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To whom it may concern

My thoughts are attached concerning Social Insurance

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The different perspectives on accounting for social insurance essentially are divided over the point of recognition of a liability and related expense for social insurance costs in the basic financial statements.

As accountants we typically err on the side of caution and record liabilities in the financial statements when a promise exists to transfer resources to another entity. The convention of conservatism is a guide for accountants to use in difficult situations from understating liabilities. The matching principle says to match costs with the period that the corresponding benefits were derived. Sometimes to adhere to the matching principle management is forced to make estimates that are to be objective and reasonably reflect the economic substance of accruals. Also, full disclosure of information in the main body of financial statements should be included if it meets the definition of a basic element, is measurable with sufficient certainty and is relevant and reliable. The supporters of the primary view are firmly entrenched behind these generally accepted recognition and measurement concepts and **their intentions are noble, points well taken, but the proper way to account for social insurance is the alternative approach.**

An accrual of a liability for anticipated future social insurance disbursements cannot be made because receiving social insurance is not a guarantee to future recipients. Social insurance is a governmental general welfare program much like Medicaid and General Welfare and therefore is subject to accounting for non-exchange transactions. The Social Security Benefit Statement states,

> **"We can't provide your actual benefit amount until you apply for benefits. And that amount may differ from the estimates stated above because:**
> 1) **Your earnings may increase or decrease in the future.**
> 2) **Your estimated benefits are based on current law. The law governing benefit amounts may change**."

The point is the amount of benefits to be paid to persons with 40 quarters of employment may change. **The primary view contends** that future changes in law or policy should not be considered in determining the current liability obligation as of the eligibility date. The supporters of the primary view maintain that a prior service cost should be made to reflect benefit reductions and that disclosures will be made that explains that current law may be changed in the future, and that actual amounts will vary sometimes greatly. The problem is that social insurance is not an employee benefit explicitly promised upon gainful employment. <u>**THERE IS NO PROMISE**</u>. The AICPA Liaison Task Force erred when it stated,

"……. 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."

This statement is merely a product of wishful thinking rather than properly reasoned and grounded on law. The primary view draws a parallel between social insurance and pensions and other postretirement benefits as its framework for long term liability recognition. The problem is that pensions and other postretirement benefits are contractual promises whereas social insurance is not. The **Employee Retirement Income Security Act (ERISA) of 1974** prohibits any defined benefit pension plan from making a pension plan amendment that would reduce a participant's accrued benefit. The right to receive certain money on a certain date may not be limited by a new condition narrowing that right Section 204(g), 29 U.S.C. Section 1054(g). There are two exceptions to this part of ERISA. ERISA Section 204(g) allows the reduction of accrued benefits by amendment in cases where a plan faces "substantial business hardship," 29 U.S.C. Section 1082(c)(8), and in cases involving terminated multiemployer plans, Section 1441. The United States Supreme Court held in Nachman Corp. vs. PBGC and Lockheed Corp. V. Spink that if a worker has been promised a defined pension benefit upon retirement and if he has fulfilled whatever conditions are required to obtain a vested benefit—he actually will receive it. The primary view could argue that if the company becomes insolvent it would be like a Social Insurance reform where the worker would not receive benefits. This is not true because ERISA created the Pension Benefit Guarantee Corporation (PBGC) to protect workers with vested benefits in a defined benefit pension plan to ensure they receive their entitled benefits up to a maximum threshold. Also, if business hardship causes benefits to be substantially cut the PBGC will contribute to ensure workers receive their promised benefits up to a maximum threshold. Social Insurance **approximated** benefits, on the other hand, can be cut unilaterally by Congress if hardship is encountered. There is **NO GAURANTEE** present that estimated benefits will be paid. Social Insurance benefits checks even though are technically from a trust fund, effectively are **<u>subject to available appropriation</u> by Congress and therefore are non-exchange transactions**. Social insurance benefits are not quid pro quo. It is inappropriate to compare social insurance benefits to defined benefit pension plan benefits. In accounting jargon, we are comparing apples and oranges. As a corollary to my central point the IRS shares the view of the Supreme Court towards defined benefit pension plans regarding anti cutbacks (See 26 U.S.C. Section 411(d)(6). The IRS has minimum funding requirements and can issue a tax lien against a corporation if funding levels for the defined benefit pension plan is not met. No provisions are in place for social insurance funding.

The accounting profession relies on the legal system in determining whether to record a liability in many instances. For example, under the purview of SFAS #5 Accounting for Contingencies an accountant often obtains a legal opinion on whether to accrue a liability in the financial statements. The legal system clearly would favor the Alternative View in this circumstance because Congress can unilaterally change benefits. A class action lawsuit by social insurance recipients objecting to benefit reductions would probably be fruitless. **I believe that the FASAB should select a panel of legal experts to provide a majority opinion on whether Congress can unilaterally cut benefits after the eligibility date has been met by participants**. The majority opinion would be determining factor on whether to book a liability and related expense in the financial statements for long term benefit payments. Again, my opinion is that Congress can unilaterally cut benefits. The primary view has a decent argument based on most common accounting principles but the legal system dictates that no liability should be booked.

The alternative view has a very strong point in citing the exposure draft of the International Public Sector Accounting Standards Board that promulgates liability recognition in the main body of the financial statements equal to the amount of the next payment. An article appearing in the Journal of Accountancy written by D.J. Gannon and Alex Ashwal, partner and senior manager with Deloitte and Touche, in September, 2004 offered an insightful look at the convergence of international standards and U.S. Standards with changes being made to U.S. Standards to conform to international standards more than vice versa (http://www.aicpa.org/PUBS/JOFA/sep2004/gannon.htm). This likely is a stronger point than most people commenting on the exposure draft realize.

The alternative view has another strong point in that recognition by the federal government of a liability in the body of the financial statements would require symmetrical asset recognition by all members meeting eligibility criteria for social insurance. This reminds me of the situation a few years ago where the NJ State Treasurer wanted school districts to book a receivable and not have the related liability booked by the State of New Jersey. This cannot happen because under GASB #33 paragraph 54 and 55 Symmetrical Recognition criteria forbid this practice. **Social insurance participants cannot legally record an asset for expected benefits**

I shall cross examine some key points made by the primary view.

Primary View Point

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.

Cross Examination

These standards are not applicable to Social Insurance because of reasons stated above.

Primary View Point

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.

Cross Examination

Social Insurance is law but the primary view misses the point that the budget only lasts one year like other governmental programs such as education funding. Social insurance cannot be considered a long term liability because of the legal red tape.

Primary View Point

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.

Cross Examination

First of all the Alternative Position does not believe that a liability can be recorded for the long term projected impact of social insurance because of legal considerations. Second, liabilities are affected by future events other than in conjunction with measuring the present value of a past event. **What about loss contingencies (i.e. unasserted claims)?**

Primary View Point

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.

Cross Examination

Where is the point in terms of Social Insurance? The Alternative view will present accrual based information along with a complete sensitivity analysis in the Required Supplementary Insurance. The Required Supplementary Information will be extremely useful as a fiscal barometer of social insurance to decision makers in drafting policy changes. Understanding the Required Supplementary Information is a very important aspect in considering the overall financial condition of an entity. Accrual based information on Social insurance should be a tool for future policy decisions rather than interpreted as a present obligation.