#29 Daniel L. Kovlak Non-Federal - Other

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Wendy Comes, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6K17V
441 G Street, NW – Suite 6814
Washington, DC 20548

Dear Ms. Comes:

The Greater Washington Society of Certified Public Accountants (GWSCPA) Federal Issues and Standards Committee (FISC) appreciates the opportunity to provide comments on the Federal Accounting Standards Advisory Board's (FASAB) Preliminary Views, *Accounting for Social Insurance, Revised.*

FISC consists of 18 GWSCPA members who are active in accounting and auditing in the Federal sector. This comment letter represents the consensus comments of our members.

General

We congratulate the FASAB for taking a giant step towards more transparent reporting relating to the accounting and reporting for these programs. The comments within this letter, and the answers to FASAB's questions, relate primarily to the Social Security and Medicare programs.

Because each of the "Social insurance" programs is different, we believe that the FASAB should address each program individually, in its own standard, or at least group the similar programs in the same standard. We believe that FASAB has "pension-type" programs (Social Security and Railroad Retirement) and "insurance-type" programs (Medicare and Black Lung). We believe the pension-type funds should follow accounting similar to pensions outside of the Federal government and the insurance-type programs should follow accounting similar to insurance organizations outside of the Federal government.

Responses to Questions for Respondents

Q1. 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.

We believe that full accrual accounting should be used for these programs. This is consistent with the new definition of a liability proposed in the recent FASAB exposure draft Statement of Federal Financial Accounting Concepts entitled *Definition and Recognition of Elements of Accrual-Basis Financial Statements* (Elements ED). Per the Elements ED, a liability is:

> A *present obligation of the Federal government to provide assets or services to another entity at the determinable date, when a specified event occurs, or on demand.*

Therefore, we support the option that is discussed in paragraphs A22 to A32 of the PV, which is to begin accruing the liability when participants begin work in covered employment. We believe that waiting until 40 quarters of work have been completed leaves out a significant liability related to those workers who have not reached the 40 quarter mark but, in almost all cases, will reach it.

The Alternative View is based on the concept that a liability does not exist unless the beneficiary has satisfied the 40 quarters requirement and they are alive to collect the benefit. This is a very narrow interpretation of how this liability should be measured. The full accrual approach is what the American public would expect to see reflected within the Federal government's financial statements and therefore, would be the most useful to the American public.

We do not agree with the argument against full accrual accounting in paragraph A133 that the Federal government can change these programs at any time in the future. Like any other liability, these programs should be accounted for in accordance with the current circumstances. When, and if, the circumstances change, those changes will be reflected in the accounting for the period of change.

We also do not agree with the argument in paragraph A144 that "Inclusion of such an enormous "liability" for social insurance would substantially diminish the materiality of other items currently on these statements and would reduce the attention paid to non-social insurance programs." Suggesting not recording a liability because it is too big is unsupportable and defies transparency.

Q2. The recent FASAB exposure draft regarding a Statement of Federal Financial Accounting Concepts entitled Definition and Recognition of Elements of Accrual-Basis Financial Statements (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.

Yes. Since the current estimates already include the concept of past, current, and future earnings for beneficiaries, providing a greater amount of detail should not be an issue. Therefore, this information should be provided on the full accrual basis.

The Alternative View suggests that the certainly of the measurement would be in question, but this is the case with any estimate. In this case, the event horizon is much longer so it would be natural to assume that the uncertainty would be greater. This uncertainty is fully disclosed.

Q3. 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 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.)

3.1 – 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?

Yes. We believe that this presentation should be adopted along with the full accrual accounting.

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?

Yes. We believe that the reasons for changes in SOSI amounts during the reporting period should be reported. We favor the Primary View approach. However, the presentation will need to be revised to reflect full accrual accounting.

One member believes that the liabilities which would be reported within the balance sheet are not the liabilities of the individual agencies, but rather are the liabilities of the Federal government. As such, it may be more appropriate to reflect this information at the "parent" or "plan sponsor" level, as opposed to the "child" or "third-party administrator" level. In the private sector, the analogous liabilities - pensions - are reported by the pension plan sponsor, not by the third party administrator responsible for managing the program. The Federal agencies administering these programs can be viewed as third party administrators. They are carrying out the plan requirements designated by Congress. They are not responsible for directly collecting the revenues associated with these programs nor are they responsible for the design of the programs. Ultimately, these functions rest with the Federal government and therefore, the liability should rest with the Federal government at the government-wide level. FASAB has already set a precedent of allowing for different reporting models at the agency and government-wide level.

Another approach to addressing this issue would be to show the liabilities on the "child's" financial statements with an offsetting asset entitled "Due from the General Fund." This is how the Department of the Treasury shows the offset to the U. S. Government debt.

Q4. 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.

We do not believe that fiscal sustainability information should replace reporting current period costs or the related long-term liabilities on a full accrual basis.

However, if the FASAB wants to pursue the fiscal sustainability approach as a matter of providing additional analysis, it should. We view a fiscal sustainability project to be much broader than the social insurance issues. We believe that such a statement would be more analytical in nature, than financial, and therefore, it should be presented separately from the basic financial statements.

Q5. 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 nonearmarked 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.

Under the full accrual method this would not be necessary.

However, if the Board adopts the Alternative View, the Board would need to recognize deferred revenue. Furthermore, if the Board adopts the Alternative View, it would need to revisit the Earmarked Funds standard to ensure a consistent accounting treatment across all Earmarked Funds, not only the Social Insurance Funds.

Q6. 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.)

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

Generally, the detailed guidance on measurement (including selection of assumptions) seems to be based on rational choices made from among various possibilities. The suggested required disclosures provide at least a minimum degree of transparency to aid users in understanding the choices that were made.

One FISC member believes that the stochastic graph shown in paragraph A75 is very useful and should be included as one of the basic note disclosures regardless of which view is adopted.

If the Primary View is adopted, the Board should consider adding a footnote disclosure that discusses the nature of the social insurance liabilities, how they differ from a pension, and that it is possible for Congress to change the terms of the programs at any time in the future by new legislation.

Regardless of the approach taken by the Board, the standard should clearly articulate what information should be included on the face of the individual statements, what information should be included within the notes, and what information should be included within the required supplementary information. The existing standard is open to significant interpretation on this matter.

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

We have no additional comments on the details of the Alternative View.

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This comment letter was reviewed by the members of FISC, and represents the consensus views of our members.

Very truly yours,

Daniel L. Kovlak
FISC Chair