense amounts were taken from lines m and r of the SOSI illustration immediately above.

The opening balance of Net Position was "backed into" based on the other amounts used.

Pro Forma *Statement of Net Cost*

	2,005 (millions)
Social Security Program	
Accrued Cost of Social Insurance:	
Service Cost	$520,000
Interest on the Obligation	520,000
Social Security Operating Expenses	4,758
Expenses of Other SSA Programs	39,380
Total Operating Cost	1,084,138
Less: Exchange Revenues	339
Net Operating Cost, Social Insurance Program	1,084,477
Cost not allocated to programs: Actuarial Losses	521,000
Net cost	$1,605,,477

Pro Forma *Statement of Changes in Net Position*

	2,005 Cumulative Results of Operations (millions)	2,005 Unexpended Appropriations (millions)
Net Position, Beginning Balance	($11,681,215)	$705
Budgetary Financing Sources		
Appropriations Received		52,536
Appropriations Used	51,752	(51,752)
Tax Revenue	559,661	
Interest Revenue	87,616	
Transfers-In/Out, Net	(16,006)	
Other Budgetary Financing	85	
Other Financing Sources:		
Transfers-In/Out	5	
Imputed Financing Sources	452	
Total Financing Sources	683,565	784
Net Cost	(1,605,477)	
Ending Balances	($12,603,127)	$1,489

Pro Forma *Balance Sheet*

	2,005 (millions)
Assets	
Intragovernmental:	
Fund Balance with Treasury	5,370
Investments	1,809,422
Interest Receivable	23,472
Accounts Receivable	307
Total Intragovernmental	1,838,571
Accounts Receivable, Net	6,982
Property, Plant and Equipment, Net	1,419
Other	9
Total Assets	1,846,981
Liabilities	
Intragovernmental:	
Accrued Railroad Retirement	3,642
Accounts Payable	8,309
Other	108
Total Intragovernmental	12,059
Benefits Due and Payable	61,272
Accounts Payable	394
Accrued Social Insurance Responsibility	14,374,000
Other	894
Total Liabilities	14,387,347
Net Position	
Unexpended Appropriations	1,489
Cumulative Results of Operations	(12,603,127)
Total Net Position	(12,601,638)
Total Liabilities and Net Position	$1,846,981

Appendix C: Alternative View - Pro Forma Financial Statements

The following table contains a pro forma illustration of the statement of social insurance (SOSI). This illustration is consistent with current standards.

United States Government

Statements of Social Insurance

Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2005	2004	2003	2002	2001
Federal Old-Age, Survivors and Disability Insurance (Social Security):					
Contributions and Earmarked Taxes from:					
Participants who have attained age 62	464	411	359	348	309
Participants ages 15-61	15,290	14,388	13,576	13,048	12,349
Future participants (under age 15 and births during period)	13,696	12,900	12,213	11,893	11,035
All current and future participants	29,450	27,699	26,147	25,289	23,693
Expenditures for Scheduled Future Benefits for:					
Participants who have attained age 62	5,395	4,933	4,662	4,402	4,255
Participants ages 15-61	23,942	22,418	21,015	20,210	18,944
Future participants (under age 15 and births during period)	5,816	5,578	5,398	5,240	4,700
All current and future participants	35,154	32,928	31,075	29,851	27,899
Present value of future expenditures less future revenue	5,704[1]	5,229[2]	4,927[3]	4,562[4]	4,207[5]
Federal Hospital Insurance (Medicare Part A):					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility age	162	148	128	125	113
Participants who have not attained eligibility age	5,064	4,820	4,510	4,408	4,136
Future participants	4,209	4,009	3,773	3,753	3,507
All current and future participants	9,435	8,976	8,411	8,286	7,757
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	2,179	2,168	1,897	1,747	1,693
Participants who have not attained eligibility age	12,668	12,054	10,028	9,195	8,568
Future participants	3,417	3,246	2,653	2,470	2,225
All current and future participants	18,264	17,468	14,577	13,412	12,487
Present value of future expenditures less future revenue	8,829[1]	8,492[2]	6,166[3]	5,126[4]	4,730[5]

Federal Supplementary Medical Insurance (Medicare Part B):					
Premiums:					
Participants who have attained eligibility age	363	332	283	252	258
Participants who have not attained eligibility age	2,900	2,665	2,148	1,856	1,845
Future participants	924	891	688	600	593
All current and future participants	4,187	3,889	3,119	2,708	2,696
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	1,622	1,475	1,306	1,132	1,159
Participants who have not attained eligibility age	11,541	10,577	8,845	7,463	7,415
Future participants	3,408	3,277	2,622	2,238	2,206
All current and future participants	16,571	15,329	12,773	10,833	10,780
Present value of future expenditures less future revenue[6]	12,384[1]	11,440[2]	9,653[3]	8,125[4]	8,084[5]
Federal Supplementary Medical Insurance (Medicare Part D):					
Premiums and State Transfers:					
Participants who have attained eligibility age	185	176			
Participants who have not attained eligibility age	1,790	1,857			
Future participants	572	618			
All current and future participants	2,547	2,651			
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	880	773			
Participants who have not attained eligibility age	7,913	7,566			
Future participants	2,440	2,431			
All current and future participants	11,233	10,770			
Present value of future expenditures less future revenue[6]	8,686[1]	8,119[2]			

	2005	2004	2003	2002	2001
Railroad Retirement:					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility	4	4	4	3	3
Participants who have not attained eligibility	37	37	40	40	41
Future participants	41	39	41	41	41
All current and future participants	82	80	85	83	84
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	84	81	80	74	73
Participants who have not attained eligibility	73	72	73	76	74
Future participants	16	14	14	13	13
All current and future participants	173	167	167	162	161
Present value of future expenditures less future revenues[7]	91[1]	87[2]	83[3]	79[4]	77[5]
Black Lung (Part C) *present value of future expenditures less future revenue*[8]	(5)[9]	(4)[10]	(4)[11]	(5)[12]	(4)[13]

[1] The projection period is 1/1/2005 - 12/31/2079 and the valuation date is 1/1/2005.
[2] The projection period is 1/1/2004 - 12/31/2078 and the valuation date is 1/1/2004.
[3] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[4] The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
[5] The projection period is 1/1/2001 - 12/31/2075 and the valuation date is 1/1/2001.
[6] These amounts represent the present value of the transfers from the General Fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These intragovernmental transfers are included as income in the Centers for Medicare & Medicaid Services' (CMS) Financial Report but are not income from the Governmentwide perspective of this report.
[7] These amounts approximate the present value of the financial interchange and transfers from the General Fund of the Treasury to the Social Security Equivalent Benefit (SSEB) Account (see later discussion of Railroad Retirement Program). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] Does not include interest expense accruing on the outstanding debt.
[9] The projection period is 9/30/2005 - 9/30/2040 and the valuation date is 6/30/2005.
[10] The projection period is 9/30/2004 - 9/30/2040 and the valuation date is 6/30/2004.
[11] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 6/30/2003.
[12] The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 6/30/2002.
[13] The projection period is 9/30/2001 - 9/30/2040 and the valuation date is 6/30/2001.

Note: Details may not add to totals due to rounding.

The following notes are an integral part of this statement.

Appendix C: Alternative View - Pro Forma Financial Statements

The following table contains a pro forma illustration of a statement of changes in social insurance. As appropriate, the information could be combined with the statement of social insurance.

Illustrative Statement of Changes in Social Insurance
For the Year Ended September 30,
20XX
(in billions of dollars)

	Social Insurance				
	Social Security	Medicare HI	Medicare SMI	Other (e.g.,Railroad Retirement)	Total
Social Insurance, Beginning of Year	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
Changes in Valuation Period	XXX	XXX	XXX	XXX	XXX
Changes in Demographic Data and Assumptions	XXX	XXX	XXX	XXX	XXX
Changes in Economic Data and Assumptions	XXX	XXX	XXX	XXX	XXX
Legislative Changes	XXX	XXX	XXX	XXX	XXX
Methodological Changes	XXX	XXX	XXX	XXX	XXX
Changes in Medicare Provider Assumptions		XXX	XXX		XXX
Other changes	XXX	XXX	XXX	XXX	XXX
Net Change in Social Insurance	XXX	XXX	XXX	XXX	XXX
Social Insurance, End of Year	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX

Note: Beginning of year and end of year amounts would agree to the Statement of Social Insurance

Appendix C: Alternative View - Pro Forma Financial Statements

The following table contains a pro forma illustration of a statement of fiscal sustainability. Paragraphs 75/–76 describe the statement and provide additional disclosure requirements, including key measures of fiscal sustainability and intergenerational equity, projected annual cash flows, and changes in fiscal sustainability during the reporting period.

Statement of Fiscal Sustainability
as of January 1, 20XX

	75-Years		Infinite Horizon	
	PV Dollars	**%GDP**	**PV Dollars**	**%GDP**
Social Security				
Scheduled Benefits	$ XX.X	X.X%	$ XX.X	X.X%
Earmarked Revenue	$ XX.X	X.X%	$ XX.X	X.X%
Net	$ XX.X	X.X%	$ XX.X	X.X%
Medicare				
Part A				
Scheduled Benefits	$ XX.X	X.X%	$ XX.X	X.X%
Earmarked Revenue	$ XX.X	X.X%	$ XX.X	X.X%
Net	$ XX.X	X.X%	$ XX.X	X.X%
Parts B and D				
Scheduled Benefits	$ XX.X	X.X%	$ XX.X	X.X%
Earmarked Revenue	$ XX.X	X.X%	$ XX.X	X.X%
Net	$ XX.X	X.X%	$ XX.X	X.X%
Total Social Security and Medicare	$ XX.X	X.X%	$ XX.X	X.X%
Rest of Government				
Other Future Outlays	$ XX.X	X.X%	$ XX.X	X.X%
Earned Revenue	$ XX.X	X.X%	$ XX.X	X.X%
Net Outlays	$ XX.X	X.X%	$ XX.X	X.X%
Other Revenues	$ XX.X	X.X%	$ XX.X	X.X%
Revenues less Outlays	$ XX.X	X.X%	$ XX.X	X.X%
Total Government (Social Security, Medicare, and Rest of Government)				
Outlays in Excess of Revenues	$ XX.X	X.X%	$ XX.X	X.X%
Debt Held by Public	$ XX.X	X.X%	$ XX.X	X.X%
Fiscal Imbalance	$ XX.X	X.X%	$ XX.X	X.X%

Other Sustainability Measures

Total Government Fiscal Gap	$	XX.X	X.X%	$	XX.X	X.X%
Summary of Net Outlays						
Social Security	$	XX.X	X.X%	$	XX.X	X.X%
Medicare Part A	$	XX.X	X.X%	$	XX.X	X.X%
Medicare Part B and D	$	XX.X	X.X%	$	XX.X	X.X%
All Other	$	XX.X	X.X%	$	XX.X	X.X%
Total	$	XX.X	X.X%	$	XX.X	X.X%
Summary of Revenues						
Social Security	$	XX.X	X.X%	$	XX.X	X.X%
Medicare Part A	$	XX.X	X.X%	$	XX.X	X.X%
Medicare Part B and D	$	XX.X	X.X%	$	XX.X	X.X%
All Other	$	XX.X	X.X%	$	XX.X	X.X%
Total	$	XX.X	X.X%	$	XX.X	X.X%
Fiscal Imbalance per:						
Citizen	$	XX.X		$	XX.X	
Full-time Worker	$	XX.X		$	XX.X	
Household	$	XX.X		$	XX.X	

Net Outlays by Cohort

Social Security				
Current Beneficiaries	$ XX.X	X.X%	$ XX.X	X.X%
Other Current participants	$ XX.X	X.X%	$ XX.X	X.X%
Future Participants	$ XX.X	X.X%	$ XX.X	X.X%
Medicare				
Part A				
Current Beneficiaries	$ XX.X	X.X%	$ XX.X	X.X%
Other Current participants	$ XX.X	X.X%	$ XX.X	X.X%
Future Participants	$ XX.X	X.X%	$ XX.X	X.X%
Parts B and D				
Current Beneficiaries	$ XX.X	X.X%	$ XX.X	X.X%
Other Current participants	$ XX.X	X.X%	$ XX.X	X.X%
Future Participants	$ XX.X	X.X%	$ XX.X	X.X%
Total Social Security and Medicare	$ XX.X	X.X%	$ XX.X	X.X%

Appendix D: Fact Sheets on Social Insurance Programs

Social Security Facts

Coverage

About 156 million persons will work in Old-Age, Survivors, and Disability Insurance-(OASDI)-covered employment or self-employment in 2004. About 96 out of 100 workers in paid employment and self-employment are covered or eligible for coverage under the program.[80]

Eligibility for benefits under OASDI requires some minimal level of work in OASDI-covered employment. This requirement is satisfied by a worker's accumulation of quarters of coverage (QCs). One QC is credited for each calendar quarter in which, for 2004, at least $900 was earned. This dollar threshold is periodically adjusted.[81] Once a worker accumulates 40 QCs s/he becomes "permanently eligible."

Benefit receipt among the elderly

As of December 31, 2003, about 91 percent of the population aged 65 and over were receiving benefits.[82] The monthly benefit amount to which an individuals (or spouses and children) may become entitled under OASDI is based on individuals' taxable earnings during their lifetime. The maximum amount of earnings on which contributions were payable was $84,900 in 2002, $87,000 in 2003, and $87,900 in 2004.

OASDI old-age benefits are based on earnings averaged over most of a worker's lifetime. The OASDI managers apply a formula to these earnings to arrive at the worker's basic benefit, which is the amount the worker would receive at the worker's full retirement age, which, for most people, is age 65. However, beginning with people born in 1938 or later, that age will gradually increase until it reaches 67 for people born after 1959.

Although OASDI is not "means-tested", the level of pre-retirement (career-average) earnings replaced by OASDI benefits for a worker retiring at age 65 varies because the benefit formula is weighted in favor of workers with low levels of earnings. The chart below shows the replacement rate in 2003 for individuals and couples (i.e., worker with a spouse who is not insured) at various earnings levels. These levels represent average earnings over the worker's career, wage-indexed to 2002.

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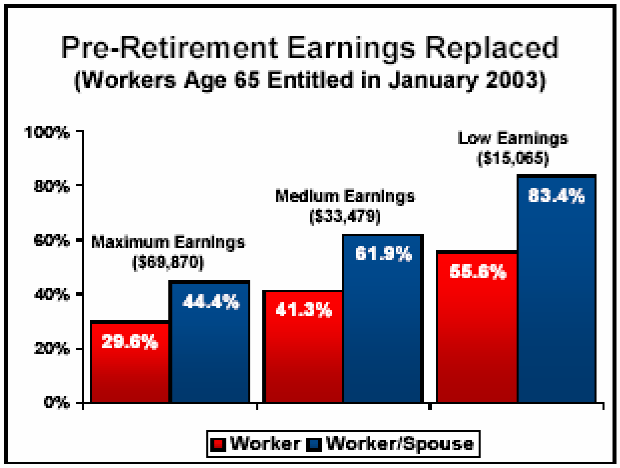
[80] Social Security Administration's (SSA) Fact Sheet on the OASDI Program, January 2004, see http://www.ssa.gov/OACT/FACTS/factsheet.html.

[81] The *2004 Annual Report of The Board of Trustees of The Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* ("2004 OASDI Report"), March 24, 2004, p. 105-6. The 2004 OASDI Report can be found at http://www.ssa.gov/OACT/TR/index.html. Also see SSA's FY 2003 Performance and Accountability Report at http://www.ssa.gov/finance.

[82] SSA's Fact Sheet on the OASDI Program, January 2004.



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Protection for survivors of young workers

When a person who has worked and paid Social Security taxes dies, certain members of the family may be eligible for survivors benefits. Up to ten years of work is needed to be eligible for benefits, depending on the person's age at the time of death.

Social Security survivors' benefits can be paid to:

- A widow/widower -- full benefits at full retirement age (currently age 65), or reduced benefits as early as age 60
- A disabled widow/widower -- as early as age 50
- Widows/widowers at any age if they take care of the deceased's child who is under age 16 or disabled, and receiving Social Security benefits
- Unmarried children under 18, or up to age 19 if they are attending high school full time.
- Children at any age who were disabled before age 22 and remain disabled.
- Dependent parents age 62 or older

About 97 percent of persons aged 20-49 who worked in covered employment in 2003 have acquired survivorship protection for their children under age 18 (and surviving spouses caring for children under age 16).[84]

The amount of the survivors benefit is based on the earnings of the person who died. The more they paid into OASDI, the higher the benefits will be. The amount a survivor

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[83] SSA's Performance and Accountability Report for Fiscal Year (FY) 2003, Overview, see http://www.ssa.gov/finance/. The $68,870 "maximum earnings" represents career average earnings rather than the ceiling of OASDI contributions of $87,000 for 2003.
[84] SSA's Fact Sheet on the OASDI Program, January 2004.

receives is a percentage of the deceased's basic OASDI benefit, e.g., widows or widowers at full retirement age or older would get 100 percent, widows or widowers age 60 to 64 would get 94 percent, widows or widowers at any age with a child under age 16 would get 75 percent, etc.

Disability protection

Disability benefits are payable to workers if they suffer a severe and prolonged disability, and to disabled worker's widow(er) or adults disabled since childhood, who are otherwise eligible.

The OASDI definition of disability is a strict one. To be eligible for disability benefits, a person must be unable to do any kind of substantial gainful work because of a physical or mental impairment (or a combination of impairments), which has lasted or is expected to last for a continuous period of at least 12 months, or that is expected to result in death.

Beneficiaries continue to receive disability benefits as long as they continue to be disabled and otherwise meet work or other eligibility requirements. The case is reviewed periodically to see if there has been any improvement in their condition. If they are still eligible when full retirement age is reached, disability benefits automatically convert to retirement benefits.

The monthly disability benefit payment is based on the OASDI earnings record of the insured worker.

About 90 percent of persons aged 21-64 who worked in covered employment in 2003 were eligible for monthly cash benefits,[85] and spouses or children were eligible for auxiliary benefits in the event of disability.[86] About 7.5 million people received disability benefits in 2003.

[The Social Security Administration also administers the Supplementary Security Income (SSI) program. The SSI is a Federal income supplement program funded by general tax revenues (not OASDI taxes). SSI pays monthly benefits to people who are age 65 or older, or blind or have a disability and who do not own much or have a lot of income. SSI monthly benefits can go to disabled and blind children, as well as adults. People who get SSI can usually get food stamps and Medicaid, too. How much beneficiaries get depends on where they live. The basic SSI amount is the same nationwide. However, many states add money to the basic benefit.]

Financing

In 2003, contributions accounted for 84 percent of total OASDI income. Contributions consist of taxes paid by employees, employers and the self-employed on earnings covered by OASDI. These taxes were paid on covered earnings up to a specified

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[85] SSA's Fact Sheet on the OASDI Program, January 2004.

[86] The 2003 Annual Report of The Board of Trustees of The Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds ("2003 OASDI Report"), pages 110-1.

maximum annual amount, which was $87,900 in 2004 and is increased each year automatically as the average wage increases.

Table II.B1.—Summary of 2003 Trust Fund Financial Operations

	Amounts (in billions)		
	OASI	DI	OASDI
Assets at the end of 2002	$1,217.5	$160.5	$1,378.0
Total income in 2003	543.8	88.1	631.9
Net contributions	456.1	77.4	533.5
Taxation of benefits	12.5	.9	13.4
Interest	75.2	9.7	84.9
Total expenditures in 2003	406.0	73.1	479.1
Benefit payments	399.8	70.9	470.8
Railroad Retirement financial interchange	3.6	.2	3.7
Administrative expenses	2.6	2.0	4.6
Net increase in assets in 2003	137.8	15.0	152.8
Assets at the end of 2003	1,355.3	175.4	1,530.8

Note: Totals do not necessarily equal the sums of rounded components.

Two percent of OASDI income came from subjecting up to 50 percent of OASDI benefits above a certain level to Federal personal income taxation, and 13 percent of OASDI income came from interest earned on investment of OASDI reserves.

More than 98 percent of expenditures from OASDI in 2003 went to pay retirement, survivor, and disability benefits totaling $470.8 billion. The financial interchange with the Railroad Retirement program resulted in a payment of $3.7 billion from OASDI, or about 0.8 percent of total expenditures.[87] The administrative expenses of the OASDI program were $4.6 billion, or about 1.0 percent of total expenditures.

Selected Social Security Terminology

Average Indexed Monthly Earnings

The dollar amount used to calculate workers' Social Security benefits if they attained age 62 or became disabled (or died) after 1978. To arrive at average indexed monthly earnings (AIME), the Social Security Administration (SSA) adjusts the worker's actual past earnings using an "average wage index." If they attained age 62 or became disabled (or died) before 1978, SSA uses Average Monthly Earnings (AME). A certain number of years of earnings are needed to compute the average indexed monthly earnings. After SSA determines the *number* of years, SSA chooses those years with the highest indexed earnings, sums such indexed earnings, and divides the total amount by the total number of months in those years to derive the *average indexed monthly earnings.*

[87] The Railroad Retirement Act requires an annual financial interchange between the Railroad Retirement and OASDI programs. The purpose of the interchange is to put OASDI in the same financial position it would have been had railroad employment always been covered by OASDI.

Workers become eligible for retirement benefits when they attain age 62. For example, a worker reaches age 65 in 2005 and therefore becomes eligible that year, SSA would divide the national average wage index for 2003 ($34,064.95) by the national average wage index for each year prior to 2003 in which the worker had earnings and multiply each such ratio by the worker's earnings. This would give the indexed earnings for each year prior to 2003. The year 2003 is significant because it is the year in which the worker reaches 60 years of age, which is the base year for the index, i.e., it equal "1." SSA considers any earnings in or after 2003 at face value, without indexing. Then SSA computes the average indexed monthly earnings.

[The above is from *Actuarial Note: Unfunded Obligation and Transition Cost for OASDI*. SSA Web site]

Benefit Formula, Social Security

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

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

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

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

Disability Insured

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

Participants can get disability benefits if they:

- Are under full retirement age
- Have enough Social Security credits and

- Have a severe medical impairment (physical or mental) that's expected to prevent them from doing "substantial" work for a year or more, or have a condition that is expected to result in death.

Disability Benefits, Social Security

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

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

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

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

Whatever their age, claimants must have earned the required number of work credits within a certain period ending with the time they became disabled. The participants' Social Security statement shows whether they meet the work requirement at the time it was prepared. If participants stop working under Social Security after the date of the Statement, they may not continue to meet the disability work requirement in the future.
[SSA Web site]

Primary Insurance Amounts

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

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

Survivor Benefits, Social Security

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

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

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

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

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

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

Taxes, Income on Social Security Benefits

Some people who get Social Security benefits have to pay income taxes on them. This applies to beneficiaries with other substantial income in addition to Social Security benefits (for example, wages, self-employment, interest, dividends and other taxable income reported on the tax return). No one pays taxes on more than 85 percent of their Social Security benefits and some pay on a smaller amount, based on these IRS rules:

- ✓ If beneficiaries file a federal tax return as "individuals" and have combined income* between $25,000 and $34,000, they may have to pay income tax on 50 percent of Social

Security benefits. If their combined income is above $34,000, up to 85 percent of Social Security benefits is subject to income tax.

- ✓ If a joint return is filed, beneficiaries may have to pay taxes on 50 percent of their benefits if they and spouses have a combined income* that is between $32,000 and $44,000. If the combined income is more than $44,000, up to 85 percent of Social Security benefits is subject to income tax.

Medicare Facts

Introduction

Medicare was established in 1965 as a federal social insurance program because the private health care market failed to provide adequate, affordable, health insurance to much of America's elderly population. In 1965, Congress recognized that few older people in the United States were free of the fear that expensive health services could do away with any and all of their savings. The Medicare program was enacted to provide health insurance for people 65 years of age and older. This protection was expanded to people receiving Social Security Disability Insurance and people with serious kidney disease in 1972[88].

The Centers for Medicare & Medicaid Services (CMS) administers the Medicare program, and works in partnership with the States to administer Medicaid, State Children's Health Insurance Program (SCHIP), and health insurance probability standards. Through Medicare, Medicaid and SCHIOP about one in four Americans receive health care coverage. Over 75 million people are covered by at least one of these programs; they spend about one in three of the nation's health care dollars.

With the passing of the Medicare Prescription Drug, Improvement and Modernization Act in December 2003, Medicare will undergo many changes in the upcoming years. The 2003 legislation authorized the biggest expansion in coverage since the program was created in 1965. For the first time, Medicare beneficiaries will have prescription drug coverage for drugs they consume at home. This is a major policy change since drugs have become an increasingly important component in modern health care[89].

Medicare Characteristics

Enacted by the Social Security Act Amendments of 1965, Medicare is the nation's largest health insurance program, covering nearly 40 million Americans (approx. 14% of pop.) at an annual cost of just under $300 billion. Medicare provides health insurance to:

- People age 65 or older;
- Some people with disabilities under age 65; and
- People with permanent kidney failure requiring dialysis or a transplant.

Medicare has 3 components: Hospital Insurance (Part A), Medical Insurance (Part B) and the new Prescription Drug Benefit (Part D)[90].

- Medicare Part A helps pay for inpatient hospital services, skilled nursing facility

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[88] National Academy of Social Insurance, *Medicare and the American Social Contract – Final Report of the Study Panel on Medicare's Larger Social Role* (Washington, DC: National Academy of Social Insurance, February 1999)

[89] National Academy of Social Insurance, *Social Insurance Sourcebook,* website material, http://www.nasi.org/publications3901/publications.htm, Washington, DC.

[90] Medicare Part C, which provides Part A and Part B coverage and, optionally Part D coverage, through private managed care plans; also called Medicare Advantage

services, home health services, and hospice care.

- Medicare Part B helps pay for doctor services, outpatient hospital services, medical equipment and supplies, and other health services and supplies.
- Medicare Part D (begins 01/01/2006) provides coverage on prescription drugs. For 2004 and 2005 there is discount card and Transitional Assistance worth up to $600/beneficiary.

Table I.C1.—Medicare Data for Calendar Year 2003

	HI	SMI	Total
Assets at end of 2002 (billions)	$234.8	$34.3	$269.1
Total income	$175.8	$115.8	$291.6
Payroll taxes	149.2	—	149.2
Interest	15.0	2.0	17.0
Taxation of benefits	8.3	—	8.3
Premiums	1.6	27.4	29.0
General revenue	0.5	86.4	86.9
Other	1.1	0.0	1.1
Total expenditures	$154.6	$126.1	$280.8
Benefits	152.1	123.8	275.9
Hospital	109.4	17.9	127.3
Skilled nursing facility	14.3	—	14.3
Home health care	2.6	7.1	9.7
Physician fee schedule services	—	48.3	48.3
Managed care	19.5	17.2	36.8
Other	6.3	33.3	39.6
Administrative expenses	$2.5	$2.3	$4.9
Net change in assets	$21.2	–$10.3	$10.8
Assets at end of 2003	$256.0	$24.0	$280.0
Enrollment (millions)			
Aged	34.6	33.1	35.0
Disabled	6.0	5.3	6.0
Total	40.6	38.5	41.0
Average benefit per enrollee	$3,747	$3,219	$6,966

Note: Totals do not necessarily equal the sums of rounded components. [91]

The traditional Medicare plan is fee for service, available everywhere in the United States. Beneficiaries are free to go to any doctor, specialist, or hospital that accepts Medicare and most providers participate in the Medicare program.

People who qualify for Medicare may have choices beyond the traditional Medicare plan. Some people may have Medicare Managed Care Plans or Private Fee-for-Service Plans (Part C) available in their area. These options are health plans offered by private insurance companies. Medicare pays a set amount of money every month to the private healthcare provider administering the plan. In turn, that organization manages the Medicare coverage for its members.

The Medicare Program

What is Medicare Part A? Medicare Part A (Medicare Hospital Insurance or Medicare HI) helps cover inpatient care in hospitals, including critical access hospitals, and skilled nursing facilities (not custodial or long-term care). It also helps cover hospice care and some home health care. Cost: Most people don't have to pay a monthly payment, called a premium, for Part A. This is because they or a spouse worked in covered employment

[91] Medicare Board of Trustees, 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, Washington, DC, March 23, 2004, page 3.

and paid Medicare taxes. If an individual did not work in covered employment and pay Medicare taxes a sufficient amount of time, they may still be able to buy Part A coverage.

What is Medicare Part B? Medicare Part B (Supplementary Medical Insurance or Medicare SMI) helps cover doctors' services and outpatient hospital care. It also covers some other medical services that Part A doesn't cover, such as some of the services of physical and occupational therapists, and some home health care. Part B helps pay for these covered services and supplies when they are medically necessary. Cost: Unlike Part A, recipients must pay the Medicare Part B premium each month ($66.60 in 2004) – see below for more on the premium structure. New premium rates become effective every year in January. If the participant receives Social Security benefits, RRB benefits, or OPM retirement benefits the premium is taken out of those monthly payments[92]. Medicare Part B is a voluntary program, for which you must enroll in at the time you are eligible.

What is Medicare Advantage? Medicare Advantage, or Part C as it is sometimes referred to, is the new name for Medicare+Choice. This is Medicare's managed care option. Under this plan, private health care providers agree to provide Medicare-covered services to enrollees in return for fixed rate of payment from Medicare for each enrollee (a "capitation rate"). Medicare law establishes how the capitation rate is established for each Medicare enrollee who chooses to join a Medicare managed care plan, based on a variety of factors including Medicare costs in area, beneficiary age and sex, and whether the beneficiary is institutionalized. Currently, almost all Medicare health plans paid under capitation arrangements offer some benefits beyond those covered under standard Medicare fee-for-service plans.

A substantial increase in Medicare Advantage plans is projected for 2006 as the provisions of the *Medicare Prescription Drug, Improvement and Modernization Act* give higher payments to Medicare Advantage plans. The higher payments provide incentives for expansion of coverage areas and for the provision of additional benefits to plan enrollees. In addition, preferred provider plan demonstrations are being conducted from 2003 through 2005 that will increase total managed care enrollment for those years[93].

What is Medicare Part D? This is the new Prescription Drug Plan included in the *Medicare Prescription Drug, Improvement and Modernization Act of 2003* (Public Law 108-173). Beginning January 1, 2006, all Medicare beneficiaries (those entitled to Part A and/or enrolled in Part B) are eligible for subsidized prescription drug coverage under Part D. Beneficiaries may access the subsidized coverage by enrolling in either a stand-alone prescription drug plan (PDP) or an integrated Medicare Advantage plan that offers Part D coverage alongside the Medicare medical benefit. Since the new plan does not become effective until 2006, in the transitional period Medicare recipients will be provided discount cards as well as a $600 credit for lower income individuals to use on

[92] Recipients may be able to receive assistance from their states to pay for both Part A or Part B.
[93] Medicare Board of Trustees, 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, Washington, DC, March 23, 2004, page 133.

prescription drugs purchases. The new Part D coverage for 2006 is[94]:

- A $250 Deductible
- 25% co-insurance coverage for expenses $250 - $2,250
- Beneficiary is responsible for all costs until $3,600 out-of-pocket limit is reached
- Catastrophic coverage: pay higher of 5% Co-insurance or a minimal co-payment

Beneficiaries with low incomes and modest assets will be eligible for subsidies that eliminate or reduce their Part D premiums and cost sharing. Following are some of the rules that apply:

- For dual eligible[95] beneficiaries whose income does not exceed 100% of the Federal poverty level (FPL), there is no premium or deductible, and co-payments are reduced to $1 for generic drugs and $3 for all other drugs. There is also no cost sharing in the catastrophic coverage.
- For dual eligible beneficiaries whose incomes does not exceed 135% FPL, and whose assets are less than three times the SSI limit[96], there is no premium or deductible, co-payments are $2 for generic drugs and $5 for any other drugs. There is also no cost sharing in the catastrophic coverage.
- For beneficiaries not in the above categories, whose incomes are below 150% FPL and who have less than $10,000 in assets ($20,000 for a couple), the premium is reduced on a linear sliding scale (down to $0 at or below 135% FPL); the deductible is reduced to $50; the co-insurance is reduced to 15%. After reaching the catastrophic coverage, co-payments are $2 for generic drugs and $5 for any other drugs.

Eligibility Requirements

In general, you are eligible for Medicare HI if you or your spouse worked at least 40 quarters in Medicare-covered employment and you are 65 years old and a citizen or permanent resident of the United States. You might also qualify for coverage if you are a younger person with a disability or with End-Stage Renal Disease.

Here are some simple guidelines. You can receive Medicare HI at age 65 without paying premiums if:

- You are already receiving retirement benefits from Social Security or the RRB
- You are eligible to receive Social Security or RRB benefits but have not yet filed for them
- You or your spouse had Medicare-covered government employment

If you are under 65, you can get Part A without having to pay premiums if:

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94 Medicare Board of Trustees, 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, Washington, DC, March 23, 2004, page 144.
95 Beneficiaries eligible for both Medicare (Part A and/or B) and Medicaid
96 SSI limits assets to $2,000 for individuals and $3,000 for couples.

- You have received Social Security or RRB disability benefits for 24 months
- You are a kidney dialysis or kidney transplant patient

While you do not have to pay a premium for Medicare HI if you meet any of the above conditions, you must pay for Medicare SMI if you want it. The Medicare SMI monthly in 2004 is $66.00.

What if I have not worked the required 40 quarters in covered employment? Although most Medicare beneficiaries do not pay a premium for Medicare HI services, there are instances where individuals who have not yet met all requirements for Medicare may obtain coverage. Seniors and certain persons under 65 with disabilities who have fewer than 30 quarters of coverage may obtain Part A by paying a monthly premium set according to a formula in the Medicare statute, for 2004 the monthly premium was $343. In addition, seniors with 30-39 quarters of coverage, and certain disabled persons with 30 or more quarters of coverage, are entitled to pay a reduced premium, for 2004 it was $189.[97]

How is Medicare Financed?[98]

Medicare is the biggest health program in the United States: it covers 35.1 million persons over the age of 65, and 5.5 million disabled persons.

Payroll Taxes and Premiums. The HI component of Medicare is financed by a tax levied on all wage and salary income. The tax is 1.45% each for the employee and the employer.

Example: Jo Waller makes $50,000 a year would pay $725 a year. Her employer also would pay $725.

The wage base for Social Security in 2004 is $87,900, the maximum amount on which taxes can be levied. But there is no maximum wage base for Medicare taxes. An individual making $1,000,000 a year would pay a Medicare payroll tax of $14,500, and his employer would pay an equal amount. Self-employed persons pay 2.9% of earnings.

For Medicare SMI, Medicare beneficiaries pay a premium of $66.60 a month in 2003 for their Part B coverage. This can be deducted from the beneficiary's monthly Social Security benefit check. These premiums pay for about 25% of the cost of Part B spending; the rest comes from general tax revenues.

With the passing of the Medicare Modernization Act of 2003, the Part B premium will be increased, beginning in 2007, for beneficiaries meeting certain thresholds. Beneficiaries

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[97] U.S. Department of Health and Human Services, *HHS Announces Premium and Deductible Rates for 2004,* website material, http://www.hhs.gov/news/press/2003.html, October 16, 2003.

[98] National Academy of Social Insurance, *Social Insurance Sourcebook,* website material, http://www.nasi.org/publications3901/publications.htm, Washington, DC.

with modified adjusted gross incomes under $80,000 will continue to pay premiums that are 25% of twice the actuarial rate (no change from current premium). For beneficiaries with incomes between $80,000 and $100,000, the applicable percentage is 35%; for those with incomes between $100,000 and $150,000, the percentage is 50%; for incomes between 150,000 and $200,000, the percentage is 65%; and for incomes above $200,000, the percentage is 80%. For married couple the income thresholds are doubled. These thresholds are to be updated each calendar year by the CPI.[99] There is a 5-year adjustment period for this provision, that is, the amount of premium above the 25% of twice the actuarial rate is phased in – at 20, 40, 60, 80, and 100 percent for 2007 to 2011 and later, respectively.

If the differential premiums were in effect in 2004, according to estimates by Commerce Clearing House, a beneficiary with an income of $80,000 a year would pay $82.18 a month for the Part B premium. The maximum, for someone earning over $200,000 a year, would be $187.84 a month. The provision will affect a very small number of Medicare beneficiaries—less than 5% of the Medicare population has an income of $70,000 a year or more, according to the Centers for Medicare and Medicaid Services (CMS).

The new Part D drug benefits will also be financed by a new beneficiary premium. The premium represents 25.5% of the cost of basic coverage on average. For prescription drug plans (PDPs) and the drug portion Medicare Advantage (MA) plans, the premium will be determined by bids. Taken together, all PDP bids and MA drug bids will form a national weighted average (weighted by plan enrollment). Each plan's premium will be 25.5% of the national weighted average plus or minus the difference between the plan's bid and the average. The remaining 74.5% represents a federal subsidy.

A new Medicare Prescription Drug Account within the Medicare SMI trust fund will be established to fund Part D. Amounts in this account will be kept separate from other funds in Part B and do not affect the computation of the Part B premium. The account will generally consist of periodically appropriated general revenues, premiums from Part D enrollees, State contributions to Medicare drug costs, interest, and any leftover balance from temporary drug discount card's Transitional Assistance Account.

[99] Medicare Board of Trustees, 2004 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, Washington, DC, March 23, 2004, page 152.

Railroad Retirement Fact Sheet

The Railroad Retirement Board (RRB) is an independent agency in the executive branch of the Federal Government. The RRB's primary function is to administer comprehensive retirement-survivor and unemployment-sickness benefit programs for the nation's railroad workers and their families, under the Railroad Retirement and Railroad Unemployment Insurance Acts. In connection with the retirement program, the RRB has administrative responsibilities under the Social Security Act for certain benefit payments and railroad workers' Medicare coverage.

During fiscal year 2004, retirement-survivor benefits of some $9.0 billion were paid to about 649,000 beneficiaries, while net unemployment-sickness benefits of $83 million were paid to some 32,000 claimants. At the end of fiscal year 2004, the average annuity paid to retired rail employees was about $1,680 a month, spouse benefits averaged $620 a month, and benefits for aged widow(er)s averaged $1,030 a month. The maximum biweekly rate for unemployment and sickness benefits was $560.

Development of the Railroad Retirement and Unemployment Insurance Systems

The RRB was created in the 1930's by legislation establishing a retirement benefit program for the nation's railroad workers. Private industrial pension plans had been pioneered in the railroad industry; the first industrial pension plan in America was established on a railroad in 1874. By the 1930's, pension plans were far more developed in the railroad industry than in most other businesses or industries; but these plans had serious defects which were magnified by the Great Depression.

Retirement program.--The economic conditions of the 1930's demonstrated the need for retirement plans on a national basis, because few of the nation's elderly were covered under any type of retirement program. While the social security system was in the planning stage, railroad workers sought a separate railroad retirement system which would continue and broaden the existing railroad programs under a uniform national plan. The proposed social security system was not scheduled to begin monthly benefit payments for several years and would not give credit for service performed prior to 1937, while conditions in the railroad industry called for immediate benefit payments based on prior service.

Legislation was enacted in 1934, 1935, and 1937 to establish a railroad retirement system separate from the social security program legislated in 1935. Such legislation, taking into account particular circumstances of the rail industry, was not without precedent. Numerous laws pertaining to rail operations and safety had already been enacted since the Interstate Commerce Act of 1887. Since passage of the Railroad Retirement Acts of the 1930's, numerous other railroad laws have subsequently been enacted.

While the railroad retirement system has remained separate from the social security system, the two systems are closely coordinated with regard to earnings credits, benefit payments, and taxes. The financing of the two systems is linked through a financial interchange under which, in effect, the portion of railroad retirement annuities that is equivalent to social security benefits is reinsured through the social security system. The purpose of this financial coordination is to place the social security trust funds in the same position they would be in if railroad service were covered by the social security program instead of the railroad retirement program.

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

Unemployment program.--The railroad unemployment insurance system was also established in the 1930's. The Great Depression demonstrated the need for unemployment compensation programs, and State unemployment programs had been established under the Social Security Act in 1935. While the State unemployment programs generally covered railroad workers, railroad operations which crossed State lines caused special problems. Unemployed railroad workers were denied compensation by one State because their employers had paid unemployment taxes in another State. Although there were cases where employees appeared to be covered in more than one State, they often did not qualify in any.

A Federal study commission, which reported on the nationwide State plans for unemployment insurance, recommended that railroad workers be covered by a separate plan because of the complications their coverage had caused the State plans. Congress subsequently enacted the Railroad Unemployment Insurance Act in June 1938. The Act established a system of benefits for unemployed railroaders, financed entirely by railroad employers and administered by the RRB. Sickness benefits were added in 1946. [More History]

Railroad Retirement Act

Under the Railroad Retirement Act, retirement and disability annuities are paid to railroad workers with at least 10 years of service. Such annuities are also payable to workers with 5 years of service if performed after 1995.

Provisions.--Full age annuities are payable at age 60 to workers with 30 years of service. For those with less than 30 years of service, reduced annuities are payable at age 62 and unreduced annuities are payable at full retirement age, which is gradually rising from 65 to 67, depending on the year of birth. Disability annuities can be paid on the basis of total or occupational disability. Annuities are also payable to spouses and divorced spouses of retired workers and to widow(er)s, surviving divorced spouses, remarried widow(er)s, children, and parents of deceased railroad workers. Qualified railroad retirement beneficiaries are covered by Medicare in the same way as social security beneficiaries.

Jurisdiction over the payment of retirement and survivor benefits is shared by the RRB and the Social Security Administration. The RRB has jurisdiction over the payment of retirement benefits if the employee had at least 10 years of railroad service, or 5 years if performed after 1995; for survivor benefits, there is an additional requirement that the employee's last regular employment before retirement or death was in the railroad industry. If railroad employees or their survivors do not qualify for railroad retirement benefits, the RRB transfers the employee's railroad retirement credits to the Social Security Administration, where they are treated as social security credits.

Financing.--Payroll taxes paid by railroad employers and their employees are the primary source of funding for the railroad retirement-survivor benefit programs. Railroad retirement taxes, which have historically been higher than social security taxes, are calculated, like benefit payments, on a two-tier basis. Railroad retirement tier I payroll taxes are coordinated with social security taxes so that employees and employers pay tier I taxes at the same rate as social security taxes. In addition, both employees and employers pay tier II taxes which are used to finance railroad retirement benefit payments over and above social security levels. These tier II taxes are based on the ratio of certain asset balances to the sum of benefit payments and administrative expenses.

Revenues in excess of benefit payments are invested to provide additional trust fund income. Railroad retirement funds are invested in non-governmental assets, as well as in governmental securities. The National Railroad Retirement Investment Trust's Board of seven trustees oversees these investments. The Board of Trustees is comprised of three members selected by rail labor; three members likewise selected by rail management; and one independent member selected by a majority of the other six members.

Additional trust fund income is derived from the financial interchange with the social security trust funds, revenues from Federal income taxes on railroad retirement benefits, and appropriations from general treasury revenues provided after 1974 as part of a phase-out of certain vested dual benefits.

Railroad Unemployment Insurance Act

Under the Railroad Unemployment Insurance Act, unemployment insurance benefits are paid to railroad workers who are unemployed but ready, willing, and able to work and sickness benefits to railroad workers who are unable to work because of illness or injury. The RRB also operates a placement service to assist unemployed railroaders in securing employment.

Benefit year.--A new unemployment-sickness benefit year begins every July 1, with eligibility generally based on railroad service and earnings in the preceding calendar year. Up to 26 weeks of normal unemployment or sickness benefits are payable to an individual in a benefit year. Additional extended benefits are payable to persons with 10 or more years of service.

Financing.--The railroad unemployment-sickness benefit program is financed by taxes on railroad employers under an experience-rating system. Each employer's payroll tax rate is determined annually by the RRB on the basis of benefit payments to the railroad's employees.

RRB Organization and Functions

The RRB is headed by three members appointed by the President of the United States, with the advice and consent of the Senate. (*See also* Organizational Chart.) One member is appointed upon the recommendation of railroad employers, one is appointed upon the recommendation of railroad labor organizations and the third, who is the Chairman, is appointed to represent the public interest. The Board Members' terms of office are 5 years and are scheduled to expire in different years. The President also appoints an Inspector General for the RRB.

The primary function of the RRB is the determination and payment of benefits under the retirement-survivor and unemployment-sickness programs. To this end, the RRB employs field representatives to assist railroad personnel and their families in filing claims for benefits, examiners to adjudicate the claims, and information technology staff, equipment and programs to maintain earnings records, calculate benefits and process payments.

The RRB also employs actuaries to predict the future income and outlays of the railroad retirement system, statisticians and economists to provide vital data, and attorneys to interpret legislation and represent the RRB in litigation. Internal administration requires a procurement staff, a budget and accounting staff, and personnel specialists. The Inspector General employs auditors and investigators to detect any waste, fraud, or abuse in the benefit programs.

The RRB and the Federal Government

As an independent agency in the executive branch of the Federal Government, the RRB reports to the President on its operations and to Congress. Officials of the RRB testify at congressional hearings on proposed legislation to amend the Railroad Retirement and Railroad Unemployment Insurance Acts. Congress has jurisdiction over the amounts available to the railroad retirement system for benefit payments and for administration.

The RRB works closely with other federal agencies and with some State agencies. Its dealings with some of these agencies, such as the President's Office of Management and Budget, the Office of Personnel Management, the Government Accountability Office, and the Department of the Treasury, are similar to the dealings of other executive branch agencies with these units. The RRB's relations with certain others - principally, the Social Security Administration, the Centers for Medicare & Medicaid Services, the State employment security departments and, on a smaller scale, the Department of Labor - are related directly or indirectly to the various benefit programs.

The RRB and the Railroad Industry

The administrative organization of the RRB fosters close relations with railroad employers, employees and their representatives. Two of the three Board Members are appointed on the recommendations of railway labor and management associations and labor and management officials have been active in the development of the railroad retirement and unemployment insurance programs since their inception.

In addition, the RRB relies on railroad employers and labor groups for assistance in keeping railroad personnel informed about the benefit programs. Informational programs are conducted for railroad management and labor officials to acquaint them with the details of the benefit programs, and these officials, in turn, educate railroad workers as to their benefit rights and responsibilities.

Railroad employers and railway labor groups also cooperate with the RRB in a joint placement program to find jobs for unemployed personnel. These joint placement efforts help to reduce the costs of the unemployment insurance program.

The RRB has direct contact with railroad employees through its field offices where its personnel explain benefit rights and responsibilities on an individual basis, assist employees in applying for benefits, provide related services for annuitants and answer any questions related to the benefit programs. The RRB maintains field offices in railroad locales across the United States.

Unemployment Insurance Facts

Purpose

In general, the Federal-State Unemployment Insurance Program provides unemployment benefits to eligible workers who are unemployed through no fault of their own (as determined under State law), and meet other eligibility requirements of State law. Unemployment insurance payments (benefits) are intended to provide temporary financial assistance to unemployed workers who meet the requirements of State law.

Each State administers a separate unemployment insurance program within guidelines established by Federal law. Eligibility for unemployment insurance, benefit amounts and the length of time benefits are available are determined by the State law under which unemployment insurance claims are established.

In the majority of States, benefit funding is based solely on a tax imposed on employers. Three (3) States require minimal employee contributions.

Eligibility

The unemployed worker must meet the State requirements for wages earned or time worked during an established (one year) period of time referred to as a "base period". In most States, this is usually the first four out of the last five completed calendar quarters prior to the time that the worker's claim is filed. Unemployed workers must be determined to be unemployed through no fault of their own (determined under State law), and meet other eligibility requirements of State law.

Continued Eligibility

The unemployed worker must file weekly or biweekly claims (after the week(s) has ended), and respond to questions concerning continued eligibility. The unemployed worker must report any earnings from work during the week(s); and also report any job offers or refusal of work during the week.

Registering For Work

Claimants who file for unemployment benefits may be directed to register for work with the State Employment Service, so it can assist him or her in finding employment.

Disqualification from Eligibility

If unemployed workers' reason for separation from their last job is due to some reason other than a "lack of work" - a determination is made about whether they are eligible for benefits. Generally all determinations of whether or not a person is eligible for benefits are made by the appropriate State under its law or applicable federal laws.
If claimants are disqualified/denied benefits, they have the right to file an appeal. Unemployed workers' employers may also appeal a determination if they do not agree with the State's determination regarding the worker's eligibility.

Benefits

In general, benefits are based on a percentage of an individual's earnings over a recent 52-week period - up to a State maximum amount. Benefits can be paid for a maximum of 26 weeks in most States. Additional weeks of benefits may be available during times of high unemployment (see Extended Benefits). Some States provide additional benefits for specific purposes. Benefits are subject to Federal income taxes and must be reported on the beneficiaries' Federal income tax return. The beneficiary may elect to have the tax withheld by the State Unemployment Insurance agency.

Black Lung Benefits Facts

The Black Lung Benefits Act provides monthly payments and medical benefits to coal miners totally disabled from pneumoconiosis (black lung disease) arising from their employment in or around the nation's coal mines. The Act also provides monthly benefits to a miner's dependent survivors. Unless the miner was awarded benefits pursuant to a claim filed before 1982, a survivor must establish that pneumoconiosis was a substantially contributing cause of the miner's death to be entitled to benefits.

The program provides two types of medical services related to black lung disease: diagnostic testing for all miner-claimants to determine the presence or absence of black lung disease and the degree of associated disability; and, for miners entitled to monthly benefits, medical coverage for treatment of black lung disease and disability. Diagnostic testing includes a chest x-ray, pulmonary function study (breathing test), arterial blood gas study, and a physical examination. Medical coverage includes (but is not limited to) costs for prescription drugs, office visits, and hospitalizations. Also provided, with specific approval, are items of durable medical equipment, such as hospital beds, home oxygen, and nebulizers; outpatient pulmonary rehabilitation therapy; and home nursing visits.

Who May File Claims?

Present and former coal miners (including certain transportation and construction workers who were exposed to coal mine dust) and their surviving dependents, including surviving spouses, orphaned children, adult disabled children, and fully dependent parents, brothers and sisters, may file claims.

Payment of Benefits

The last coal mine operator for whom the miner worked for a cumulative period of at least one year is usually responsible for the payment of benefits; however, the Black Lung Disability Trust Fund pays benefits when:

- The miner's last coal mine employment was before January 1, 1970;
- There is no liable coal mine operator; or
- The miner's most recent employment of at least one year with an operator ended while the operator was authorized to self-insure, and such operator is no longer financially capable of securing benefit payments.

In 2001, the basic monthly benefit for a totally disabled miner or the surviving spouse of the miner is $500.50 per month. This may be increased to a maximum of $1001.00 per month for claimants with three or more qualified dependents. Because the Act links benefit rates to Federal employee salary rates, benefit levels are usually adjusted annually in accordance with changes in the Federal employee pay schedules.

Insurance / Self-Insurance

The Black Lung Benefits Act requires each coal mine operator to secure the payment of its benefits liability by either qualifying as a self-insurer or by purchasing and maintaining in force a commercial insurance contract (including a policy or contract procured from a State agency). Any coal mine operator who is required to secure the payment of benefits and who fails to do so is subject to a civil penalty of up to $1,000 for each day of noncompliance. In addition, the president, treasurer and secretary of an uninsured coal mine operator that is a corporation may be liable for the payment of benefits owed to former employees. Coal transportation and coal mine construction employers who are not also coal mine operators do not have to secure benefit payments in advance; however, once an employee is awarded benefits, the Department may require the employer to secure a bond or otherwise guarantee payment.

Appendix E: Glossary

Best estimate

The single most-likely amount in a range of possible estimated amounts; in statistics, the estimated mode. In the past, accounting pronouncements have used the term best estimate in a variety of contexts that range in meaning from "unbiased" to "most likely." SFAC 7 uses best estimate in the latter meaning, as distinguished from the expected amounts. [*SFAC 7, Glossary]*

Closed Group

See Closed Group (to New Entrants)

Closed Group (to New Entrants)

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

Current participants

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

Deterministic Model

See "Stochastic Model" below.

Fiscal Gap

The fiscal gap assumes the public debt is maintained at a constant percentage of GDP. Fiscal gap measures assist in understanding the effect of allowing public debt to increase as a constant percentage of GDP. It illustrates the amount of present value dollars that would be necessary to maintain public debt as a constant percentage of GDP.

Fiscal Imbalance

The fiscal imbalance is the present value of net receipts/outlays plus public debt. The fiscal imbalance illustrates the amount of present value dollars that would be necessary to balance future outlays and receipts and repay existing debt. The fiscal imbalance measure places no constraints on the level of debt. However, excessively high levels of debt can have serious negative consequences on the Government through substantial interest cost in relation to receipts and be unsustainable in attracting investors.

Fiscal Sustainability

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

Fully Insured

“Fully insured” status means that a social insurance participant is eligible for benefits. Social insurance benefits include pensions and health care for retirees and the disabled. Social Security and Medicare participants become permanently fully insured when they attain at 40 quarters of work in covered employment (QC). Social Security and Medicare participants may be fully insured without being permanent fully insured. This is important with respect to disability benefits, which include subsistence payments and medical care. Disability benefits may be needed well before the participants attained retirement age. A participant who receives disability benefits for 24 consecutive months is eligible for Medicare and, when if he or she continues receiving disability benefits until attaining retirement age, he or she is converted to Social Security pension benefits. To be fully insured, participants generally need a minimum of 6 QC. Once a worker has accumulated 40 QCs, he or she remains permanently fully insured, that is, no further QCs are required.[100]

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

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

[100] 2003 OASDI Trustees’ Report, page 111.

41	40
42 and over	40

Future participants

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

Intergenerational Equity

Intergenerational equity assesses the extent to which different age groups may be required to assume financial burdens to sustain Federal responsibilities. It is a concept involving relative contributions of current and future citizens. This standard focuses on reporting the fiscal obligations and responsibilities being accumulated by the current generation, however one defines it, that are passed on to future generations.

Open Group

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

Prior Service Cost

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

Stochastic Model

A stochastic model incorporates many independent simulations. The Trustees' Report explains that, in contrast to a deterministic model, the stochastic model presents:

> [T]he results of 5,000 independent stochastic simulations …. Each of the 5,000 simulations is determined by allowing the above variables to vary throughout the long-range period. The fluctuation in the variable is projected by using standard time-series modeling, a method designed to help make inferences based on historical data. Generally, each variable is modeled by an equation that captures a relationship between current and prior years' values of the variable and introduces year-by-year random variation, as reflected in the historical period. For some variables, the equations additionally reflect relationships with other variables. Parameters for the equations are estimated using historical data for periods ranging from 20 years to 103 years depending on the nature and quality of data available. … Each time-series equation is designed such that, in the absence of random variation, the value of the variable would equal the value assumed under the intermediate set of assumptions. For each simulation of the model, values of the variables listed above are determined by using Monte Carlo techniques to randomly assign

the year-by-year variations. Each simulation produces an estimate of the financial status of the combined OASI and DI Trust Funds. …

The results from this model should be interpreted with caution and with a full understanding of the inherent limitations. Results are very sensitive to equation specifications, degrees of interdependence among variables, and the historical periods used for the estimates. …[101]

Valuation date

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

[101] 2005 Trustees' Annual Report, pp. 158-9

Appendix F: List of Abbreviations

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

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