>>> "Pete Rose" <prose5@midsouth.rr.com> 3/1/2007 10:24 AM >>>
Wendy, attached are my comments regarding the PV on Accounting for Social Insurance.

If you have any questions, feel free to contact me.

Pete Rose, CGFM

March 1, 2007

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

Dear Wendy:

I am pleased to provide my comments on FASAB's preliminary views regarding Accounting for Social Insurance, Revised.

Feel free to contact me if you have any questions.

Sincerely,

Pete Rose

Pete Rose, CGFM

Attachment

Federal Accounting Standards Advisory Board
Preliminary Views
Accounting for Social Insurance, Revised

Comments of Pete Rose, CGFM

The preliminary views (PV) document presents two different views by Board members regarding the accounting and reporting for five social insurance programs:

Old Age Survivors, and Disability Insurance (OASDI or "Social Security")
Medicare Hospital Insurance and Supplementary Medical Insurance Benefits
Railroad Retirement benefits
Unemployment Insurance for the general public
Black Lung benefits

The basic assumption in the PV is that these are all insurance programs of a social nature. Before addressing the questions in the PV, I would first like to comment on the basic assumption.

Random House Webster's Concise College Dictionary (1999) provides definitions for the following:

Insurance (key definitions)
1. The act, system, or business of insuring property, life, one's person, etc., ***against loss or harm*** arising in specific contingencies, in return for payment. (Emphasis added.)
2. Coverage by contract in which one party agrees to indemnify or reimburse another for loss that occurs under the terms of the contract.
3. ***Any means of guaranteeing against loss or harm***. (Emphasis added.)

Pension (key definitions)
1. A fixed amount, other then wages, paid at regular intervals to a person or to the person's surviving dependents ***for past services***, injury or loss sustained. (Emphasis added.)
2. An allowance, annuity, or subsidy.
3. To grant or pay a pension to.

Pension Plan
A plan maintained by a company or organization, either with or without contributions by employees, for making regular payments of benefits to retired or disabled employees.

Vested (key definitions)
1. Held completely, permanently, and inalienably.
2. Protected or established by law, tradition, etc.

Vested interest (key definition)
A permanent right given to an employee under a pension plan.

In applying the definitions to the social programs, I conclude that two have the attributes of pension plans (Social Security and Railroad Retirement) and the other three have the attributes of insurance programs. There are no guarantees against loss or harm provided by the Social Security and Railroad Retirement. They provide a pension to an eligible person.

Both Social Security and Railroad Retirement provide a fixed amount, paid at regular intervals, to a person or the person's surviving dependents ***for past services***. To be eligible for social security, a person has to have a minimum of 40 quarters of coverage. (PV, page 121.)

To be eligible for railroad retirement, a railroad worker prior to 1995 had to have at least 10 years of service; after 1995, annuities are payable to workers with 5 years of service. (PV page 136.)

An insurance program is a means of ensuring against loss or harm. According to Medicare Facts, PV page 129, "The Medicare program was enacted ***to provide health insurance*** for people 65 years of age and older.) (Emphasis added). Thus, Medicare ensures against losses associated with illnesses and other disabilities.

Page 139 states, in general, that unemployment insurance provides benefits to eligible workers who are unemployed through no fault of their own.

With regard to Black Lung, page 140 states: "The Black Lung Benefits Act provide monthly payment and medical benefits to coal miners totally disabled from pneumoconiosis (black lung disease) arising from their employment in or around the nation's coal mines.

In terms of accounting a reporting requirements, pension plans and insurance programs are vastly different. **Therefore, my recommendation is that the Board consider establishing accounting and reporting standards for the two pension plans separate from those of the three insurance programs.**

Questions for Respondents

Q1. Which obligating event do you believe creates a liability and expense that should be recognized? Please provide the rationale for your answer.

My responses are based on my recommendation to separate pension programs from insurance programs.

Social Security

The preliminary view is that an expense and liability should be recognized when participants become fully insured, which essentially is after 40 quarters for social security. I believe this is in error. After 40 quarters, a person is ***vested***. That is, a person has a permanent right to receive a benefit.

The obligating event that creates a liability and expense occurs when a person meets the eligibility requirements. A person needs to attain the appropriate age, which currently is more than 65 but less than 67. **An extremely important eligibility requirement, not mentioned by either view, is that the person must file for the benefit and be approved.** I am sure there are individuals who have meet the contribution and age requirements but who have not filed for benefits for one reason or another. He or she will not automatically receive a payment without first filing for the benefit.

I imagine that the Board is concerned about the future effects of social security liabilities. By recognizing benefits early (based on the vesting date) or by requiring a new statement (to display fiscal sustainability), this would provide readers of the financial statements about the significant future commitments required by the federal government.

However, if the Board adopts a pension standard similar to that used by state and local governments, the actuarial liabilities would be presented in required supplementary information, including funding progress, etc. This would preclude the need to recognize a liability before it actually is incurred. It would also preclude the need for a new statement.

Both social security and railroad retirement are, for all intents and purposes, defined benefit programs. An individual can get information from the Social Security Administration about how much the "pension" will be at retirement, based on years of contribution and average salary. The same is true for railroad retirees.

The obvious difference between social security and state/local pension plans is that the federal government is not the employer. However, all the characteristics of a pension plan are met. There is a mandatory contribution required by both the employer and employee. A person can become vested after an appropriate period of time. There are benefits paid at regular intervals. Therefore, there is no reason not to use a pension standard for federal financial reporting.

In addition to the primary eligibility requirement for individuals, page 122 lists the eligibility requirements for the survivors of young workers. Again, the requirements are quite similar to those available to many members of state/local retirement systems.

Railroad Retirement Program
This is quite similar to Social Security. An individual is vested after five or ten years, depending on the year service was performed. The obligating event occurs when the eligibility requirements have been met. The person must file for benefits and be approved. The eligibility requirements are listed on page 136.

Medicare
The preliminary view considers the obligating event for Medicare to be the same of the obligating event for Social Security. I disagree. In fact, unlike Social Security, a person is not even vested for Medicare benefits after 40 quarters!

If a person was vested after 40 quarters, then any illness that occurs after the 40th quarter would be covered. However, we know that is not the case. To be eligible for Medicare, a person has to be 65 years of age and have worked at least 40 quarters in Medicare-covered employment. The spouse of the individual is also covered even if the spouse had not worked in covered employment. However, it may be necessary for the spouse to pay the Medicare premium, since no social security benefits are available.

For Medicare, the obligating point that creates a liability and expense does not occur when the person becomes 65. **It occurs when the person who is 65 or older is diagnosed with an illness.** After all, Medicare is an insurance program, is it not? If I get sick and visit a doctor who refuses to accept Medicare, I either have to pay the doctor myself or find another doctor who will accept Medicare. **No liability can be recognized by Medicare, since no claim will be filed.**

The liability and expense can be substantial. Under the accrual basis of accounting, the liability and expense are recognized in the period the claim is incurred, regardless of the length of time over which payments are made. Thus, if a person on Medicare is diagnosed with a liver problem in FY2007 and treatment is provided for the next 20 years, the total expense is still recognized in FY2007. Future payments reduce the outstanding liability.

Under insurance accounting, Medicare must recognize the expense and liability associated with incurred but unreported claims (IBNR). This occurs when a person visits a provider but no claim has yet been filed.

Medicare charges premiums to cover costs. For FY2007, my premium is $93.50 per month. However, I am not billed directly. Instead, it comes from my social security pension benefit. My wife's premium is the same. However, because she does receive any social security benefit, she has to pay it when she is billed, which is usually in advance of receiving coverage.

Under insurance accounting, the premiums collected during the fiscal year are supposed to be used to cover the expenses incurred during that year. This means that all claims, reported or not reported, that are incurred in FY2007 are charged to the premiums collected in FY2007. It is easy to determine how much will be collected in premiums during FY2007. Revenue equals the total contributions paid from Social Security plus the premiums paid directly by those who are not covered plus any earnings on investments. The expenses, however, are much more difficult to estimate and requires the work of actuaries.

If a person is not eligible for Medicare benefits until the person reaches age 65, how should the premiums collected prior to reaching age 65 be accounted for? On page 130, there is table showing Medicare data for calendar year 2003. Total income was $291.6 billion, and total expenditures were $280.8 billion. **However, this report is on the cash basis, not the accrual basis.** Included in revenue was $149.2 billion in payroll taxes. Most of this money has come from people who are not yet able to receive Medicare benefits, because they are not yet 65.

Accrual accounting would require money received in advance of eligibility to be deferred until it has been earned. Thus, the 1.45% paid by me and my employer prior to my reaching the age of 65 had not yet been "earned" by the federal government and should have been deferred. When I reached age 65, the federal government can begin "earning" the premiums. There are a number of methods that can be used to report revenue.

Unemployment Compensation
This program is a little more complicated, in that the guidelines are established by the federal government but the states administer the program. In this instance, I do not see where there is any obligating point on the part of the federal government. The obligating points occur within the states.

I believe, as far as the federal government is concerned, the money is maintained in a trust fund. States are able to borrow money from the fund, if needed.

Black Lung
This would be similar to Medicare. The obligating point occurs when an individual is diagnosed with the disease. The full amount of the illness is recognized at the time it occurs, and an expense and liability is reported.

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. Please provide the rationale for your answer.

As I stated in my answer to question one, I do not believe that the recognition point occurs after 40 quarters for either program. However, if it was necessary to do so, it could be done.

After all, actuaries for retirement systems and insurance companies are required to perform such projections, in order to ensure that the pension contributions or insurance payments are sufficient to cover projected expenses.

Q3. With regard to the SOSI, I believe that the existing statement needs to be changed.

As I have stated, two types of programs are involved—pension programs and insurance programs. The same statement is not appropriate for both.

Q4. Under my proposal, this would be a moot question.

Q5. 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.

I am not sure this makes any sense. Under the accrual basis of accounting, revenue is deferred if is has not been earned or due to the government. Whether the revenue is earmarked for specific purposes is not relevant. It just means that the revenue cannot be spent for other purposes.

If I understand the alternative view, it proposes to take “excess” revenue—more money coming in than is needed to meet current expenses—and defer it to a future year. That is not why revenue should be deferred. The fact that there is an excess of revenues over expenses would be quite evident by reading the financial statements.

Q6. Since I do not agree with either view, I have no additional comments.