

JFMIP Principals' Joint Statement on Financial Reporting Related to the Sustainability of Social Insurance Programs

The sustainability of Federal programs, particularly social insurance programs like Social Security and Medicare, is a critical issue to the American public and to the financial strength 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. Equally critical is the need to convey transparently, through financial reporting, information to assist the American public, the Congress and other users of the financial statements, in understanding and evaluating the current status and longer-term sustainability of social insurance and other Federal programs, including the implications of program financing on overall intergenerational equity and individuals' retirement planning.

The Federal Accounting Standards Advisory Board (FASAB) has shown leadership in improving the financial reporting related to social insurance matters. FASAB adopted a statement on social insurance programs as Required Supplementary Stewardship Information in fiscal year 2000. Furthermore, the FASAB took action that would require this statement be subject to audit for fiscal year 2006. In addition, the fiscal year 2006 financial statements will report separately information in the financial statements concerning earmarked funds, including the Social Security and Medicare trust funds. Such information should assist financial statement users, as outlined in Statement of Federal Financial Accounting Concepts (SFFAC) No. 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 No. 1, financial condition is a broader and more forward-looking concept than that of financial position. SFFAC No. 1 specifically discusses that Federal financial reporting should provide information that helps the reader to determine whether:

- the government's financial position 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.

We strongly support the view that 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;
- a comprehensive presentation of the government's long-term fiscal imbalance in relation to appropriate measures, such as GDP;
- the magnitude of the potential alternatives for resolving the long-term deficits, such as the rate of spending reductions necessary to balance the government's long-term finances; and
- intergenerational equity issues, e.g., assessing the extent to which different age groups may be required to assume financial burdens to sustain Federal responsibilities.

Such reporting should consider, among other things:

- key indicators of fiscal sustainability and intergenerational equity for the current period, sufficient prior periods to show trends, as well as projections to future periods,
- key economic drivers affecting the Federal government's 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/materially affected the change in Federal responsibilities during the reporting period (e.g., program changes, assumption changes),
- a description of other major Federal responsibilities that are not shown in detail (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 revenues, including for social insurance programs.

FASAB has played a critical role in enhancing Federal financial reporting. We have serious concerns with the current direction of FASAB's deliberations. While we believe that the full extent of Federal responsibilities should be recognized in the financial statements, our concern is with FASAB's discussions that would treat certain social insurance responsibilities as liabilities. We believe that reporting on the sustainability

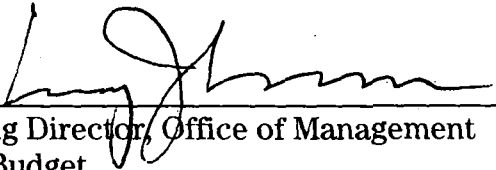
and intergenerational equity of social insurance and other Federal programs should recognize the unique aspects of these programs and reflect the unique role and reporting needs of the Federal government, consistent with the concepts in SFFAC No. 1. We note that other standard setters, such as the International Public Sector Accounting Standards Board (IPSASB) have not supported recognition of a liability for social insurance beyond amounts due and payable. Furthermore, we are very concerned that the FASAB's current discussions to recognize a liability for only certain beneficiaries would be:

- **Inappropriate**—Future scheduled social insurance benefits are not present obligations and any expected future benefits are susceptible to change. Social insurance programs are unique to government entities and are substantively different than employer sponsored pension plans, which appear to be the basic model being followed by FASAB's current discussions. Employer sponsored pension and health plans involve an exchange transaction (i.e., provision of services in exchange for certain compensation) that does not exist for social insurance programs. According to the 2006 Trustees Reports, funds in the Social Security Trust Fund and the Medicare Hospital Insurance Trust Fund will be insufficient to cover all obligations beginning in 2040 and 2018, respectively. Moreover, the Medicare Supplementary Medical Insurance Trust Fund, the fastest growing component of Medicare, will require rapidly-growing transfers from the Federal General Fund in order to cover future obligations. Furthermore, GAO officials have previously stated that the payment of benefits for Social Security and Medicare Part A are limited, by law, to the balances in the respective trust funds. In addition, in contrast to the laws governing private pension plans, the United States Supreme Court has affirmed the right of the Congress to modify these future Federal government benefits in any manner and at any time. The annual Trustees Reports of the Social Security and Medicare programs clearly note the funding shortfall and limitations under current law and the benefit statements that are sent to individuals also note this information.
- **Incomplete**—The FASAB's current discussions would not reflect the full extent of Federal responsibilities or changes in Federal responsibilities from year to year, nor would they show the impact on intergenerational equity. We believe a more comprehensive approach to displaying fiscal sustainability and intergenerational equity is called for.
- **Inconsistent**—Information included in current FASAB discussions would be inconsistent with the information presented in the Trustees Reports and the current Statement of Social Insurance and in individual benefit statements provided by the Social Security Administration, and would result in confusion to the readers of the financial statements.

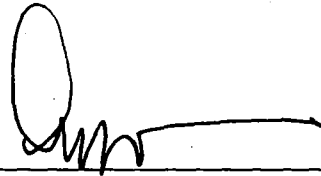
In summary, we believe that more comprehensive solutions are needed to report transparently the full extent of Federal responsibilities, and annual changes in such responsibilities. In addition, such financial reporting should assist the American public, the Congress and other users of the financial statements, in understanding and evaluating the sustainability of social insurance and other Federal programs and the

implications of program financing on intergenerational equity. To achieve these objectives, such reporting should reflect the unique nature of social insurance programs, the extent of the Federal government's responsibilities in these programs (and its ability to adjust these responsibilities). In addition, such reporting should be communicated clearly and be generally accepted by users of Federal financial statements. Finally, in developing solutions to achieve the broad financial reporting objectives discussed above, we believe that the FASAB should solicit broad user input and ensure consistency with other Board projects, such as the application of the definition of a liability, before any related exposure draft is issued.

We look forward to continuing to work with the FASAB on issues of mutual interest and concern in the future.



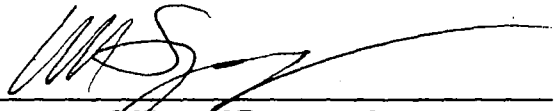
Acting Director, Office of Management
and Budget



Comptroller General of the United States



Secretary of the Treasury



Director, Office of Personnel
Management