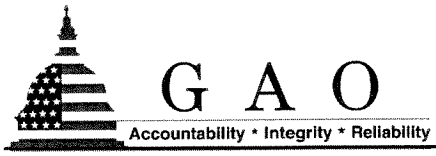


United States Government Accountability Office
Washington, DC 20548

February 9, 2009

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

Dear Ms. Payne:

The U.S. Government Accountability Office (GAO) is pleased to provide its comments on the Federal Accounting Standards Advisory Board (FASAB) Exposure Draft entitled *Accounting for Social Insurance, Revised* (ED).

We have consistently supported FASAB efforts to improve the transparency of critical information about social insurance programs to meet the objectives in SFFAC No. 1 to help readers 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.

Also, we agree with the ED concerning the addition of the following information related to social insurance reporting:

- a summary section on the Statement of Social Insurance (SOSI),
- a Statement of Changes in Social Insurance, presenting the changes in social insurance during the reporting period, and
- critical information about costs, assets and liabilities, social insurance commitments, budget flows, and the fiscal gap in a section in MD&A devoted to financial statement analysis.

However, for the reasons discussed in Mr. Werfel's alternative view in paragraphs A143-A146, we strongly believe that

1. it is not appropriate to present any information, including the closed-group measure, "below the line" on the balance sheet,
2. the open group, not the closed group, is the appropriate measure to use in the new Statement of Changes in Social Insurance and in the MD&A, and
3. it is not appropriate to disclose the accrued benefit obligation in the financial statements.

We agree with the alternative view's discussion in paragraph A147 that the current financial statements, combined with the proposed Statement of Changes in Social Insurance and Statement of Fiscal Sustainability, will provide a comprehensive, and the most appropriate, financial presentation and disclosure of social insurance programs. Fiscal sustainability information, reported in SOSI and the Statement of Fiscal Sustainability, complements historical budget and accrual information but provides a fundamentally different perspective on the government's financial health and condition than historical budget and accrual information. Both prospective and historical information are needed to obtain a complete understanding of the federal government's financial condition. Together, the prospective sustainability statements and historical financial statements provide several key measures of the federal government's financial condition and changes therein, as illustrated in the following table.

	Historical Perspective	**Sustainability Perspective**
End-of-period measures reported through	• balance sheet • budgetary resources	• Statement of Social Insurance • Statement of Fiscal Sustainability • Fiscal Gap
Period measures reported through	• net cost • operations • reconciliation of net operating cost and unified budget deficit • changes in cash balance	• changes in social insurance • changes in fiscal sustainability

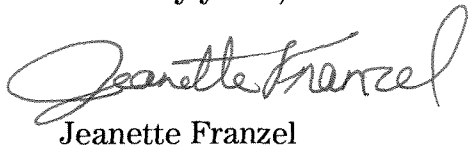
These two different, but complementary, perspectives have provided a useful and meaningful framework for reporting on the government's financial condition over the past two fiscal years in the Consolidated Financial Report (Management's Discussion and Analysis) and the Citizen's Guide to the Financial Report of the United States Government.

Moreover, as discussed in our comment letter on the ED entitled *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government,* we believe that the Statement of Fiscal Sustainability is necessary, in addition to the SOSI, to provide an appropriate comprehensive perspective on the future funding and spending for Social Security and Medicare as well as for all other government programs. For example, the Statement of Fiscal Sustainability would provide critical information about whether and to what extent projected general revenues are less than or exceed the sum of projected Medicare Parts B and D benefits (net of premiums and state transfers that represent about 25% of Medicare Part B and D funding) and discretionary spending that is also funded by general revenue. Such information is not currently provided in the SOSI.

Furthermore, as noted in the ED which retains the liability and expense recognition and measurement reporting standard contained in Statement of Federal Financial Accounting Standard 17, we continue to believe that the obligating event for liability recognition for social insurance benefits should continue to be the point at which an individual meets all eligibility requirements for benefits and the benefit payments become "due and payable." (Please refer to our comment letter dated May 7, 2007, on the Preliminary Views document, *Accounting for Social Insurance, Revised).*

The FASAB's current efforts and deliberations on the presentation of social insurance programs, along with fiscal sustainability reporting, are important steps in recognizing the need for greater transparency in connection with the federal government's current financial condition and future fiscal path. Our specific comments, which are detailed in the enclosure to this letter, provide our responses to the questions put forth in the ED. If you have any questions on our comments, we are available for further discussions. Please call me at (202) 512-2600 or Robert Dacey, Chief Accountant, at (202) 512-7439.

Sincerely yours,



Jeanette Franzel
Managing Director
Financial Management and Assurance

Enclosure

GAO Responses to Questions Set Forth in the Exposure Draft Accounting for Social Insurance, Revised

Questions:

Question 1.

The Board proposes to require social insurance component entities and the governmentwide entity to discuss and analyze key measures from the basic financial statements in their management's discussion and analysis (MD&A). See paragraphs 26-30 in the proposed standard and paragraphs A75-A79 in the basis for conclusions.

Do you believe that key measures should be presented in the MD&A as described in this exposure draft? Please provide the rationale for your answers.

We agree that critical financial statement measures, including social insurance, should be described in the MD&A. The discussion should be easy to locate, be readily understood, and explain the significance of key amounts; most importantly, the entity should explain the reasons for major changes in amounts for key items during the reporting period. MD&A should present meaningful sustainability information and the possible future effects of anticipated future events, conditions, and trends. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections.

However, for reasons described in answer to question 7 below, we believe that the open-group measure is the appropriate measure to use for analyzing the long-term sustainability of social insurance programs and, therefore, should be included in the MD&A rather than the closed-group measure.

Question 2.

The Board is proposing to add a line for the **closed group measure** to the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. See paragraphs 31-32 in the proposed standard and paragraphs A81-A100 in the basis for conclusions. Two members have submitted alternative views on this issue. See paragraphs A139-A142 in the basis for conclusions for Mr. Patton's view. Mr. Patton and other members believe that a liability greater than the due and payable amount should be recognized on the balance sheet. See paragraph A144 in the basis for conclusions for Mr. Werfel's view. Mr. Werfel and other members believe that the closed group measure should not be presented on the balance sheet.

Do you believe that the balance sheet should present a line item for the closed group measure as described in this exposure draft? Please provide the rationale for your answers.

No. For the reasons discussed in the alternative view in paragraph A144, we believe that it is inappropriate to show either the closed-group measure, as proposed, or the open-group measure anywhere on the balance sheet.

Question 3.
The Board proposes to add a new summary section of the statement of social insurance (SOSI) to present the closed and open group measures. See paragraphs 34-35 in the proposed standard and paragraphs A114-A116 in the basis for conclusions.

Do you believe that the SOSI should have a summary section as described in this exposure draft? Please provide the rationale for your answers.

Yes. We believe that a summary section is a positive addition to the SOSI. However, we believe that the standard should provide greater flexibility for determining the appropriate summary information to be provided (e.g., open group, closed group, age cohorts). Also, the assets held by the programs, referred to in paragraph 34, would not be relevant for governmentwide-entity accounting and reporting.

Question 4.
The Board proposes a new basic financial statement entitled statement of changes in social insurance amounts. The new statement would explain the changes during the reporting period in the present value amounts for the closed group measure included in the statement of social insurance. See paragraphs 36-37 in the proposed standard and paragraph A116 in the basis for conclusions. Mr. Werfel and other members have an alternative view. They believe the new statement should focus on changes in the open group measure and not the closed group measure. The question of the use of the appropriate measure is addressed in question 7 below. See paragraph A145 in the basis for conclusions.

Do you believe there should be a new basic financial statement explaining changes to the present value amount included in SOSI? Please provide the rationale for your answers.

Consistent with our comments on the earlier Preliminary Views document, we agree that there should be a new Statement of Changes in Social Insurance that displays the reasons for changes in SOSI amounts during the reporting period and that will (1) reconcile beginning and ending net present values reported in the SOSI for social insurance programs and (2) provide the reasons for significant changes in the net present value during the reporting period. We also think the Board should provide flexibility to allow this new statement to be a stand-alone statement or to be incorporated into the existing SOSI.

Such a presentation of changes in social insurance will present the full extent of changes in the net present value of projected revenues and scheduled benefits and identify and analyze those changes. This information will highlight the reasons for any improvement or deterioration in the financial condition of these programs and will provide useful information to the reader. We believe that it is important for the reader to take note of the relative changes in the SOSI in order to draw comparisons with prior year results and obtain a better understanding of the factors affecting changes in social insurance projections.

Also, for the reasons discussed in the alternative view in paragraph A145 of this ED, we believe the open group, not the closed group, is the appropriate measure to use in the

new Statement of Changes in Social Insurance. The open-group measure is consistent with measuring the long-term sustainability of social insurance programs, especially given the pay-as-you-go structure of the programs, whereas the closed-group measure is not.

Question 5.
The Board proposes to disclose an accrued benefit obligation in notes to the financial statements. This information would include a five year trend when the standard is fully implemented. See paragraph 38 in the proposed standard and paragraphs A117-A123 in the basis for conclusions. Mr. Werfel and other members have an alternative view expressing opposition to this disclosure. See paragraph A146 in the basis for conclusions.

Do you believe that an accrued benefit obligation should be disclosed as described in this exposure draft? Please provide the rationale for your answers.

No. For the reasons discussed in paragraph A146, we believe that it is inapropriate to disclose an accrued benefit obligation. We have significant concerns that disclosing yet another number, the accrued benefit obligation, would lead to more confusion and burden on the user, rather than enhancing their understanding of the sustainability of the federal government's social insurance programs. Also, the concept may be misunderstood without significant explanation.

Question 6.
The Board considered but decided not to propose adding a line item to the statement of net cost (SNC) for the change during the reporting period in the closed group measure that would be presented below exchange revenue and expenses and not included in the totals for these classifications. Some argue that this measure should not be presented on the SNC because it is a fundamentally different measure. Others believe the change is an economic cost that belongs on the SNC, and that including this number at the bottom of the SNC appropriately links all basic financial statements. See paragraphs A101-A113 in the basis for conclusions.

Do you believe that the SNC should not include a line item for the change during the period in the closed group measure, which would be presented below exchange revenue and expenses and not included in the totals for these classifications? Please provide the rationale for your answers.

We agree with the ED that the change in the closed-group measure should not be included in the Statement of Net Cost. Consistent with our comments on the earlier Preliminary Views document, it is not a cost of the current period. Only costs of goods and services provided in the period should be shown on the SNC. The change in social insurance is not a good or service provided; it is a future benefit amount that is not a cost of the current period and has yet to be incurred.

In addition, the amounts in the SOSI reflect projected future receipts and scheduled benefits, assuming that current benefit levels are continued, and show a significant

excess of future expenditures over future revenue. However, for the Social Security and Medicare Part A programs, projected scheduled benefits cannot, by law, exceed receipts plus current trust fund assets. Therefore, the SOSI does not represent projections of likely outcomes under current law. While changes in social insurance are appropriate for the Statement of Changes in Social Insurance, it would not be appropriate to include them on the accrual-basis SNC.

Question 7.
The Board decided to present the **closed group measure** (CGM) (defined in paragraph 19) as a common thread among the proposed new reporting. The proposal requires that the CGM and other key measures from the financial statements be discussed in management's discussion and analysis; that the CGM be presented on the balance sheet below assets, liabilities and net position (without being included in the totals for those categories); and that the changes in the CGM during the reporting period be presented and explained in the new summary section of the SOSI and the new statement of changes in social insurance. The Board considered the **open group measure** (defined in paragraph 24) instead of the closed group measure as the focus for the disclosure. This exposure draft discusses both the closed group measure and the open group measure throughout. Paragraphs A69-A74 provide the basic rationale for the Board's selection of the closed group measure. Mr. Werfel and other members have an alternative view regarding the presentation of the closed group measure. They oppose the addition of the closed group measure to the balance sheet. Further, they believe the open group measure is the appropriate measure to use in the new statement of changes in social insurance and not the closed group measure. See paragraph A145 in the basis for conclusions.

Do you agree with the Board's decision to feature the closed group measure? Please provide the rationale for your answers.

No. For the reasons discussed in paragraph A145, we agree with the alternative view and believe that it is inappropriate to use the closed-group measure to show the government's responsibility to future taxpayers. As noted in our response to question 2, we do not believe that either the closed-or open-group measure should be reported anywhere on the balance sheet. Further, as discussed in our response to questions 1 and 4, we believe that the open group measure should be used instead of the closed-group measure proposed in the ED, both in the MD&A and in the Statement of Changes in Social Insurance.

The open-group presentation is more consistent with the measurement of program sustainability. The open group reflects the pay-as-you-go nature of the program; receipts from future participants will be necessary to make benefit payments to current participants. It measures the extent to which future taxes will be sufficient to pay future benefits. It is consistent with what is reported in the trustee's report and it is also the bottom-line measure of the SOSI, which is a basic financial statement.

The closed-group measure, on the other hand, is not a good estimate of the net responsibility of future taxpayers. Under current law, some of the scheduled benefits to the closed-group participants would not be payable even with the receipt of all scheduled taxes from future participants over the next 75 years. Also, the closed-group measure reflects only current program beneficiaries and participants and assumes that the

program is closed to future participants, which contradicts the pay-as-you-go financing principle on which the social security program was designed.

Also, closed-group measures are typically used for private sector pension plans and retiree health programs where individuals perform services in exchange for such benefits as part of their compensation. However, social insurance transactions are nonexchange transactions. That is, payments of social insurance taxes by an individual (which do not entitle the individual to a benefit in a legal or contractual sense), and the subsequent receipt of social insurance benefits by that individual are not directly based upon taxes paid or employment services rendered, and are separate nonexchange transactions.

If presented anywhere, the closed-group measure should be limited to the SOSI summary section, related notes, or both, so that it can be viewed and discussed in an appropriate context, such as in relation to the open-group measure.

Question 8.
The Board is proposing to change the requirement currently in SFFAS 17 for specific sensitivity analysis. The standard will require the entity to provide a sensitivity analysis of the closed-and open-group measures appropriate for its particular social insurance program but will not specify a particular approach for the analysis. See paragraphs 42-43 of the standard and paragraphs A125-A137 of the basis for conclusions.

Do you believe that a general requirement that allows flexibility in the sensitivity analysis presented will produce better information regarding the sensitivity of social insurance programs? Please offer any comments that you wish to make on these provisions.

We agree that sensitivity analysis is a good approach to illustrating uncertainty if estimates, projections, assumptions, data, methodologies, or other important inputs change. We also concur with paragraph A130 of the ED that an objective of the proposed standard is to "make sensitivity analysis more concise and meaningful". However, we do not believe that the illustrative chart depicted in paragraph A137 meets this objective and leaves much room for readers' interpretation and possible confusion. Sufficient guidance should be provided in allowing flexibility in the sensitivity analysis presented to ensure that adequate and meaningful information is disclosed.

Further, we believe that the requirement for sensitivity analysis in paragraph 42 should refer only to the open-group measure. It is inappropriate to include the closed-group measure for the reasons stated in our response to question 7 and, in addition, it would unnecessarily add yet more length to the social insurance disclosures.