AMERICAN ACADEMY *of* ACTUARIES

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

April 16, 2007

Re: Accounting for Social Insurance

Dear Ms. Comes:

The American Academy of Actuaries[1] Social Insurance Committee has been in existence for more than 30 years and includes representatives of the profession who are most knowledgeable and interested in social insurance. We appreciate the opportunity to comment on the Preliminary Views - Accounting for Social Insurance, Revised document and hope to contribute to a constructive and useful outcome.

Current recognition of all future pension obligations based on service-to-date as liabilities is appropriate for the private sector. The private sector does not have taxing authority, and so must accrue financial assets to cover the expected future cost of benefits that are already earned. However, recognition of future benefits under social insurance as liabilities is not appropriate for the federal government. The federal budget and most of its programs are not constructed with such "advance funding" in mind. In particular, Social Security operates essentially as a "pay as you go" system, which is appropriate for the federal government. The federal government can change Social Security benefits or contribution funding at any time. Thus, such benefits cannot be classified as liabilities, as suggested by the Primary View. Rather, social insurance scheduled benefits for the future should continue to be referred to only as non-binding obligations.

Our comments on these issues and answers to the specific questions raised in the FASAB Preliminary Views document are below:

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

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession

We support the Alternative View, which states that only due and payable liabilities and expenses under the Social Security program should be recorded as a liability.

The Primary View suggests that a liability and expense should be recognized for a worker under the Social Security program when the worker first attains "fully insured status" under the program. While insured status is necessary for benefit receipt, it is in no way sufficient to qualify as an obligating event. Therefore, we recommend against adopting the Primary View on this point.

We believe the Alternative View correctly identifies the appropriate liability recognition point as the time when a benefit for a given month becomes due and payable. The federal government has the ability to alter or even eliminate the potential future benefit obligations that have accrued. Thus, it is simply not possible under these programs to declare that there has been an obligating event for recognizing a liability for benefits for any month of eligibility until the worker is due benefits for that month. Before that time there is no binding commitment over which the worker has control and so no liability can be recognized. The Alternative View should be followed and the current recognition point for liability retained.

2. *Do you believe that 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 Views (see paragraphs 16-18 and especially subparagraph 16g in the standard; also see A54-S55 in basis for conclusions?*

Social Security and Medicare future obligations reflecting the intended (scheduled) benefits in current law are measurable, and are currently measured in a number of different forms. But these future obligations are not "*measurable for the purposes of recording a liability*" until they become due and payable on a month-by-month basis.

Because attaining insured status at a point in time before actual benefit eligibility does not mean that the individual will still be insured if other criteria are met, it is not possible to compute or assign any value to potential future benefits without great speculation on events that are not under the control of the worker, some of which are under the control of the federal government. If it is not possible to say that an obligating event has occurred for purposes of recording a liability, then it is certainly not possible to measure any amount as a liability.

Paragraphs 16g and 16f in the Primary View state that for workers not yet disabled or at retirement eligibility age, a liability should be included for "… the future benefits attributed to past work in covered employment….". Because even insured status at a later time is not guaranteed based on insured status at the current time, no future benefits can yet be “attributed” to those or other earnings for purposes of recording a liability.

Thus, the very uncertainty that any insured status will persist into the future, along with multiple other uncertainties, makes it inappropriate to measure potential future benefits for the purpose of recording a liability. Any attempt to measure a potential benefit at the time of attaining any form of insured status would be so highly speculative and uncertain that it could not be considered a liability.

3. *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 SNC and BS; 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. (Paragraph 16 and Appendix B for 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.

   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?

   Since social insurance obligations for future months of eligibility do not meet the definition of a liability, showing these amounts on the balance sheet would be misleading and inappropriate. Deeming potential future benefits as liabilities would fail to be consistent with the actual funding mechanism of the social insurance programs. Because future benefits can be paid on a current cost (pay as you go) basis only if future tax collections are made at the same time, such future taxes would have to be deemed current assets if future benefits were to be deemed current liabilities. Both possibilities make no real practical sense and neither qualifies for the designation. Thus, this information should not be added to SOSI or the balance sheet.

   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?

   The Alternative View approach to illustrating changes in SOSI is superior. The Alternative View table of change would highlight on the first line the extent to which the SOSI balance changes just because of the change in valuation date. The other categories of change are logical, informative, and readily available as they coincide with values already computed and provided in the annual trustees reports for Social Security and Medicare. The Alternative View wisely adopts this carefully thought out approach. This table would be a useful addition to the required supplementary information in the financial statements.

4. *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 provide sustainability information on the entire government, including information on intergenerational equity (See paragraphs 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?*

   Yes, we agree that a statement of fiscal sustainability would be a useful and informative addition to the consolidated financial report for the entire federal government. But such a statement should be developed only if it can fairly and appropriately represent the prospects for all federal programs.

   The form of any statement of sustainability must be developed so that meaningful information can be presented in a way that will be informative but not misleading. Here we differ with the table included in the Alternative Views. The table would provide summarized present value amounts over long periods including the next 75 years and also the infinite future. Such summarized numbers are inappropriate for assessment of sustainability. To portray sustainability, the elements of timing and trend are critical. To "sustain" something means that it must first be established, and then maintained. This cannot be demonstrated or ascertained in a summarized value for a long period.

   For "sustainability" as opposed to the narrower concept of "sustainable solvency," a measure of the level of total program cost and the trend in that level is needed. A ready and compelling candidate that would allow comparison across all federal programs is the ratio of projected annual program cost to annual gross domestic product (GDP). Expressed in these terms, the various program costs could be compared or combined in a form that readily relates to the fundamental potential tax (revenue) base for all federal programs, the GDP itself. The level and trend of such annual ratios would provide a clear picture of expected draw on the economy to fulfill the intended spending. Expressing future revenue levels and trends in a similar manner would complete the sustainability picture.

   What is not appropriate or even useful for an analysis of sustainability is an aggregate number over a long period, as in either the 75-year period or the infinite horizon. Such numbers, while useful for some purposes, have no ready relevance to sustainability and should not be used in this context. The presentation in the Alternative View of present value summarized shortfalls over these periods expressed as a ratio to the numbers of current workers or current households is inappropriate and misleading. The financial shortfalls over the next 75 years, and over the infinite future, cannot possibly be borne by only today's workers or households. Eliminating these shortfalls will occur through changes in scheduled benefits and taxes that will affect most if not all current and future workers and beneficiaries throughout the next 75 years and beyond. Thus, such long-term ratios should be presented for long periods only relative to the number of workers or households expected to exist during the period as a whole. Aggregated shortfalls over many years can be meaningfully compared only to aggregated resources over the same period.

5. *Do you believe the board should consider recognizing deferred revenue for earmarked revenues in excess of related program costs?*

   We believe that the board should research this question as a separate project.

6. *The primary and Alternative Views include detailed guidance on measurement (including selection of assumptions), display, disclosure and required supplementary information (paragraphs 15-37 Primary View; 64-84 Alternative View). Please make any comments that you wish on both views.*

   6.1 Comments on the Primary View

   As stated above, reporting future social insurance benefits as liabilities on the balance sheet would be inappropriate and misleading. The nature of the programs' benefit structures and financing mechanisms makes a liability designation for future benefits inappropriate just as it would be inappropriate to characterize future potential tax collections as current assets. The membership and preferences of the Congress change over time, and so do the desires and values of the American people. We cannot foresee what changes may be pursued over the next 75 years.

   We disagree with the Primary View position of adding line items to the balance sheet and the statement of net cost that would create a new and different liability calculation in financial statements. In addition, we disagree with the Primary View regarding the statement of change, and reject the statement put forth in the Primary View.

   Finally, and most important, we strongly recommend against the Primary View on inclusion of future benefits as liabilities. Such benefits are correctly recorded as a liability upon becoming both due and payable. There is no basis for extending the concept of liability beyond the long-held view of due and payable benefits. The government retains the unique ability to alter these benefits and revenues unilaterally. The benefits are non-transaction events, and there is no logical basis for establishing a liability recognition point before the benefits become due and payable.

6.2 Comments on the Alternative View

We agree with the approach for liability recognition in the Alternative View, which is to continue the long-held practice of recognizing social insurance benefits for any month of eligibility as liabilities only, once such benefits are due and payable.

Social insurance information displayed in government financial statements for Social Security and Medicare should be consistent with the information presented in the annual trustees reports for these programs. To this end, we encourage the inclusion of, as supplementary information, a statement of changes in social insurance as presented in the Alternative View, entirely consistent with the Trustees Reports.

Finally, we agree that a statement of sustainability for all federal programs would be a useful and informative addition to the consolidated financial statement for the entire federal government. However, we believe that to address sustainability the fundamental characteristics of timing and trend are essential. We believe that the only representation that satisfies these criteria, and could be readily and simply applied to all federal programs, is projected annual cost of these programs, and projected annual revenue expressed annually as percentages of the projected gross domestic product (GDP). Thus we reject the summarized values over long periods as useful indicators of sustainability, and particularly object to expressing these values on a per capita basis including only current workers or households.

We thank you for this opportunity to share our thoughts in regard to the issue of accounting for social insurance. If you have any specific questions or would like more information, please contact Samuel Genson, the American Academy of Actuaries' pension policy analyst, at 202-223-8196. Thank you for your consideration of this matter.

Sincerely,

Kenneth G. Buffin, MAAA, FCA, FSA, FIA, EA
Chair, Social Insurance Committee
American Academy of Actuaries