April 30, 2007

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

Dear Ms. Comes:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Federal Accounting Standards Advisory Board (FASAB) Preliminary Views (PV), *Accounting for Social Insurance, Revised,* and is pleased to offer its comments. Overall, we are supporting the Primary View as described in the PV because we believe it is a worthwhile and significant step forward by the Board with respect to federal accounting and financial reporting for social insurance programs. However, we also recommend that the Board view this step as part of an evolutionary process and not the final step in that evolution. Therefore, once a final standard is issued for social insurance programs and effective for several years, the Board should be open to evaluating whether additional steps should be taken to further improve the accounting and financial reporting for social insurance.

As noted above, we are supporting the Primary View. It will recognize an expense and related liability for social insurance program benefits accumulated at the balance sheet date when participants substantially meet eligibility requirements during their working lives in covered employment. However, as noted in our response to Question 1 below, we believe that a more sound and appropriate recognition approach should be based on when workers begin their employment and not at the point where they become fully insured.

In our view, the difference between the two views presented in the PV goes to the very heart of what financial statements should be—in this case, the financial statements of a sovereign national government. Financial statements have the purpose of serving their users. In the world of commerce, they are used to assist providers of capital in making their decisions as to how that capital shall be allocated and deployed. For governments, financial statements are used to monitor performance and stewardship, but perhaps even more importantly, to assist citizens, their elected representatives, and civil servants to formulate economic, social, and political policy. Generally, financial statements should provide information in a neutral, unbiased manner to allow users to make key decisions, including policy decisions. A critical issue involves determining where to draw the line between financial reporting versus analysis and decision-making. We believe the Primary View is more consistent with the overall purpose of general purpose financial statements and will provide better information for users to make decisions.

Except in circumstances where a compelling reason for a difference in accounting treatment exists, we also believe that federal government financial statements are most useful when they are comparable in methodology to the financial statements of commercial and not-for-profit enterprises, as well as those of state and local governments. Users harbor basic notions of what financial statement numbers mean, in this case the costs of and the liability for social insurance.

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Finally, we understand there are numerous policy issues surrounding the federal social insurance programs and their funding. Our purpose in providing this response to the Board is only to provide feedback on what we believe to be the appropriate accounting and financial reporting for these transactions and not to provide any commentary on the underlying policy issues themselves.

As requested by the Board, we considered the questions raised in the PV and our responses are included in the following section of this letter.

Responses to PV Questions

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.

As noted in previous letters to the FASAB on this topic, we believe that these social insurance programs are currently executed and publicized as exchange programs. While we note that there are some who argue that these transactions are not legally an exchange, we believe that based on the characteristics of the transactions and the way the government describes them publicly to the citizenry that, on balance, they should be treated as exchange transactions. It is our view that 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. The federal government reinforces this notion by periodically sending workers a statement of estimated future benefits. Further, workers rely on these promises in planning their own retirements and their employers rely on them in determining the level of pension and other postemployment benefits to provide their employees. All of these factors reinforce our conclusion that these transactions should be treated as exchange transactions. Therefore, the question becomes identifying the appropriate obligating event that should trigger recognition. It is our view that the obligating event that gives rise to liability recognition is when participants begin work in covered employment rather than when fully insured status is obtained (e.g., 40 quarters or equivalent of work in covered employment). Upon beginning their employment, workers immediately begin having payroll taxes relating to social insurance programs deducted from their salaries. This is the point when we believe the obligation begins and should be measured. The actuarial measurement of the expense and liability could then take into consideration the likelihood of forfeiture by participants that will not attain eligibility requirements. The approach we favor incorporates measurement and attribution qualities similar to those used in the financial reports of other types of entities. We believe those measures and attributes are superior to the ones reflected in the two views presented in the PV. However, all the questions posed in the PV are framed in a way that asks commentators to discuss the Primary View versus the Alternative View. We therefore believe that the Board at this time does not intend to consider views other than those set out in the PV. In that case, we prefer the Primary View over the Alternative View because it recognizes the federal obligation to provide social insurance benefits during at least some of the period in which that obligation accrues, as opposed to waiting until the date when benefits become payable. As stated in the first paragraph of this letter, we hope that, whatever standard is eventually promulgated, the FASAB will be willing to take additional future steps to revise and improve the financial reporting of social insurance.

As for the Alternative View, its position for liability recognition is that future scheduled social insurance benefits are not present obligations; that recognition of future social insurance benefits would result in a mismatch of costs and the transfer of services; and that the federal government can change the laws relating to social insurance programs in the future. We did not find these arguments to be persuasive and believe that they promote an overly narrow interpretation of how the liability should be measured.

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 (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.

We believe that Social Security and Medicare obligations are measurable for purposes of recording a liability, particularly given the fact that both the Social Security Administration and Centers for Medicare and Medicaid Services already complete an actuarial estimate of the future liability over a 75 year basis. Since current estimates already include the concept of past, current and future earnings for beneficiaries, providing a greater amount of detail regarding these categories of earnings should provide additional benefits in excess of the incremental cost, if any. The Alternative View seems to argue that the certainty of the measurement would be in question, but this is the case with any estimate. Certainly, as agencies measure events that are expected to occur further and further in the future, reliability decreases. To some extent, however, the effect is decreased because the present value of a future exchange transaction decreases with its distance from the present. We are pleased that both views support the presentation of ranges, such as illustrated by the chart presented by the Primary View in paragraph A75, and also by the Alternative View in paragraph A181.

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?

Generally, we found the information relating to the SOSI provided by the Primary View to be more useful than that put forward by the Alternative View. We agree that for clarity, lines should be added to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet. Further, as explained throughout the PV, the amounts are likely to be very large and have several components representing several different social insurance programs. The amounts are also the result of multiple calculations applied to a variety of assumptions. Therefore, it is important for the SOSI to be tied to the other basic statements and that the reasons for the various changes in the liability from period to period be explained comprehensively and understandably.

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.

We view sustainability information primarily as an analytic and policy matter separate from general purpose financial reporting. Sustainability information does not identify the amount of present obligations of the federal government, or the question of what is the most recent period's cost of providing social insurance. Instead, we believe that the information provided through the Primary View (that is, revisions to the SOSI and inclusion of the liability and expense in the balance sheet and statement of net cost) is more appropriate for general purpose financial reporting purposes.

With this said, we do not oppose the Board researching and developing guidance related to such sustainability information. However, it should not replace the accounting proposed in the Primary View for purposes of financial statement reporting, nor should it delay the Board in adopting such accounting.

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. government-wide 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.

Overall, the PV does not discuss the recognition of deferred revenue in enough detail for us to comment on. However, it appears that if the Board decides to adopt the Alternative View, that it will have no choice but to recognize deferred revenue for earmarked revenues in excess of program costs. The next exposure document should cover the deferred revenue aspects of the proposal in much greater detail. In developing that guidance, if the Primary View is adopted, we recommend that there be much more discussion and consideration of deferring revenue for amounts received from a participant's date of employment until fully insured status is achieved.

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.

Generally, the detailed guidance on measurement (including selection of assumptions) seems to be based on rational choices made from among various possibilities. The suggested required disclosures provide at least a minimum degree of transparency to aid users in understanding the choices that were made. We do have several other suggestions and comments:

- The current SOSI provides a significant amount of information but some of the ideas put forth within the PV are in fact more useful. We encourage the Board to explore ways to present information about social insurance in an easily understandable, user-friendly manner. For example, we found the graphic presentation (using stochastic modeling) in paragraph A75 which presents the probability distribution of possible future outcomes centered on the Trustees' intermediate assumptions to be very useful. The Board should consider whether this and other similar user-friendly reporting should be required.
- To alleviate concerns expressed by those who support the Alternative View, the Board should consider adding a footnote disclosure that discusses the nature of the social insurance liabilities, how they differ from a pension, and that it is possible for Congress to change the terms of the programs at any time in the future by new legislation.
- Whatever approach the Board ultimately takes, it should be clear within the statement what information should be included on the face of the individual statements, what information should be included within the notes, and what information should be included within the required supplementary information.

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

We have no additional comments on the details of the Alternative View.

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The AICPA appreciates the opportunity to comment on the PV. This comment letter was prepared by AICPA members with experience in federal auditing and accounting matters and was reviewed by the Accounting Standards Executive Committee (AcSEC) who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,

Peter Knutson
Chairman
FASAB Social Insurance Task Force

Mary M. Foelster
Director
Governmental Auditing and Accounting

cc: FASAB Social Insurance Task Force
Ben Neuhausen
Daniel J. Noll