



# AMERICAN ACADEMY *of* ACTUARIES

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August 10, 1998

Wendy M. Comes  
Executive Director  
Federal Accounting Standards Advisory Board  
441 G Street Northwest, Suite 3B18  
Washington, D.C. 20548

Re: FASAB Request for Comments on the Proposed Statement of Recommended Accounting Standards, Accounting for Social Insurance

Dear Ms. Comes:

The Pension and Social Insurance Committees of the American Academy of Actuaries are pleased to comment on this proposed statement.

## **Scope of Statement**

1. Paragraph 36 of the proposal lists various characteristics of social insurance programs. While there is admittedly not one universally accepted definition of social insurance programs, we would support the following as a more comprehensive definition:

Government-sponsored programs with all of the following characteristics:

- a. The program, including benefits and financing method, is prescribed by statute.
  - b. The program provides for explicit accountability of benefit payments and income, usually in the form of a trust fund.
  - c. The program is financed by contributions (e.g., taxes or premiums) from or on behalf of participants, which in some programs are supplemented by government income from other sources. Investment income on program assets may also be used to finance the program.
  - d. The program is universally (or almost universally) compulsory for a defined population, or the contribution is set at such a subsidized level that the vast majority of the population eligible to participate actually participates.
2. The actuarial profession, social scientists, et al have debated the definition of “social insurance” for years. By using that term, FASAB leaves open to debate which programs

should be covered by the statement. It may be easier for the statement to simply list the covered programs and then amend the statement when appropriate.

3. Railroad retirement benefits and black lung benefits are very different types of programs than the other three listed in paragraph 35 and perhaps should be subject to somewhat different reporting requirements; also, we believe there are other programs that are somewhat conceptually similar to the programs in this statement, such as Federal Flood Insurance, Federal Deposit Administration Corporation, Pension Benefit Guaranty Corporation, to name a few; why would these programs not be included in the statement?
4. Technically, paragraph 39 is not accurate (this error appears in several other places as well). For example, FICA benefits are based on covered employment, irrespective of whether the appropriate taxes were correctly remitted. FASAB may wish to consult with SSA General Counsel to avoid spreading a popular misconception.
5. Paragraphs 22-24 refer to concepts such as “society’s welfare,” “the nation’s current and future well-being” and “burdens on future taxpayers that they are able and willing to bear” that are policy/political issues beyond the scope of accounting or actuarial standards.

### **Need for Statement**

This proposal covers two broad areas: component entity accounting and consolidated government wide entity accounting. We understand the need for some definition of the types of information that should appear in the federal government’s consolidated financial statements. However, we are unclear as to why a standard is needed for a component entity when that component entity already issues very thorough financial statements. We would encourage that wherever possible, it be made clear in the statement that any current report that includes the information specified by this statement is acceptable regardless of format or additional information provided.

### **Comments regarding specific disclosures:**

1. The third bullet under paragraph 27 states “an estimate of the present value of contributions that future participants will make to finance benefits for current participants.” We believe this statement is unclear. Using social security as an example, does this mean:
  - # The shortfall of the present value of expected benefits of current participants minus the present value of expected contributions made by current participants (i.e., the shortfall of a closed group liability that will presumably be paid by future participants), or

- # The excess of future contributions by future participants over the benefits that those future participants will receive on the theory that those participants first pay their own benefits and that any excess will go to pay the benefits of current participants?
2. Section 1a of paragraph 48 indicates that cash flow information should be shown on three bases: total outflow, inflow from all sources, inflow excluding interest. We understand the current differences of opinion as to which cash inflow is more appropriate and agree with the approach of showing all three. However, in section 1b, in determining percentages, only the total outflow and the inflow excluding interest on treasury securities are used. This could be construed as indicating a preference for the exclusion of interest on treasury versus the inclusion of interest, and we believe that creating the possibility of such an inference is inadvisable.
  3. One of the percentages to be displayed is related to taxable payroll. However, an exception is provided for certain benefits that are not financed by payroll taxes. As previously indicated, we believe a social insurance program is one that is provided by some type of earmarked taxes, be they payroll or otherwise. As such, we believe that if a program is included in this statement, there should be some type of projectable earmarked tax that can be used as a basis for this type of ratio even though it may not be based on payroll (e.g. tons of coal may be an appropriate metric for the black lung program.)
  4. Costs are also to be shown as a percentage of gross domestic product. This creates at least two issues:
    - P For consolidated reporting purposes it does not make sense to have various projections of gross domestic product. As a result, organizations will have to work with each other in determining projected gross domestic product. This could prove to be very difficult and time consuming.
    - P The projection of cash flows under any of these programs requires a considerable number of assumptions and actuarial methods. When these projected cash flows are divided by projected GDP, the results are not useful unless the GDP is calculated based on same assumptions and methods used in the projected cash flows. As a result, it may be necessary to create entirely new econometric models at significant cost to prepare useable ratios (of course all these new econometric models must then be compared across systems to ensure comparability.)
    - P Just as the econometric models must be comparable across systems, then so too must the assumptions underlying the liabilities.

In short, we are unconvinced that projection of cash flows as a percentage of GDP is likely to produce meaningful figures without a tremendous amount of potentially unsuccessful effort.

5. Our comments regarding the taxable payroll section also apply to section 2 (dependency ratios) of paragraph 48. Also, the definition of “dependency ratio” is at odds with current practice. This is the definition of the support ratio. The dependency ratio equals 1/support ratio.
6. The last sentence of section 3 of paragraph 48 indicates that closed group estimates should be shown for five years. To the extent that the information is not readily available, we believe that implementation relief should be permitted.
7. The potential for misuse of sensitivity analysis is great. Our experience is that particularly for social insurance, most users do not sufficiently understand the relationship between various assumptions, and as a result, the disclosure of sensitivity information may cause more harm than good. As a result, our preference is that no sensitivity analysis be provided. However, if FASAB is committed to the use of sensitivity analysis, then we believe a better approach to sensitivity is (as used in the Social Security Trustees report) where the actuaries demonstrate the sensitivity of the results by reporting calculations performed on various SETS of assumptions. This type of sensitivity analysis allows the actuary to maintain assumptions which are internally consistent, as opposed to the FAS 106 approach which shows a change in one assumption but does not disclose any of the other changes which would likely occur if the trend assumption changed. (The FAS 106 approach helps financial statement users create consistency between various companies, but that type of consistency would seem less relevant for the Federal Government.) We would also note that in section 4 of paragraph 48, salary growth and retirement rates are also significant assumptions.
8. Occasionally, the Federal Government has difficulty obtaining information from States. Has the board investigated the feasibility of the requirement in Section 5, paragraph 48?
9. The statement should clarify whether cash flows should be on a “true cash” or an incurred basis.
10. Paragraph 91 equated closed group liabilities with actuarial liabilities. This is misleading. A closed group measure is one type of actuarial liability. Another type of actuarial liability is the open group measure. Both are equally legitimate approaches, and for social insurance, the open group is probably the more useful.
11. Paragraph 97 states that a closed group liability is “a rough estimate of the maximum transition cost.”

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"We believe that this statement is seriously misleading. Unlike private section retirement plans, many social insurance plans do not define an "accrued benefit." Thus, the transition liability is completely undefined until such time as laws are passed which define the transition liability. The closed group liability may well be useful, but it should not be associated with the term "transition liability."

Please contact David Rivera at the American Academy of Actuaries if you would like to discuss this information further. Thank you for considering our suggestions.

Sincerely,

James F. Verlautz, FSA, MAAA  
Chair  
Committee on Pension Accounting

Dwight K. Bartlett III, FSA, MAAA  
Chair  
Committee on Social Insurance