Response to FASAB
"Accounting for Social Insurance, Revised, Exposure Draft (November 17, 2008)"

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I appreciate the opportunity to comment on this exposure draft and hope to contribute to a constructive and useful outcome.

Q1. The Board proposes to require social insurance component entities and the government-wide entity to discuss and analyze key measures from the basic financial statements in their management's discussion and analysis ("MD&A"). See paragraphs 26–30 in the proposed standard and paragraphs A75—A79 in the basis for conclusions.

Do you believe that key measures should be presented in the MD&A as described in this exposure draft?

Please provide the rationale for your answers.

I agree that key measures should be presented as described in the exposure draft, with two exceptions, as follow:

The exposure draft states the MD&A "should encompass the possible future effects of anticipated future events, conditions and trends." Measurement of the net obligations for most of the programs covered by the exposure draft requires projection of income and expenses many years into the future. These projections, in turn, require assumptions regarding future events, conditions and trends. These assumptions are subject to a high degree of uncertainty, as is widely recognized. As appropriate, the exposure draft calls for a sensitivity analysis showing the possible effects of variance between assumed and actual experience over time. The section of the MD&A that discusses the possible future effects of anticipated future events, conditions and trends should be subsumed into the sensitivity analysis for those programs for which a sensitivity analysis is required.

The exposure draft should substitute discussion of the open group measure for the closed group measure in the MD&A, for the reasons given in the response to Question 7 below.

Q2. The Board is proposing to add a line for the closed group measure to the balance sheet below assets, liabilities, and net position and not included in the totals for these classifications. See paragraphs 31—32 in the proposed standard and paragraphs A81—A100 in the basis for conclusions. Two members have submitted alternative views on this issue. See paragraphs A139—A142 in the basis for conclusions for Mr. Patton's view. Mr. Patton and other members believe that a liability greater than the due and payable amount should be recognized on the balance sheet. See paragraph A144 in the basis for conclusions for Mr. Werfel's view. Mr. Werfel and other members believe that the closed group measure should not be presented on the balance sheet.

Do you believe that the balance sheet should present a line item for the closed group measure as described in this exposure draft?

Please provide the rationale for your answers.

The balance sheet should present a line item for neither the closed group method nor the open group method. The Board bases its proposal for adding a line for the closed group measure to the balance sheet below assets, liabilities, and net position on what the Board describes as a liability-commitment-expectation continuum. Because the social insurance systems covered by the exposure draft fall outside the liability segment of the continuum, they should not affect the reported net position of the federal government; but because they represent more than mere expectations of future expenditures, they warrant a line item on the government's balance sheet below assets, liabilities, and net position.

In, fact, no such continuum exists. Rather, federal programs fall onto a multi-dimensional array of combinations regarding the source, degree of certainty and timing of funding and expenditures. For example, although the government has a commitment to national defense at least as strong as to the social insurance programs covered by the exposure draft, funding for defense is appropriated from general revenues on a year-by-year basis. Funding for highway and airport construction comes from dedicated trust funds like some social insurance programs but is derived from taxes on gasoline and airport usage fees, respectively. Funding for entitlement programs such as Medicaid comes from general revenues and is essentially open ended, while funding for the closely related SCHIP program comes from block grants to the states. Medicare Part A is funded by a trust fund derived from a dedicated tax, while Parts B and D are funded by member premiums and general revenues.

As the foregoing examples illustrate, the variety of funding mechanisms for federal programs is too broad to place on a single continuum. The exposure draft fails to provide any compelling argument that the five covered programs are both so similar to each other yet so distinct from other government programs as to require special treatment on the balance sheet. Therefore, no additional line item of any kind relating to these programs should be presented on the balance sheet.

Q3. The Board proposes to add a new summary section of the statement of social insurance ("SOSI") to present the closed and open group measures. See paragraphs 34—35 in the proposed standard and paragraphs A114—A116 in the basis for conclusions.

Do you believe that the SOSI should have a summary section as described in this exposure draft?

Please provide the rationale for your answers.

The SOSI should show only the open group measure, for the reasons given in the response to Question 7 below.

Q4. The Board proposes a new basic financial statement entitled "statement of changes in social insurance amounts." The new statement would explain the changes during the reporting period in the present value amounts for the closed group measure included in the statement of social insurance. See paragraphs 36—37 in the proposed standard and paragraph A116 in the basis for conclusions. Mr. Werfel and other members have an alternative view. They believe the new statement should focus on changes in the open group measure and not the closed group measure. The question of the use of the appropriate measure is addressed in question 7 below. See paragraph A145 in the basis for conclusions.

Do you believe there should be a new basic financial statement explaining changes to the present value amount included in SOSI?

Please provide the rationale for your answers.

I agree with the alternate view expressed by Mr. Werfel, for the reasons given in the response to Question 7 below.

Q5. The Board proposes to disclose an accrued benefit obligation in notes to the financial statements. This information would include a five year trend when the standard is fully implemented. See paragraph 38 in the proposed standard and paragraphs A117—A123 in the basis for conclusions. Mr. Werfel and other members have an alternative view expressing opposition to this disclosure. See paragraph A146 in the basis for conclusions.

Do you believe that an accrued benefit obligation should be disclosed as described in this exposure draft?

Please provide the rationale for your answers.

I do not agree that an accrued benefit obligation should be disclosed as described in the exposure draft. The Board claims this new disclosure comes at the request of users, but does not attempt to explain how it would be used other than "to provide information for the many users who are interested in knowing what such an amount might be and in evaluating the obligation in this way." This rationale is simply too vague to be compelling. For example, the users may have requested the disclosure because they have agreed among themselves that the last 5 digits would be the winning number in a lottery. It is incumbent on the Board to explain how the disclosure would be used rather than merely relying on a request from users.

Q6. The Board considered but decided not to propose adding a line item to the statement of net cost (“SNC”) for the change during the reporting period in the closed group measure that would be presented below exchange revenue and expenses and not included in the totals for these classifications. Some argue that this measure should not be presented on the SNC because it is a fundamentally different measure. Others believe the change is an economic cost that belongs on the SNC, and that including this number at the bottom of the SNC appropriately links all basic financial statements. See paragraphs A101—A113 in the basis for conclusions.

Do you believe that the SNC should not include a line item for the change during the period in the closed group measure, which would be presented below exchange revenue and expenses and not included in the totals for these classifications?

Please provide the rationale for your answers.

The SNC should not include a line item for the change during the period of either the closed group or open group measure. As discussed in the response to Question 2 above, the Board has not provided a sufficient rationale for special treatment for the five social insurance programs covered by the exposure draft.

Q7. The Board decided to present the closed group measure (CGM) (defined in paragraph 19) as a common thread among the proposed new reporting. The proposal requires that the CGM and other key measures from the financial statements be discussed in management’s discussion and analysis; that the CGM be presented on the balance sheet below assets, liabilities and net position (without being included in the totals for those categories); and that the changes in the CGM during the reporting period be presented and explained in the new summary section of the statement of social insurance and the new statement of changes in social insurance. The Board considered the open group measure (defined in paragraph 24) instead of the closed group measure as the focus for the disclosure. This exposure draft discusses both the closed group measure and the open group measure throughout. Paragraphs A69-A74 provide the basic rationale for the Board’s selection of the closed group measure. Mr. Werfel and other members have an alternative view regarding the presentation of the closed group measure. They oppose the addition of the closed group measure to the balance sheet. Further, they believe the open group measure is the appropriate measure to use in the new statement of changes in social insurance and not the closed group measure. See paragraph A145 in the basis for conclusions.

Do you agree with the Board’s decision to feature the closed group measure?

Please provide the rationale for your answers.

I disagree with the Board's decision to feature the closed group measure. Congress has stated its intent that social insurance programs be funded on a pay-as-you-go basis, that is, the benefits of each cohort of participants are funded largely by the taxes paid by and on behalf of future cohorts. This applies even to those programs funded by dedicated trust funds. While it is true these trust funds have at times built up significant assets, these asset build-ups are merely an artifact of setting the funding tax at a long-term level rate to avoid the necessity of periodically raising the rate to follow expense trends. For example, when the 1983 OASDI amendments were adopted, the accompanying financial projection showed that, although the trust fund would grow to a substantial level during the first half of the 75-year projection period, the trust fund would exceed the targeted one year of expenses by only a miniscule amount at the end of the projection period.

The closed-group measure provides meaningful information only for programs intended to be fully pre-funded, that is, programs for which the benefits of each cohort are funded by the taxes paid by and on behalf of that cohort. The closed group measure includes only the payroll taxes and benefits associated with participants at the beginning of the projection period (including past payroll taxes net of benefit payments represented by the initial assets). Therefore, in a fully pre-funded program, the closed group measure includes both the benefits expected to be paid to members of the closed group and the payroll tax income intended to fund those benefits, as is appropriate. However, using the closed group method for a program funded on a pay-as-you-go basis excludes the payroll tax income from future new entrants intended to fund a portion of the benefits paid during the projection period. The resulting mismatch between benefits and funding presents a distorted picture of the financial position of the program.

The open group measure is appropriate for programs funded on a pay-as-you-go basis, because the open group measure includes all payroll tax income during the projection period, both from participants at the beginning of the period and later entrants. In this manner, the benefits valued are matched to the tax income intended to fund those benefits.

Q8. The Board is proposing to change the requirement currently in SFFAS 17 for specific sensitivity analysis. The standard will require the entity to provide sensitivity analysis of the closed and open group measures appropriate for its particular social insurance program but will not specify a particular approach for the analysis. See paragraphs 42—43 of the standard and paragraphs A125—A137 of the basis for conclusions.

Do you believe that a general requirement that allows flexibility in the sensitivity analysis presented will produce better information regarding the sensitivity of social insurance programs?

Please offer any comments that you wish to make on these provisions.

A sensitivity analysis is an important component of the disclosure for a program which requires projections of income and expense far into the future. The sensitivity analysis should be confined to the open group measure, for the reasons given in the response to Question 7 above. Given the complexity of these programs and of the calculations required to properly value them, a high degree of flexibility should be allowed in determining what information to provide in the sensitivity analysis.

Please offer any comments that you wish to make on these provisions.

The definitions of current and future participants do not make completely clear the treatment of current residents age 15 or over not currently participating in a given social insurance program, but who may, and in some cases are likely to, become participants in the future. Examples include students who have not yet joined the labor force, and employees of state governments electing out of OASDI who may enter OASDI covered employment at a future date.