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AUDITOR GENERAL

April 16, 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:

We have read the Federal Accounting Standards Advisory Board's (Board) preliminary views (PV) document titled *Accounting for Social Insurance, Revised* and have organized our comments primarily among the six questions raised in the preface of the PV. We applaud the Board's efforts to improve upon the financial reporting for social insurance and look forward to the Board's deliberations on this important topic.

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.

We support the primary view regarding the recognition of the expense and liability for the three social programs mentioned in the question. We consider the 40 quarter criteria as appropriate. The 40 quarter criteria strikes a reasonable balance between what we consider two extremes, e.g. waiting until a person turns 62 until a liability is recognized versus recognizing a liability the moment a person first begins paying taxes on their first job. One reason we prefer the 40 quarter criteria is that the Social Security Administration should have a very good estimate of the earnings a person has paid into the system and a better basis for estimating what that person would receive during their retirement under the current payment regulations. We think waiting until the threshold eligibility age waits too long to recognize the liability and therefore would materially understate the reported liability. Conversely, we consider the entrance into covered employment as too soon to recognize the liability as it introduces too many variables into the estimation methodology (a person's first years of employment may substantially underestimate their likely earnings as they mature into steady employment). We consider the 40 quarter criteria as meeting the traditional accrual criteria of "reasonably estimable" and "probable" for recognition of the liability and expense.

Q2. The recent FASAB exposure draft regarding a Statement of Federal Financial Accounting Concepts entitled Definition and Recognition of Elements of Accrual-Basis Financial Statements6 (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 do 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. Please see our response to question 1 as we discussed our rational for supporting the "40 quarter" criteria.

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?

Not at this time. We anticipate that the social insurance liability and expense amounts will immediately relegate the other items on the balance sheet and statement of net cost, respectively, to immaterial items. It is with this concern in mind that we support the alternative view. We would prefer to see the social insurance liabilities on the statement of social insurance (SOSI) and the expense amounts on the statement of changes in social insurance proposed by the Alternative View and allow the users to place these amounts into perspective. Since the SOSI is a basic financial statement of the federal government, the Alternative View will allow the Governmental Accountability Office (GAO) to place the materiality of these amounts in its own context and allow it to opine on the fair presentation of this statement without necessarily impacting the opinions on the other financial statements (granted, we look forward to the time when the GAO does not provide a disclaimer opinion on the Financial Report of the United States).

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.

As discussed in our response to question 3.1, we favor the reporting as proposed by the Alternative 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. 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.

Yes, we would consider a statement of fiscal sustainability as very helpful in informing Congress, the President, and current and future beneficiaries of these federal programs as to the likelihood of receiving benefits.

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. 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.

No, we do not see a need at this time for the Board to consider this accounting treatment. We would also prefer to know the results of the Boards' *Definition and Recognition of Elements of Accrual-Basis Financial Statements* project to better assess whether this issue should be pursued.

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.

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

We have no other comments on the PV but we encourage the Board to deliberate quickly on this issue. We anticipate that any standard that makes material changes to accounting and reporting on social insurance will take several years to implement. Yet, such accounting and reporting becomes essential when there is significant doubt regarding the sustainability of the programs. This information will be essential for the Congress and the President to make informed decisions on these important federal programs.

We appreciate the opportunity to comment on this important topic. If you have any questions or desire further details on our comments, please contact me or Craig M. Murray, C.P.A., Director of Professional Practice.

Sincerely,

Thomas H. McTavish

Thomas H. McTavish, C.P.A.
Auditor General

By e-mail