Written Comments on
"Accounting for Social Insurance, Revised
Statement of Federal Financial Accounting Standards
Preliminary Views"
From Steve Goss, Chief Actuary, Social Security Administration
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I, along with Alice Wade, Al Winters, and others in the Office of the Chief Actuary at the Social Security Administration, have worked with the FASAB closely for many years through the development of the Required Supplementary Stewardship Information and its evolution into the Statement of Social Insurance. Our role of working daily in analyzing program policies and legislation that would change these policies, along with developing assumptions, methods, and projections for the future experience of the programs has given us certain insight into the nature and workings of these programs. It is therefore our pleasure to share with the Board our comments on the preliminary views document that was released for comment on October 23, 2006.

In general, we believe the Alternative View represents a more appropriate position for accounting for Social Insurance than does the Primary View. The position of the Alternative View regarding the recognition of a liability is consistent with long standing views of FASAB and we believe that the Primary View makes no compelling case for changing that long held position.

The questions posed in the Preliminary Views document provide an excellent format in which to elaborate on our general comment, and to remark on certain very preliminary material set forth on the question of sustainability in the Alternative View. Our comments on these issues and answers to the specific questions are below.

1. *Which obligating event do you believe creates a liability and expense that should be recognized?*

   We support the Alternative View which states that only liabilities and expenses under the Social Security program that are both due and payable should be recorded as a liability. We do not support the Primary View.

   The Primary View suggests that a liability and expense should be recognized for a worker under the Social Security program when the worker first attains "fully insured status" under the program. While insured status is one necessary condition for benefit receipt, it is in no way sufficient to qualify as an obligating event for liability recognition.

   Fully insured status as indicated in the Primary View can be achieved for those who are relatively young by having worked enough to earn only 6 quarters of coverage. Only when "permanently fully insured status" has been achieved, by having earned 40 quarters of coverage, is there any notion of an obligation for retired worker benefits. Fully insured status may be met with less than permanently insured status at any time up to age 62. Thus, achieving fully insured status at any age below age 62 does not indicate that insured status will be met when other benefit eligibility criteria may be met in the future.

But even attaining the current requirement for permanently fully insured status (40 quarters of coverage) fails to provide an obligating event for a liability. In addition to the usual uncertainties related to survival to retirement age and subsequent work activities, an overriding uncertainty exists under the Social Security (and any Federal Social Insurance) program. That uncertainty is related to the fact that the Federal Government has the right and ability to alter or even eliminate the potential benefit that appears to have been earned. As one example, the requirement for permanently fully insured status could well be changed to something more than 40 quarters of coverage by the time the worker approached age 62. This might readily be the case if the earliest eligibility age for retirement benefits, age 62, were changed in the future. Thus, it is simply not possible under these programs to declare that there has been an obligating event for recognizing a liability for benefits for any month of eligibility until the worker is due benefits for that month. Prior to that time there is no binding commitment over which the worker has control and so no liability can be recognized. The Alternative View should be followed and the current recognition point for liability retained.

A technical, but critical issue is associated with the suggestion by the Primary View to establish a premature point of liability recognition. Insured status itself is considerably more complicated and potentially elusive than recognized in the Primary View. For example, insured status for disabled worker benefits under the Disability Insurance Program requires less than 40 quarters of coverage on a lifetime basis, generally, but also generally requires earning 20 quarters of coverage within the last 40 quarters of time. This means that even if 40 quarters of coverage are earned at some point, there is no assurance on this basis that the worker will then or in the future be insured for disability benefits.

The elusive and potential changeable status of insurability (both fully insured and disability insured statuses) leads to the prospect that the Primary View would recognize a liability at one point in time based on then current insured status, only to rescind the liability at a subsequent time when the individual has lost insured status. This situation would occur even under current law with no change, and simply adds to the case stated above for not recognizing liability based on insured status alone.

Much discussion has occurred within the public sessions of the FASAB on the topic of liability recognition in recent years. Many possibilities have been put forth including careful consideration of the definition of liability and asset, and consideration of even a constructive obligation. It has been clear that even the criteria for a constructive obligation are not met with social insurance benefits. In the recent concepts paper on elements of accrual accounting, it was well established that an asset cannot exist without the holder of the asset having exclusive control. Similarly, for there to be a liability the entity with the liability cannot have the ability to single handedly alter the liability. Because the Federal Government retains the right to alter up to the time when a benefit is due, such benefit cannot be a liability until it is both due and payable.

Other concepts related to liability, such as the need for an exchange transaction to create an obligating event, simply do not exist based on the crediting of earnings or payment of taxes while working. Benefits are not directly related to or committed upon the receipt of earnings or the payment of taxes. Again, as FASAB has ruled in SFFAS 17 and has upheld since, a liability can only be recognized when a benefit is due and payable.

2. *Do you believe that 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 Views (see paragraphs 16-18 and especially subparagraph 16g in the standard; also see A54-S55 in basis for conclusions.*

Social Security and Medicare future obligations reflecting the intended (scheduled) benefits in current law are in principle measurable, and are in fact currently measured in a number of different forms. But these future obligations are not "*measurable for the purposes of recording a liability*" until they become due and payable on a month-by-month basis.

Attaining insured status at a point in time before actual benefit eligibility does not mean that the individual will still be insured subsequently when other criteria may be met. It is not possible to compute or assign any value to potential future benefits without great speculation on events that are not under the control of the worker, some of which are in fact under the control of the Federal Government. If it is not possible to say that an obligating event has occurred for purposes of recording a liability, then it is certainly not possible to measure any amount as a liability.

Paragraphs 16g and 16f in the Primary View state that for workers not yet disabled or at retirement eligibility age, a liability should be included for "… the future benefits attributed to past work in covered employment…." Because even insured status at a later time is not guaranteed based on insured status at the current time, no future benefits can yet be "attributed" to those or other earnings for purposes of recording a liability.

Thus, the very uncertainty that any insured status will persist into the future, along with multiple other uncertainties, make it inappropriate to measure potential future benefits for the purpose of recording a liability. Any attempt to measure a potential benefit at the time of attaining any form of insured status would be so highly speculative and uncertain that it could not be considered to be a liability.

3. *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 SNC and BS; 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. (Paragraph 16 and Appendix B for illustration).*

   The Alternative View proposes to leave the SOSI unchanged but to add a new principle 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.

   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?

   No, the Primary View proposal to add line items to the SOSI that tie revised expenses and liabilities amounts to the Balance Sheet and Statement of Net Cost should not be adopted. Recording Social Insurance obligations as liabilities on the balance sheet for future months of potential eligibility would not be an accurate depiction of the Federal Government's financial position. Since Social Insurance obligations do not meet the definition of a liability (until they are due and payable), showing these amounts on the balance sheet as liabilities would be misleading and inappropriate.

   In particular, deeming very large amounts of potential future benefits as liabilities would fail to be consistent with the actual funding mechanism of the Social Insurance programs. Future benefits can be paid on a current cost (pay as you go) basis only if future tax collections are made at the same time. Thus, such future taxes would have to be deemed as current assets if future benefits were to be deemed as current liabilities. Both possibilities make no real practical sense and neither qualifies for the designation. Thus this information should not be added to SOSI or the balance sheet.

   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?

   The Alternative View approach to illustrating changes in SOSI is vastly superior. One of the largest drawbacks of the present value dollar amounts shown in SOSI, and elsewhere, is the fact that the amounts increase substantially from one report to the next solely because of the change in the valuation period. The Alternative View table of change would highlight on the first line the extent to which the SOSI balance changes just because of the change in valuation date. The other categories of change are logical, informative, and readily available as they coincide with values already computed and provided in the annual Trustees Reports for Social Security and Medicare. The presentations of change in these reports have been developed and refined for decades. The Alternative View wisely adopts this carefully thought out approach. This table would be a useful addition to the required supplementary information in the financial statements.

4. *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 provide sustainability information on the entire Government, including information on intergenerational equity (See paragraphs 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?*

Yes, we agree that a Statement of Fiscal Sustainability would be a useful and informative addition to the consolidated Financial Report for the entire Federal Government. But such a statement should be developed only if it can fairly and appropriately represent the prospects for all Federal programs.

Some attempts to develop this kind of analysis are based on the assumption that discretionary (non-entitlement) Federal spending will automatically and certainly be balanced against revenue, and thus will not provide any potential for long term shortfalls or surpluses. This is inappropriate. If this statement is to be created and is not to be misleading, it must reflect a reasonable extrapolation of actual current action. For the discretionary portion of the budget, current tax rates and policy should be the basis for reasonable extrapolations of current policy, spending levels, and trends. Recent policy and spending reflect current intent at a political level, and this should be reflected for the future.

If projected future values for Social Security (for example) are to reflect scheduled benefit costs as opposed to reduced benefits that would be payable after the trust funds exhaust, then values reflecting "intent" will be shown. It should be made clear that these values are not expected to be payable under current law, while they do reflect the apparent *intent* of the Congress to pay benefits in the future. For Social Security, the expected funding gap reflects an extrapolation of current policy and if this is done for the entitlement programs, then it should be done similarly for all Federal programs.

The form of any statement of sustainability must be developed so that useful information can be presented in a way that will be clear and in no way misleading.

Here we differ with the table included in the Alternative View. Their proposed table would provide summarized present value amounts over long periods including the next 75 years and also the infinite future. In fact, such summarized numbers are inappropriate and inefficient for portraying sustainability. To portray sustainability, the elements of timing and trend are critical. To "sustain" something means that it must first be established, and then maintained. This cannot be demonstrated or ascertained in a summarized value for a lengthy period. In fact, a summarized value for a period can only indicate the cumulative financial status at the end point of the period, providing no information about the levels or trends within or beyond the period.

For this purpose, the concept of "sustainable solvency" was developed for analysis of Social Security financial status under reform proposals. To be deemed sustainably solvent, the program financing must be projected to be adequate to permit payment of all scheduled benefits throughout the next 75 years, with a ratio of trust fund reserves (or assets) to program annual cost that is stable or rising at the end of the 75-year period. The latter requirement is the essential element of sustainability and thus includes attention to both level and trend in the financial measure.

For "sustainability" as opposed to the narrower concept of "sustainable solvency", a measure of the level of annual program cost and, just as important, the trend in that level is needed. A ready and compelling candidate that would allow comparison across all Federal programs is the ratio of projected annual program cost to annual gross domestic product (GDP). Expressed in these terms, the various program costs could be compared or combined in a form that readily relates to the fundamental potential tax (revenue) base for all Federal programs, the GDP itself. The level and trend of such annual ratios would provide a clear picture of the expected draw on the economy to fulfill the intended spending. Expressing the future revenue levels and trends in a similar manner would complete the sustainability picture.

What is not appropriate or even useful for an analysis of sustainability is an aggregate number over a long period of time, as in either the 75-year period or the infinite future. Such numbers, while useful for some purposes have no ready relevance to sustainability, and should not be used in this context.

Because such summarized values are easily misunderstood, great care must be used in their presentation in instances where they are relevant. The presentation in the Alternative View of present value summarized shortfalls over these periods expressed as ratios to the numbers of current workers or current households is inappropriate and misleading. The financial shortfalls over the next 75 years, and over the infinite future cannot possibly be borne by only today's workers or households. Eliminating these shortfalls will occur through changes in scheduled benefits and taxes that will affect most if not all current and future workers and beneficiaries throughout the next 75 years and throughout the infinite future.

Thus, such ratios should be presented for long periods only relative to the number of workers or households expected to exist during the period as a whole. Aggregated shortfalls over many years can only be meaningfully compared to aggregated resources over the same period.

A final note relates to the glossary entry for "Fiscal Sustainability" in the Preliminary Views document. Here a definition of "sustainable solvency" (described above, as developed by the Office of the Chief Actuary and used for over a decade in reform proposals and in the Trustees Report) is mischaracterized and is attributed to the Government Accountability Office. The glossary says "being able to pay full benefits as they come due permanently." This is really incorrect in two ways. First, care should be taken in characterizing solvency for the future as the projected or expected ability to pay full benefits, under a specific set of assumptions, on a timely basis. If the projection indicates that the best estimate for the future would be a solvent program with only a small reserve margin, then there would actually be almost a 50 percent chance that the program would not be solvent at any given future point in time. The second point is that under a projection that indicates sustainable solvency, there is no assurance of "permanent" solvency. The specification for sustainable solvency requires that the trend be stable or improving at the end of 75 years under best estimate assumptions. There is of course the possibility that experience may be worse than expected during the 75 years, and that the trend may not turn out to be as favorable at the end of 75 years.

5. *Do you believe the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?*

   We believe that further research into the merits of recognizing deferred revenue for earmarked revenues in excess of benefit payments may be beneficial. However, we do believe that this should be done as a separate project.

6. *The Primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information (paragraphs 15-37 Primary view; 64-84 Alternative view). Please make any comments that you wish on both views.*

   6.1 Comments on the Primary View

   As stated above, reporting future Social Insurance benefits as liabilities on the balance sheet would be inappropriate and misleading. The nature of the programs' benefit structures and financing mechanisms make a liability designation for future benefits inappropriate just as it would be inappropriate to characterize future potential tax collections as current assets. The membership and preferences of the Congress change over time, and so do the desires and values of the American people. We cannot foresee what changes may be pursued over the next 75 years.

We strongly disagree with the Primary View position of adding line items to the Balance Sheet and Statement of Net Cost that would create a new and different liability calculation in financial statements. The balance sheet shows financial status at a certain point in time and shows what a government owes as a result of past operations. It should include only liabilities that are present obligations of the Government. The Statement of Net Cost should reflect the principle of matching costs of government operations during a particular year with services provided by the government during that year. Showing expenses for future scheduled benefits would not match this principle. In addition we disagree with the Primary View regarding the Statement of Change, and reject the statement put forth in the Primary View.

Finally, and most importantly, we highly recommend against the Primary View on inclusion of future benefits as liabilities. Such benefits are reflected when indicated as becoming due and payable. There is no basis for extending the concept of liability beyond the long-held view of due and payable benefits. The government retains the unique ability to alter these benefits and revenues on a single-handed basis. The benefits are non-transaction events, and there is no logical basis for establishing a liability recognition point before the benefits become due and payable.

6.2 Comments on the Alternative View

We agree with the approach for liability recognition in the Alternative View, which is to continue the long held practice of recognizing Social Insurance benefits for any month of eligibility as liabilities only once such benefits are due and payable.

Social Insurance information displayed in government financial statements for Social Security and Medicare should be consistent with the information presented in the annual Trustees Reports for these programs. To this end, we encourage the inclusion as supplementary information a Statement of Changes in Social Insurance as presented in the Alternative View, entirely consistent with the Trustees Reports. But we also recommend inclusion both in the agency financial statements and in the government wide statement, specifically under the Statement of Social Insurance, the amount of trust fund reserves available at the valuation date. While Trust Fund assets do net out on the unified budget, they are very important in the narrower context of Social Security solvency. Here the fund assets have real value and will allow benefits to be paid well after exhaustion of the TF. Reflecting the starting Trust Fund assets for OASDI would help clarify the true actuarial status of the program.

Finally, we agree that a statement of sustainability for all Federal programs would be a useful and informative addition to the Consolidated Financial Statement for the entire Federal Government. However, we believe that to address sustainability the fundamental characteristics of timing and trend are essential. We believe that the only representation that satisfies these criteria and could be readily and simply applied for all Federal programs is projected annual cost of these programs, and projected revenue, on an annual basis, expressed as percentages of the projected gross domestic product (GDP) on an annual basis. Thus we reject the summarized values over long periods of time as useful indicators of sustainability, and particularly object to expressing these values on a per capita basis including only current workers or households.