



February 10, 2009

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Dear Ms. Payne:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Federal Accounting Standards Advisory Board (FASAB or the Board) on its exposure draft (ED) of the proposed statement on *Accounting for Social Insurance, Revised*. The FMSB, comprising 23 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are encouraged to comment separately.

In general, we commend the Board for continuing their deliberations on this most important topic and for their continuing efforts to ensure that reporting for social insurance is transparent and useful. However, we remain concerned that the positions taken by some of the Board members find their basis in other than established accounting and reporting principles. We have the following responses to the questions posed in the exposure draft.

Q1. The Board proposes to require social insurance component entities and the governmentwide 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.

A1. Regardless of how the ultimate standard chooses to report, or not report, social insurance costs and liabilities/obligations within the statements of net cost or balance sheet, the inclusion of the proposed information within MD&A is an important and positive step. In that regard, par. 26 reflects the following important commitments:

"In particular, the entity should explain why the changes occurred and what that indicates or implies for the program's operation. The entity should explain how costs and commitments incurred during the period were or will be financed."

"The discussion should go beyond a mere description of existing conditions to include possible future effects of those factors. The discussion should encompass the possible future effects of anticipated future events, conditions, and trends. Where appropriate, the description of possible future effects of both existing and anticipated factors should include quantitative forecasts or projections. "



Further, in paragraph A76 of the Basis for Conclusions, the ED states the following:

“Very importantly, the MD&A should include forward-looking information regarding the possible future effects of the most important existing, currently-known as well as anticipated demands, risks, uncertainties, events, conditions, and trends. MD&A should deal with the “vital few” matters, i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the financial report, including the most important problems that need to be addressed and the actions taken or planned.”

It seems that these excerpts from both the standard section and the basis make it mandatory for the preparer of the federal CFR and the annual financial reports of social insurance agencies to make it very plain the condition of these programs, to include, but not be limited to, information on the following:

1. The specific nature and limitations of the authorizing legislation of social insurance programs.
2. The absence of purposeful advanced funding of the future costs of the programs.
3. A statement clearly contrasting the basis of accounting for federal social insurance programs with the accounting for pension and OPEB costs and liabilities of state and local governments
4. The likelihood that these programs will be reduced in future years due to the absence of funding.
5. The mechanisms built into the current law that will require a formal reduction in social security and Medicare funding and benefits when certain circumstances occur (see the separate 2007 Citizen’s Guide that accompanied the 2007 Annual Report of the U.S. Government for an example of how this might be expressed.)
6. Estimates of the year in which funding and benefits will be reduced for individuals currently receiving benefits under the program.

In short, the MD&A should clearly say what all of the reported numbers clearly indicate--that the social insurance programs will not continue in their current form and that citizens now receiving benefits and those currently qualified to receive benefits in the future will not receive the benefits they now anticipate.

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.

A2. The “compromise” presented in the ED is not supported by the concepts statements of the FASAB, nor of other standards setting organizations. As noted in par. A98, the below-the-line item is not an element and, therefore, should not be included on the balance sheet as proposed. However, if the line was, instead, changed to a note to the balance sheet appearing both on the bottom of the balance sheet and as a note to the liability section of the balance sheet, then what the ED seeks to accomplish

“might” be achievable. Although this can be explored by the Board, it should continue to deliberate on the possibility of recognizing some form of liability and/or obligation associated with social insurance within the balance sheet and statement of net cost.

In this regard, although the Board is to be commended for its continued efforts to identify the better way of reporting social insurance liabilities and obligations, it is difficult to appreciate how either the compromise position or the alternative view expressed by Mr. Werfel serves the information needs of the citizens, the Congress, or the Administration. By way of illustration, the following are among the points of logic that fail to relate to understood accounting principles and precedence, or the information needs of users:

1. The compromise position on balance sheet disclosure and Mr. Werfel’s view does not acknowledge that non-exchange transactions can impose a “liability” on the government in selected instances, such as:
 - a. When the government consistently communicates a long-term obligation to participants through annual notices of anticipated benefits,
 - b. Through the creation of a Trust Fund mechanism into which taxes from individual taxpayers are deposited,
 - c. The distinction that the federal government intentionally makes to taxpayer by segregating taxes collected for social security and for Medicare from those income and other taxes that clearly are collected as general revenue for Federal programs,
 - d. Through the acknowledgement that funds borrowed by the Treasury from the various social insurance trust funds represent a “liability” to be repaid,
 - e. Through the acceptance of, application for, and reliance upon, the federal government’s obligation by current recipients who established their long-term financial objectives on the promise of social insurance benefits,
 - f. Through the reinforcement of the existence of a federal obligation by private sector and public sector pensions and OPEB plans who publicize the anticipated award of federal benefits in their communications with their participants
2. The alternative view of Mr. Werfel appears to rely on notions presented in the Preliminary Views document—which are not otherwise found in accounting theory, such as:
 - a. The recognition of a “large” liability for social insurance would reduce the importance of liabilities associated with exchange transactions and federal pension liabilities (ref. par. A24.b),
 - b. The ability of the Congress to change benefit provisions of social insurance programs reduces the justification for recognition (ref. par. A24.c),
 - c. The notion that because current and qualified beneficiaries are on notice that the social insurance programs are unsustainable, this eliminates the requirement to recognize a liability or other form of obligation on the balance sheet.

In contrast, the alternative view of Mr. Patton opens the door to possibly recognizing some portion of social insurance on the balance sheet and in the statement of net cost. Such options for recognition that could be tied to FASAB concepts and accounting theory might include the following:

1. The recognition as a balance sheet liability of the present value of future social insurance payments to “current recipients.”
2. The recognition as a balance sheet “obligation” of the present value of future social insurance payments to “qualified participants.”

3. The disclosure in the notes to the financial statement—referenced to the balance sheet—of the potential obligation of the government associated with the remainder of the closed group participants.

The future incremental obligations associated with the closed group would not be associated with the balance sheet or the notes, but would rather be reported within the Statement of Social Insurance.

The points made within the ED that are supportive of the above approach to recognition and disclosure include, by way of illustration, the following:

1. From par. A19: "...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."
2. From par. A20: "...payroll tax contributions received during the reporting period should be matched against such costs rather than against the benefits paid out during the reporting period to truly evaluate the inter-period equity of the program. "
3. From par. A21: "...an expense may be incurred and a liability may arise equally for exchange, nonexchange, or quasi-exchange transactions so long as a present obligation exists. " and "...the use of "trust funds" and the "investment" of excess payroll taxes in special Treasury securities, arguably creates a constructive obligation at a point much earlier in time than when the payments are due and payable."
4. From par. A28: "... reporting on sustainability is not a substitute for or alternative to their proposal to alter expense and liability recognition on the statement of net cost and balance sheet." (also noted in par. 51)
5. From par. A37: the attain-fully-insured-status obligating event – or earlier event – would be measurable and auditable.
6. From par. A61: "...that as a general principle, decision-making is best informed if the government recognizes the costs of its commitments at the time it makes them."
7. From par. A68: "...actuarial assumptions and estimates are commonly used in measuring long-term liabilities such as for pension obligations and veteran's benefits."
8. From par. A69: "The closed group measure represents a reasonably good estimate of the net responsibility of future taxpayers, under current laws, to pay benefits to current participants."
9. From par. A72: "The Board believes that the closed group measure is one way to quantify the financing challenges relating to social insurance programs. It is relevant to the concerns of users who are assessing options for dealing with those challenges. The measure not only draws attention to the challenge but also quantifies it in a way that can support further analysis and decision-making."
10. From par. A96: "...financial statements need to explain why the point estimates on the balance sheet have limitations for assessing financial condition."

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.

A3. This new information will be helpful to users and would not be impacted by any decision by the Board to recognize some level of liability or obligation on the balance sheet.

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. 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. Do you believe that 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.

A4. This additional information will be very useful to users of both the consolidated financial report and the reports of the social insurance agencies and departments. Par. 37 makes the following very important notation, as follows: “The most significant changes should be explained in the entity’s MD&A as well as in disclosures associated directly with the SCSIA.” Both of these additions to reported information will be important in understanding the elements that create change in reported amounts, and will be especially important when the Congress begins to respond to the currently unsustainable nature of social insurance program. Further, as noted in par. A116, “(t)he format in Attachment E also includes beginning of the year and end of year present values, which would agree with the balances for the current year and immediate past year presented in the SOSI for the closed group. This will illustrate the link between current and prior years.”

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 the exposure draft? Please provide the rationale for your answers.

A5. This additional disclosure is an excellent idea. It would permit the reader to relate the (nonexchange related) obligations of the federal government to current participants and qualified participants to its substantively comparable obligations to active and retired federal employees and to qualifying veterans.

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 not included in the totals for these classifications? Please provide the rationale for your answers.

A6. With reference to the answer to question 2, the inclusion of a separate line as contemplated is not supported by the concepts statements of the FASAB, nor of other standards setting organizations. A below-the-line item is not an element and, therefore, should not be included on the Statement of Net Cost. However, if the line was provided as appearing both on the bottom of the statement of net cost and as a disclosure within the notes to the financial statements, then the ultimate standard might be strengthened. Although this can be explored by the Board, it should continue to deliberate on the possibility of recognizing some form of costs associated with social insurance within the statement of net cost.

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 these 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 discussed 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.

A7. The presentation of the closed group measure would be most justified relative to established theory and practice, and, as recommended in the previous answers, would be the only measure that should be contemplated for recognition and/or disclosure relative to the balance sheet and statement of net cost. The open group measure cannot be related to either current or qualified participants and, therefore, would be most appropriately reported and discussed within the SOSI and in the anticipated Statement of Sustainability.

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 to the analysis. See paragraphs 42-43 of the standard and paragraphs A125-A137 of the basis for the 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.

A8. Yes, we believe that allowing flexibility in the sensitivity analysis presented will produce better information. The justification in the ED appears to be well founded.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions concerning the letter, please contact Anna D. Gowans Miller, MBA, CPA, staff liaison for the FMSB, at amiller@agacgfm.org or 703.684.6931 ext. 313.

Sincerely,



Robert L. Childree, Chair,
AGA Financial Management Standards Board

cc: Samuel T. Mok, CGFM, CIA, CICA
AGA National President

**Association of Government Accountants
Financial Management Standards Board**

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