Subject: Comments on Preliminary Views of Revised Accounting for Social Insurance
From: "Juan Kelly" <jkelly@mahoneyandassociates.com>
Date: Mon, November 13, 2006 10:41 am
To: <comesw@fasab.org>

Ms. Comes, I have carefully read the above exposure draft and am please to offer my comments on this Statement of Federal Accounting Standards. I have attached my responses to the questions posed in the body of the draft. Additional comments follow:

- The comment in Paragraph 10 of the Proposed Standard as espoused in the Primary View ignores the fact that “externalities” are a fact of life. We all are impacted by them daily so the time to recognize their financial impact is now, not later.

- It is important to recognize the distinction alluded to in Paragraph 16 of the Proposed Standard as espoused in the Primary View between closed (subparagraphs 16a and 16b) and open (subparagraph 16c) accounting.

- It is noted in Paragraph A13 of the Basis for Conclusions as espoused in the Primary View that financial reporting on employee pensions is based on current law. That is not correct; instead the measurements of expense and liability are based on the “substantive provisions” of the employee pension plans.

- It is noted in Paragraph A16 of the Basis for Conclusions as espoused in the Primary View that attainment of “fully insured” status and continuing employment increasing the present value of social insurance benefits are tickets to be punched in order that the conditions for social insurance eligibility have been substantially met. Eligibility for Social Security disability benefits and death in covered employment ($255 fixed benefit) are two obvious examples where this statement needs to be reexamined.

- It is noted in Paragraph A36 of the Basis for Conclusions as espoused in the Primary View that “apprehension” is called for; I believe we need more “comprehension” instead.

- It is noted in Paragraph A38 of the Basis for Conclusions as espoused in the Primary View that other countries will negatively interpret large new liabilities reported in our federal government accounting. I believe that the exposure draft released by the IPSASB last month will render this point moot as discussed in Paragraph A110 of the Basis for Conclusions as espoused in the Alternative View.

- It is noted in Paragraph A59 of the Basis for Conclusions as espoused in the Primary View that funding generally is on a level percentage of basis. Any qualified actuary will be able to confirm that judicious selection of compensation and cost trend assumptions will produce a similar result when the “benefits approach” is used.

- It is noted in Paragraph A129 of the Basis for Conclusions as espoused in the Alternative View that social insurance is not an employee benefit. The Handbook of Employee Benefits, Sixth Edition, takes a different view in Table 1-1 on Page 6.

- It is noted in Paragraph A133 of the Basis for Conclusions as espoused in the Alternative View that amounts of social insurance benefit payments are uncertain and not reliably estimable. What good then are pre-retirement counseling and financial planning? To quote the old adage, a failure to plan with the best available information is a plan to fail (as information is updated so is the plan). To beat this point to death, recall a paraphrase of Deming’s quotation “to manage is to measure.”

- It is noted in Paragraph A136 of the Basis for Conclusions as espoused in the Alternative View that social insurance taxes are nonexchange transactions. There are significant sectors (e.g., public) of the economy where the mandate for social insurance taxes has limited if any application. To say there is no exchange is at best an oversimplification.

Sincerely,
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Request for Comments

The FASAB encourages you to become familiar with all proposals in this proposed Statement before responding to the questions in this section. The paragraphs cited in parentheses in a question are particularly relevant to that issue, but other portions of the document also may enhance your understanding of the question.

The Board also would welcome your comments on other aspects of the proposals in this preliminary views document. Because the proposals may be modified before an exposure draft is issued, it is important that you comment on the proposal that you agree with as well as the one that you disagree with and/or any aspects of either. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Comments should be sent by e-mail to comesw@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V

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Washington, DC 20548

All responses are requested by April 16, 2007.
Questions for Respondents:

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. and 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. – 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. — 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. – in the basis for conclusions for more), and (2) "threshold eligibility" at age 62 for Social Security and 65 for Medicare (see par. 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.

I believe liability recognition should occur when participants begin work in covered employment and continuing as long as such work continues**. All periods of covered employment receive similar treatment when it comes to the benefits accrued under the applicable social insurance programs. There is no clear demarcation as to when covered employment figures into the calculation of an individual's social insurance benefits. Hence, it is arbitrary and improper to say that liability begins to accrue either when participants become fully insured via completion of 40 quarters of covered employment (not correct in the case of disability benefits)**

or when the threshold eligibility is reached (as cited on Page 16 of the draft). Whether the contributions made by employees commending with their covered employment are earmarked is irrelevant; the fact is that the contributions are recognized as revenue. To say that there is no corresponding expense is indefensible under GAAP whether it be the private sector or public sector interpretation.

The recent FASAB exposure draft regarding a Statement of Federal Financial Accounting Concepts entitled *Definition and Recognition of Elements of Accrual-Basis Financial Statements*1 (*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 – 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. – and especially subpar. 16g in the standard; also see – in the basis for conclusions)? Please provide the rationale for your answer.

Not only do I 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, I go further as I expounded in my response to Question #1. The fine points of the pro rata methodology can be debated ad infinitum; the fact is that the expenses accruing from covered employment are both measurable and material.

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. 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. in the proposed standard and Appendix C for an illustration.)

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[1] The *Elements* ED is available at www.fasab.gov/exposure.html.

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?

Please provide the rationale for your answers.
FASB has come to the realization that the devil is in the details which to be properly understood need to be in the financial statements not the footnotes, witness FAS 158 effective for financial statements of entities with publicly traded securities with respect to periods ending after December 15, 2006. It is no different in the governmental sector.

I 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 consistent with GAAP. Similarly, I believe that the reasons for changes in SOSI amounts during the reporting period should be reported as proposed by the Primary View.

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. in the standard and 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.

I do not believe the proposal should be adopted. It amounts to additional expense to us as taxpayers with immaterial utility.

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. governmentwide 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. in the standard and -- 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.

I believe the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs consistent with GAAP.

Q6.The Primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information. (See pars. – for the Primary View and pars. – for the Alternative View.)

6.1 Please offer any comments that you wish to make on the Primary View provisions.

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

The accounting fiascos experienced by the City of San Diego and Enron make it all too plain that the era of obfuscation and hiding in the sand are over so let's Keep It Simple and Smart (KISS). To not embrace the Primary View as a step in the right direction is the KISS of death.