DATE: 04/16/2007

FROM: Terry Bowie, Acting Chief Financial Officer
National Aeronautics and Space Administration

TO: Ms. Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board

SUBJECT: Responses to FASAB Preliminary Views-Accounting for Social Insurance, Revised

We would like to thank you for the opportunity to provide comments on the proposed revisions being considered to the Statement of Federal Financial Accounting Standards, "Accounting for Social Insurance".

Enclosed you will find our responses to the Board's questions. In summation, we strongly support the Alternative View based on the premise of recognizing social insurance obligations when all eligibility requirements are met and benefits are due and payable.

We consider social insurance programs to be significantly different from other types of retirement programs in the private sector; therefore, it is important to consider the impact of changing their accounting treatment, cost implications, and the future impact of congressional legislation. Social insurance is a program that requires an in-depth examination and ample consideration should be given to all of these conditions.

In addition, the proposal as outlined in the Primary View would negatively affect the Federal Government's ability to produce useful financial statements necessary for sound decision making and their complexities would present significant problems for both the preparers and users of the financial statements.

If you have any questions on the enclosed responses, please contact Leslie Hyland by phone at 202-358-4645 or by email at leslie.hyland-1@nasa.gov.

Enclosure

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
OFFICE OF THE CHIEF FINANCIAL OFFICER
COMMENTS ON PRELIMINARY VIEWS
PROPOSED STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS
"Accounting for Social Insurance, Revised"

Question 1: 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.

Response 1: We agree with the Alternative View based on the premise that 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. The Primary View does not take into consideration all of the conditions that would significantly affect liability recognition based on when the participant becomes fully insured. For example, changes in current laws and the inability to accurately estimate offsetting future income.

Question 2: 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 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.

Response 2: We do not agree with the Primary View proposal 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. Social insurance programs are uniquely different from retirement plans and warrant other considerations. We support the Alternative View that the obligations are measurable when they become due and payable for purposes of recording the liability.

Question 3.1: 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

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

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.)

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?

Response 3.1: We do not agree with the proposal of the Primary View to add additional line items to the SOSI that tie to revised expense and liability amounts reported on the statement of net cost and the balance sheet. Adding to the complexities of the financial statements would not be in the best interest of the preparers, auditors or the public. It would not improve the understandability and relationships between those statements. We support the Alternative View established in SFFAS 17 recognizing the expenses and liabilities for the appropriate period due and payable.

Question 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?**

Response 3.2: Yes, we believe that the reasons for changes in SOSI amounts during the reporting period should be reported because it provides additional relevant information to the users and improves the understandability of the statement. In efforts to ensure the information is communicated effectively to the user community, we agree with the proposal of the Alternative View but the information should be disclosed as required supplementary information.

Question 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 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.

Response 4: We believe that a statement of fiscal sustainability warrants further analysis and deliberation. Considering the complexity and uncertainty surrounding the sustainability of social insurance programs under current law, the statement of fiscal sustainability would be extremely difficult to prepare but would bring attention to the issues affecting resource allocation, fiscal policy, economic growth and the need for an appropriate resolution of those issues.

Question 5: 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 non-earmarked 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. government-wide 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.

Response 5: We do not agree with recognizing deferred revenue for earmarked revenues in excess of related program costs but disclosure is sufficient. This rationale is consistent with current accounting principles and standards. Since the issues associated with deferred revenue for earmarked revenues applies to earmarked funds and revenues of other types of programs, it warrants substantial review and analysis.

Question 6.1: 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.)

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

Response 6.1: The Primary View does not take into consideration the unique attributes associated with social insurance programs and its proposals would only add to the complexities in understanding the financial statements and using them to make sound decisions. In addition, this proposal would only result in excessive costs, unreliable estimates that adversely affect the overall intent of providing a more accurate financial position of the federal government.

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

Response 6.2: We support the Alternative View but do not support the consideration of recognizing deferred revenue for earmarked revenue. In addition, further analysis is needed regarding the disclosure of information and the format on how this information should be disclosed. We agree that additional financial information should be provided on social insurance programs but in the form of supplementary information.