>>> "Von Elm, Roger" <rvonelm@uhy-us.com> 4/17/2007 10:20 AM >>>
Wendy - UHY LLP is pleased to submit our comments on FASAB's October 2006 Preliminary Views document, Accounting for Social Insurance, Revised. Should you have any specific questions regarding our comments, please feel free to contact me below or Suesan Patton at 203-508-1042

Roger Von Elm, CPA CGFM

Partner

UHY LLP

(also doing business as Urbach Kahn & Werlin LLP)

1425 K Street NW Suite 500

Washington DC 20005

UHY LLP
Certified Public Accountants

April 16, 2007

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814 (Mailstop 6K17V)
Washington DC 20548

Dear Ms. Comes:

We are pleased to offer our comments on the FASAB's October 2006 Preliminary Views (PV), "Accounting for Social Insurance, Revised." UHY LLP operates as the attest firm in an alternative practice structure with UHY Advisors, Inc., the 13th largest professional services firm in the United States. UHY LLP provides audit and attest services to public companies, not-for-profits, local governments, and federal government agencies through over 20 practice offices across the country.

Q1. Which obligating event do you believe creates a liability and expense that should be recognized?

We believe the obligating event occurs when an individual earns wages that are subject to social insurance program taxes and that are used as the basis for calculating that individual's program benefits. With few exceptions, the benefits paid to program participants under Federal social insurance programs are currently based on both (a) the **period of time** participants work (at least 40 quarters) and (b) the **dollar amount of wages** they receive over their working lifetime. We believe an obligation and expense should be recognized based on an actuarial projection of the extent to which participants will continue working until fully insured (as defined in the PV glossary) and an actuarial projection of the likelihood that participants will live long enough to receive benefits under the program.

Regardless of whether FASAB members believe that Federal social insurance consists of a single program (as is the case for the Primary View) or two programs (as is the case for the Alternative View), it is clear that benefits provided are *based on* individual earnings. Among other things, we point to the information provided on page 3 of our Social Security Statements—"Remember, it's your earnings, not the amount of taxes you paid or the number of credits you've earned that determine your benefit amount."

Q2. 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?

Yes. We believe that the liability for fully insured participants is measurable using actuarial valuations. However, we disagree with *both* the Primary View and the Alternative View on the matter of what should be measured—that is, the obligating event. We believe FASAB should measure its obligation to provide benefits based on wages that are subject to tax that are earned to date, including benefits that have vested (the Primary View's 40 quarters) *and* benefits that are probable of being vested. To recognize expenses and liabilities based solely on fully insured (vested) benefits is completely incongruent with the way in which other organizations, including the FASB, GASB, and IASB measure similar expenses and obligations.

International Accounting Standard (IAS) 19, *Employee Benefits*, paragraph 69 as amended, describes this concept in its simplest form:

> Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive balance sheet date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

While we agree that recognition under the Primary View clearly represents major progress on this matter, we see no reason—other than political compromise—to measure the Federal government's obligation based solely on *vested* benefits when amounts that are also *probable of payment* include benefits for participants who, although not currently vested, have earned compensation and are likely to continue working until fully insured.

Q3.1 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. We believe that the information provided in the SOSI is designed to—and is very useful to—project the hypothetical date on which the “assets” of the social insurance trust funds will be used up given current fiscal policies. However, we do not agree that the two statements should articulate. We see no link between the information presented in the SOSI and the Federal government’s probable obligation to provide benefits. For example, the SOSI measures benefits for the next 75 years and includes children not yet born let alone working.

In fact, we believe that tying the SOSI measures to the balance sheet measure of the government’s probable obligation for social insurance would be a mistake and would diminish the importance of the balance sheet amount. We can easily imagine the confusion generated in a Congressional discussion of this matter when, for example, someone errantly suggests that the balance sheet obligation includes amounts payable for children not yet born. We strongly believe that there should be a clear, bright-line distinction between the two measures and their purposes.

Q3.2 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 in the Primary View, (2) as proposed by the Alternative View, or (3) some other approach?

We believe that information about *changes* in benefit obligations in the current period is just as important as measuring and reporting the probable obligation. Therefore we support disclosures in the notes to the financial statements regarding the change in the projected benefit obligation. However, as noted above, we believe that information about the balance sheet obligation should *not* be linked to SOSI measures of trust fund solvency.

Q4. Do you believe the Alternative View proposal should be adopted?

No, as stated earlier, we disagree with both views.

Q5. Do you believe that the Board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?

No. We believe, however, that if a liability is recognized only for people who are “fully insured” (Primary View), then program revenues generated in the form of taxes paid by participants who are *not* fully insured should be deferred until those participants become fully insured.

If reporting under the Alternative View, it makes no sense to defer revenues from taxes that are considered to be entirely separate from a program that "grants" social insurance benefits.

Q6.1 Please offer any comments that you wish to make on the Primary View provision.

Intergenerational Equity

Page 7 of the PV notes that both the Primary and Alternative View believe that financial statements resulting from FASAB standards are "intended to be accrual based." As we see it, for any government, one of the most important outcomes of accrual basis measurement is the ability to report on the extent to which the current period's operations have maintained intergenerational equity. Citizens, investors, and other financial report users should be able to assess whether current-year revenues were sufficient to pay for the services provided that year or whether future taxpayers will be required to assume burdens for services previously provided. Reporting a social insurance obligation that is less than the probable (projected) obligation falls short of the goal of measuring intergenerational equity—that is, the amount proposed in the Preliminary View *fails* to measure the full extent of the obligations being accumulated by the current generation, which ultimately will be passed on to future generations. Many argue that the Congress can shut down the social insurance programs whenever it likes. Until it does so, the fact is that social insurance programs—as currently financed—are passing on tremendous financial burdens to future taxpayers.

By the same token, measuring the liability based only on fully insured benefits is dishonest when the government's statements otherwise imply that all assets, liabilities, revenues, and expenses are being measured.

Q6.2 Please offer any comments that you wish to make on the Alternative View provisions.

Balance Sheet Reporting

The Alternative View suggests that reporting a liability for fully insured benefits on the face of the Federal government balance sheet would "diminish significantly the relative size and importance of other expenses and liabilities shown on the financial statements." We could not disagree more. The obligation for social security benefits properly measured will clearly dwarf other programs and expenses. How could this not be the case when expenses of these programs are 50 percent of the Federal budget when reported on a pay-as-you-go-basis?

As the old adage goes—you can't manage what you don't measure. The measurements presented as required supplementary information since 1999 have not generated any urgent discussion of this matter. We believe that it is time to give allow citizens to understand the true financial position of the U.S. and give the topic the urgency it deserves by placing the probable obligation on the face of the balance sheet. The FASB recently issued its Statement No. 158, *Employers' Accounting for Defined Benefit Pension Plans and Other Postretirement Plans*, in recognition of the fact that reporting information about significant pension and postretirement obligations in the *notes* to the financial statements and not on the face of the financial statements "failed to communicate the funded status of those plans in a complete and understandable way." The Board also concluded that not providing representationally faithful and understandable information about these obligations "might lead to the inefficient allocation of resources in the capital markets."

The Government's Ability to Adjust Its Responsibilities for Social Programs

The Alternative View also cites the "Government's ability to adjust these responsibilities" as a reason for reporting the full extent of these obligations *outside* of the balance sheet. However, we cite the Board's discussion in its Exposure Draft, "Definition and Recognition of Elements of Accrual-Basis Financial Statements":

> 44. To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on *existing* conditions, including current law, because an essential characteristic of a liability is that the government has a *present* obligation, even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. <u>The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability</u>. [Our <u>emphasis</u> added.]

We agree with this concept. It may be that—*at some point in the future*—Congress will decide to modify the formula under which benefits are calculated or cancel the programs altogether. Nevertheless, this fact does not preclude the ability to accurately measure the obligation as it exists today. This fact also does not justify reporting the obligation *outside* the Federal government's balance sheet.

Nonexchange Transactions

The Alternative View suggests that the social insurance programs consist of two separate components, both involuntary. And because they are involuntary, it cites GASBS No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* paragraph 21, which discusses recognition of government-mandated and voluntary nonexchange transactions. Although we disagree with this segmentation, we believe that the transactions encompassed in social insurance programs are more like *derived tax* transactions, defined in GASBS No. 33, paragraph 7. Derived tax revenues (and expenses to the taxpayer), result from assessments imposed by governments on exchange transactions. In this case, the underlying exchange is an employee working for wages. GASBS No. 33, paragraph 16, provides the accounting for these transactions:

> Governments should recognize *assets* from derived tax revenue transactions in the period when the exchange transaction on which the tax is imposed occurs or when the resources are received, whichever occurs first. *Revenues* should be recognized, net of estimated refunds and estimated uncollectible amounts, in the same period that the assets are recognized, provided that the underlying exchange transaction has occurred.

Although GASBS No. 33 does not address reporting a nonexchange *expense* arising from a derived tax transaction, it only makes sense that recognition of benefits expense should also occur when the underlying exchange transactions take place. (See our discussion of wages as the basis for recognition on page one.)

***

Should you have questions or wish to discuss our comments in more detail, please contact Roger Von Elm at (202) 296-2020 or Suesan Patton at (203) 508-1042.

UHY LLP