Association of Government Accountants
Nashville Chapter
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April 26, 2007

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

Dear Wendy,

The FASAB has created a Fiscal Sustainability Task Force that is expected to have developed recommendations on sustainability reporting by the end of 2007. The nature of those recommendations is unknown at this point, but the recommendations have the potential to directly impact the responses to this preliminary view. Obviously, there is a missing piece in the federal government reporting picture. Governments in general often make promises to their constituents about services to be provided without determining or without communicating to the public how long those services can be sustained using existing tax and spending structures. The federal government in particular often overextends itself, often with the best intentions, to the detriment of future generations. It appears the Fiscal Sustainability Task Force is a much needed step forward in addressing the unique obligations in the federal government that need to be considered for policy decisions and to assess the overall economic condition of the federal government, but for which may not qualify as a traditional liability for financial reporting purposes.

Facts regarding the nation's current economic condition, financial position, and long-term fiscal outlook are being disseminated to more and more individuals through the Fiscal Wake Up Tour and other methods. This increased public awareness is causing citizens to be unsettled and fearful of the future, and they recognize that the financial statements must not be providing the information needed for decision-making at the federal level. As such, there may be a tendency for many of us to reply in a manner where we want whichever option reports the most liability in the financial statements in order to help our citizens and our lawmakers wake up to the problems in the future. In this case, that would be the primary view. This emotional decision may be made regardless of the merits of the well-developed arguments of the alternative view. So we would suggest that the Board table this preliminary view and the responses received until the Fiscal Sustainability Task Force can demonstrate what the future of sustainability reporting will be, how much significance and relevance a sustainability report would have in relation to the other financial statements, and what other federal promises and obligations would be included in such a report.

In the meantime, the board will probably get very divergent views on how social insurance should be handled. In the event that the FASAB does not want to table this PV until the sustainability project can be completed, we support the primary view or a version of the primary view without the 40 quarter requirement because benefits begin accruing to a participant when a minimum of six quarters of work in covered employment is attained. The FASAB cover letter stated that members agree that social insurance information should be included in the basic financial statements, should be audited, and should be transparent. The members also agree that the financial report should highlight any long-range fiscal imbalances anticipated in social insurance programs. We believe the primary view best meets those concepts that were agreed on by the FASAB members.

Q1: In our view, based on the Board's proposed definition of a liability in the FASAB's Proposed Statement of Federal Financial Accounting Concepts Exposure Draft (ED), *Definition and Recognition of Elements of Accrual-Basis Financial Statements*, we agree that the obligating event is the point when participants have substantially met all eligibility requirements (i.e., participants become fully insured when they complete sufficient work in covered employment). However, we believe that the substance of the social insurance program as understood by participants who pay into the program is that benefits begin accruing the moment the participant is "vested" (i.e., a minimum of six quarters of work in covered employment is attained), not just fully insured at 40 quarters. These promises are made under the law. We understand the 40 quarter viewpoint and would support it against the alternative view if the board refused to consider full accrual.

We agree with the AICPA's Federal Accounting and Auditing Subcommittee's response to the 1998 exposure draft as expressed in ¶A2: "The Subcommittee believes that social insurance programs <u>are exchange programs</u>. With each period of covered employment, workers and their employers exchange a commitment to pay earmarked taxes for a promise from the Government to provide social insurance benefits in the future. 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." Therefore, we believe that liabilities should be recognized for long-term obligations under social insurance programs. The government should not be relieved of the responsibility to report a liability where such a liability exists (¶A2). The amount to be recognized as a liability should be based on events that have already occurred as of the balance sheet date and which are reliably measurable at that date. For example, a participant's payment of all required contributions and attainment of age and other eligibility criteria would indicate that a liability to that participant exists (¶A2).

The phrase "covered employment" itself conveys a promise of future benefits. The implied federal promise through current law is that those benefits are earned as a direct result of the wages earned and the amount paid into the program. Clearly, no current legislature can bind a future legislature; however, the existence of a long-term liability appears to have occurred when the promise was made and all eligibility requirements have been met. If the government does not intend to continue the program, they should notify the taxpayers immediately of the expected discontinuation date. If they do intend to continue the program, that amount should be included as an expense or a liability unless another suitable method of reporting the information is created through sustainability reporting project. Full accrual accounting would be relevant here to show the true economic condition and financial position of the government as a whole.

Also, one of the reasons given to support differing viewpoints is that the recognition of these large liabilities would diminish the relative size and importance of the other liabilities and expenses. The board should never consider ignoring a liability and related expense just because it is material or significant. If the transaction meets the definition of a liability, it must be reported unless clearly immaterial. Otherwise, faithful representation of the financial statement information becomes nonexistent, is materially misleading, and is no longer reliable for decision-making. One of the other reasons given for not including the whole amount was because of a mismatch with the revenues. The concept of interperiod (GASB terminology) or intergenerational (FASAB) equity is a much more relevant concept than matching of revenues and expenses. We agree that the matching argument may be relevant but are unsure how best to address the issue without first seeing what the board has in mind for the sustainability statement.

Q2: We believe the Social Security and Medicare obligations are measurable for purpose of recording a liability. Projections can be made on past data and trends in these areas. Significant assumptions used in calculating any liabilities could be disclosed. Actuaries and experts in the field could arrive at a number. In fact, Social Security benefits are based on the benefit formula (¶A20). As such, the present value of future benefits based on current law at the balance sheet date can be measured (¶A21). In assessing the financial condition of the United States of America, we believe presenting a best estimate based on all relevant facts and circumstances at the balance sheet date is more representationally faithful, instead of presenting no liability at all, except for the current portion due and payable. Future Social Security and Medicare recipients clearly believe that an obligation, at least, and a liability in general have occurred when all eligibility criteria have been met. As stated in our answer to Q#1 above, we believe that the substance of the social insurance program as understood by participants who pay into the program is that benefits begin accruing the moment the participant is "vested" (i.e., a minimum of **six** quarters of work in covered employment is attained), not just fully insured at 40 quarters. Therefore, reporting no liability, especially when material, could represent fraudulent financial reporting in any circumstances.

Q3.1: Yes. We agree that amounts reported on the statement of net cost should articulate with the balance sheet. Correlation between data is essential for understandability.

Q3.2: We support the reporting as proposed by the primary view as expressed in the basis for conclusions.

Q4: Regardless of whether the primary view or alternative view is adopted for social insurance, there should be a statement of fiscal sustainability developed. However, decisions made through this PV and eventual standard may have to be amended or reexamined if it is implemented prior to the fiscal sustainability project. A statement of fiscal sustainability is essential for understanding the economic condition of the government as a whole; thereby, increasing the decision utility of the information presented.

Q5: We disagree with the alternative view approach. The social insurance payments made by participants should be reported as restricted resources for only the purpose of paying the social insurance benefits. Earmarking revenues has no meaning because Congress has demonstrated time and time again that excess funds will be used for current operations. The best solution is requiring the use of irrevocable trust for the social insurance payments so that those resources are restricted for a particular purpose (i.e., payment of benefits only). Financial statement reporting should demonstrate the transparency to a reader that those funds are restricted for a particular purpose. The alternative view does not accomplish this objective. In the meantime, the future liability continues to grow exponentially because the government uses a pay-as-you-go approach, instead of setting aside assets in a real trusts whereby those invested assets can earn compounded interest.

Q6: No additional comments.

Sincerely,

Gerry Boaz
Nashville AGA President