Federal Accounting Standards Advisory Board

October 5, 2004

TO: Members of FASAB

FROM: Richard Fontenrose, Assistant Director

THROUGH: Wendy Comes, Executive Director

SUBJECT: **Social Insurance Liability Project**

The Board voted in August to consider alternatives to the "due and payable" liability for the Social Security program. The financial reporting effect of the "due and payable" obligating event for Old-age, Survivors, and Disability Insurance (OASDI or Social Security) is recognized in current financial statements of the Social Security Administration (SSA) (see Appendices A, B, C, and D) and the Financial Report of the US Government (FRUSG) (see Appendices E, F, G, and H). For OASDI, SSA reported $1.5 trillion in assets, $49 billion in liabilities, and $472 billion in costs. (Costs represent the annual OASDI cash outflow plus or minus the change in the liability.) The FRUSG reported similar liabilities and cost but no assets. (The assets were eliminated against Treasury debt during consolidation.)

In addition to the due and payable obligating event, five other events were discussed in the staff's April paper as follows:

1. Inclusion in the open group population for projection of inflow and outflow over, e.g., a 75-year or infinite projection period.
2. Birth/immigration.
3. Work in covered employment/payroll tax (employee and employer) begins.
4. 10 years (or 40 quarters) of work in covered employment ("permanent" eligibility established).
5. Meet all eligibility requirements. For Old-Age benefits, 62 years of age is the initial eligibility age.

For the October meeting staff proposes to discuss alternative recognition points for a Social Security liability that would be earlier than the current “due and payable” recognition point. Staff notes that the Elements Project will be addressing concepts that affect the Social Insurance Liability Project (SILP). The two Projects are complementary. Specific social insurance issues will inform the conceptual discussion and vice versa.

In this paper the staff focuses on alternatives 3, 4, and 5 above. Alternatives 1 and 2 – the “open group” and birth/immigration events, respectively, are similar in that they would include future Social Security participants and future events, rather than current participants and current events. There is no nexus between future participants and obligating events of the current reporting period. Recent work has focused on possible obligating events in the current period, and the Board decided at the August meeting to develop the distinction between present and future obligations. Also, staff proposes to combine obligating events 3 and 4 above into a ”workforce entry” event for the purpose of considering rationales for liability recognition earlier than “due and payable.”

Alternative A below offers a rationale for a “work in covered employment” obligating event where benefits would accumulate[1] with work performed in covered employment. Alternative A presents this as a “non-exchange transaction”-obligating obligating event. (Staff considers 40 quarters in covered employment (QC) a variation of this approach because, after 40 QCs, benefits would accumulate. Thus, it is discussed in conjunction with Alternative A.”[2])

Alternative B below presents the same recognition point as Alternative A – work in covered employment is the obligating event – except that it presents an “exchange transaction” rationale. The distinction between exchange and nonexchange is made because the Board may wish to either (1) continue to classify OASDI as a non-exchange transaction but depart from the “due and payable” recognition point, or (2) reclassify OASDI as an exchange or exchange-like transaction and develop guidance for applying full accrual concepts based on the evolving liability definition. The obligating event for Alternatives A and B are similar to the minority view of the International Federation of Accountants (IFAC) Public Sector Committee (PSC) Steering Committee (see Box #1 on page 5) in its Invitation to Comment (ITC), *Accounting for Social Policies*, dated January 2004.

Staff is presenting obligating event 5 above – the “full eligibility”-obligating event – as the third alternative for discussion in October (**Alternative C**). Benefits would not accumulate under Alternative C but rather would be recognized in total at the date of full eligibility. For Old-age and Survivors’ Insurance, full eligibility occurs at 62 years of age, the initial eligibility age. [Several variations are possible here, e.g., full retirement age (65-67 years old) or all those actually “on the rolls.”][3] This option is similar the PSC’s ITC Option 1 (see Box 2, page 13), which was the Steering Committee’s majority view.[4]

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[1] “Accumulate” – in this paper – means to increase gradually in quantity or number.

[2] On the other hand, some might argue that event 4 – i.e., 40 QCs -- has more in common with 5 than with event 3 in that both events 4 and 5 focus on one point of time in establishing eligibility, i.e., 40 QCs for event 4 and 62 years of age for event 5. Staff concludes that events 3 and 4 can be discussed as one option because the principle of accumulating benefits is critical to both.

[3] The 62-years of age threshold, of course, would not be applicable to Disability Insurance where participants are eligible earlier. Full eligibility for DI would occur when the required QCs have been accumulated.

All three alternatives presented below apply the distinction between exchange and non-exchange transactions that has been fundamental to past Boards – as has been noted in previous staff papers.[5] This requires a word of explanation.

A Note on the SFFAS 5 Framework

The staff believes that the logic of SFFAS 5 regarding obligating events is a sound, working framework for considering obligating events for Social Insurance. (The flowchart from SFFAS 5 at Appendix R illustrates the logic of SFFAS 5 regarding the recognition of liabilities.) The staff believes that this brief note on the SFFAS 5 liability framework will be useful because it will afford an opportunity to discuss the full SFFAS 5 framework, which is currently in use in practice and is the point of departure for the liability projects. Transactions and other obligating events are critical to determining whether the three essential liability characteristics with which the Board has been tentatively working – i.e., (1) a present obligation (2) to be settled by a future outflow of resources (3) based on a past transaction or event[6] – are present; and the distinction between "exchange" and "non-exchange" transactions arguably is fundamental to that determination.

The current FASAB liability definition in SFFAS 5 describes exchange and non-exchange transactions,[7] and government-related and government-acknowledged events. The staff notes the potential for some confusion here. Since (1) the focus on "obligating events" in this phase of the work has been relatively productive, (2) the explicit phrase "obligating event" is a recent addition to the FASAB working terminology, and (3) within the SFFAS 5 framework, recognition points can be either transactions or events, it will be necessary during the discussion of the SFFAS 5 framework to bear in mind that the working term "obligating event" encompasses both transactions and other obligating events. The terminology will be improved as the project progresses and the members' preferences are elicited.

SFFAS 5 required full accrual accounting for exchange transactions.[8] Conceptually, SFFAS 5 asks if the subject is a transaction and, if so, whether it is an exchange. If so, then accrual accounting is in order. If not, then the transaction is a non-exchange transaction and due and payable liability recognition point is assigned (see flowchart from SFFAS 5 at Appendix R). Use of the due and payable rule, to which the Board is now considering alternatives, would result in recognition that is consistent with accrual concepts if there is not a present obligation in excess of the due and payable amount.

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[4] Some argue that the majority view is similar to the 'due and payable" amount rather than any earlier accrual. See discussion below.
[5] See staff memo submitted for the April meeting, dated April 15, 2004, page 7-9.
[6] When the final definition is constructed the last characteristic may be an element of the first. Also, the support that seemed to be present at the at last Board meeting for adding the element of "no realistic alternative but to settle" to the definition is noted. These changes, should they be made, would not appear to affect the relevance of the characteristics previously discussed.
[7] SFFAS 5, par. 21.
[8] SFFAS 5, par. 22.

For many non-exchange transactions this may be the case. However, many argue that this is not the result for OASDI.

In SFFAS 5, if the obligating event is not a transaction, then it is either a “government-related” or “government-acknowledged” event. Government-related events involve interaction between federal entities and their environment and may be beyond the control of the entity. According to SFFAS 5, a liability is recognized for a government-related event as soon thereafter as a future outflow of resources is probable and measurable. This approach is consistent with accrual concepts. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the entity would pay for the damage and to the extent that the amount of the payment could be estimated reliably. Thus, it is a notion similar to the private sector standard with respect to contingent liabilities in FASB’s SFAS 5. Government-related events include hazardous waste spills on federal property caused by federal operations or accidents and catastrophes that affect government-owned property.

Government-acknowledged events are of financial consequence to the Government because it chooses to respond. For a liability to be recognized pursuant to a government-acknowledged event (1) the Government must formally acknowledge financial responsibility, and (2) an associated exchange or non-exchange transaction must occur. (See the flowchart at Appendix R.) If the transaction were non-exchange, e.g., emergency aid paid directly to victims without reimbursement, then a due and payable liability would be in order. (Examples of government-acknowledged events include toxic waste damage caused by nonfederal entities and damage from natural disasters). In most cases, this approach would be considered accrual accounting because the present obligation only exists after items (1) and (2) above have occurred.

Part 1 – Three Alternative Obligating Events

The staff notes that although the discussion that follows focuses on reporting liabilities and cost in the financial statements, the final standard would also encompass note disclosure, the statement of social insurance, and the required supplemental information, which will be reviewed in due course.

For retiree benefits, it may be useful to keep in mind how benefits are calculated upon retirement. A worker’s actual covered earnings each year are first adjusted or "indexed" to account for changes in “national average wages” since the year the earnings were received. SSA calculates a worker’s average monthly indexed earnings during the 35 years in which the worker earned the most. If a worker has less than 35 years of earnings, SSA averages in years of zero earnings to bring the number of years to 35. SSA applies a formula to these earnings to arrive at the worker’s basic benefit, or "primary insurance amount" (PIA). The PIA is weighted toward lower wage earners. This is the amount the worker would receive at the worker’s full retirement age (FRA), which, for most people, is age 65. (FRA is gradually increasing.) A worker receives a different amount if he or she retires early or late. Also, retirees receive an annual COLA.

Alternative A – The Obligating Event is Work in Covered Employment, Beginning with Workforce Entry: Non-Exchange Transaction

The "work in covered employment – workforce entry: non-exchange transaction" obligating event would result in a benefit obligation accumulating as work occurs in covered employment. (See Appendix I for the bar graph illustrating the accumulation of benefits.) The PSC ITC *Social Policies* presented this obligating event as Option 3, "Key Participatory Events," (see Box 1), which the PSC Steering Committee minority favored.

> ***Box 1***
> ***PSC ITC Option 3 – Key Participatory Events***
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> *In the absence of a legal obligation, a past event … giving rise to a present obligation occurs prior to the point at which an individual meets threshold eligibility criteria (where threshold criteria are applicable).*
>
> *The present obligation arises when key participatory events have occurred that lead an individual to have a reasonable expectation of eventually satisfying criteria for a benefit and, as a result, the individual has relied on that expectation over a period of time leaving the government with no realistic alternative but to settle the obligation in the future.*
>
> *The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.*

The liability on the balance sheet would represent the present value of (1) all benefits to be paid to retirees and (2) the benefits attributable to current workers' cumulative work in covered employment as of the reporting date. (See Appendix J for a pie chart of the effect of accumulation, which illustrates the fact that the amount reported on the statement of social insurance (SOSI) for the cohort of participants still working in covered employment has two components: (1) the amount accumulated as of the reporting date, representing a liability-type number; and (2) the amount of benefits to be accumulated in the future. See also illustrative balance sheet and income statement from Howell Jackson's paper[9] at Appendix K.) The accumulated benefit measure or obligation would be similar to the familiar accumulated benefit obligation (ABO) and Projected Benefit Obligation (PBO) reported for pension plans. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 87, *Employer's Accounting for Pensions*, defines the ABO as follows:

> The actuarial present value of benefits (whether vested or nonvested) attributed by the pension benefit formula to employee service rendered before a specified date and based on employee service and compensation (if applicable) prior to that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.[10]

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[9] Jackson, Howell, "Accounting for Social Security and Its Reforms," *Journal on Legislation*, Harvard Law School, Vol. 41, No. 1, p. 108.

[10] FAS87, Par. 264. The FASB discusses another measurement in SFAS 87, the projected benefit obligation (PBO), which differs from the ABO only in that it would include final salaries in its calculation for plans which base the future benefit on final salaries. The ABO uses current salaries and in that sense presents more of a termination value.

For this type of measure the cost represents the increase in the present value of the benefit liability in the reporting period due to work in covered employment pursuant to the Social Security benefit formula; e.g., a “normal cost” or “service cost” number, plus interest on the obligation, because it is a present value; plus or minus actuarial gains and losses. Actuarial gains/losses could be included in the cost reported on the statement of net cost or presented, e.g., as an “unrealized” component of net position in which case costs would be reported on both the statement of net cost (SNC) and the statement of changes in net position (SCNP). Another alternative for displaying actuarial gains/losses that has been suggested would be to expand the reporting model to allow for a separate section of the statement of net cost for revaluations. It is argued that this would separate revaluations of assets and liabilities from the operating SNC but not impede the articulation of elements consistent with their conceptual definitions.

SFAS 87 defines the PBO as follows:

> The actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using assumptions as to future compensation levels if the pension benefit formula is based on those future compensation levels (pay-related, final-pay, final-average-pay, or career-average-pay plans).

The PBO differs from the ABO only in that it would include final salaries in its calculation for plans, which base the future benefit on final salaries. The ABO uses current salaries and in that sense presents more of a termination value. Thus, for plans that base the pension benefit on the employee’s final salary, the ABO would not recognize the probable obligation and costs for until much later than the PBO. The FASB standard for pension plans, SFAS 35, *Accounting and Reporting by Defined Benefit Pension Plans,* (Issue Date 3/80) requires disclosure of the ABO. The FASB standard for employers, SFAS 87, requires the use of the PBO for cost determination and requires its disclosure in footnotes; and, it requires recognition of the unfunded ABO as a minimum liability under certain circumstances.

The ABO and PBO will be used is this paper as examples of possible measures compatible with the accumulated benefit notion. Further development of the ABO and PBO and other possible measures would take place in the measurement phase of the Social Insurance Liability Project.

In the private sector actuarial changes regarding pensions and other deferred compensation are amortized over future years thus “smoothing” the effect on net income. “Smoothing” has been criticized, e.g., for masking the true financial position of an entity and as one of the tools used to “manage” earnings. The Board did not adopt “smoothing” in its SFFAS 5 pension and post-employment healthcare standard.

The purpose of an ABO or PBO number would be primarily to report information useful for assessing financial position, inter-period equity, and costs attributable to events (e.g., work in covered employment or changes in significant assumptions) during the period. (Pro forma illustrations of statements of net cost, changes in financial position, and balance sheet for this alternative are at Appendix L. The pro forma illustrations in Appendices L through P are preliminary in nature. They are intended to start the discussion of display options rather than anything approaching a final display. See Part 2 – Objectives of Financial Reporting, pages 17-23 for a preliminary discussion of the issue regarding the objective of reporting an amount other than the due and payable liability.)

What Would Be the Basis for Concluding that an Expense and a Liability Should Be Accumulated or Accrued as Work Occurs in Covered Employment, beginning with Workforce Entry, as a Non-Exchange Transaction?

In August the Board decided that legal enforceability would not be required for a Federal liability. In her October memo for the Board, Ms. Wardlow addresses further the question of constructive obligations and their legal enforceability. For the purposes of this paper "constructive obligations" are defined as obligations that: (1) are not necessarily legally enforceable, (2) have certain characteristics that distinguish them from other Federal programs, and (3) become "present obligations" when obligating events occurs.

The characteristics of the Social Security program arguably are examples of the general constructive obligation characteristics that the Board has discussed,[11] as well as being legally enforceable absent changes in current law. The program is statutory; the formula for benefits is specific in current law and past practices; benefits are based on work in covered employment; the participant is required to pay specific taxes; permanent and indefinite budget authority has been provided to use the payroll taxes without further Congressional action; the program does not need to be periodically reauthorized. The program is not means tested, although it is arguable that the tax on benefits for higher-income individuals is a form of means testing. (See Appendix Q for the table of characteristics presented at the August meeting.)

Moreover, Social Security benefits may be paid whether or not annual appropriations have been enacted to pay the salaries of the agency employees who process payments. The Attorney General has opined that obligations "authorized by law" qualify as exceptions to the Antideficiency Act prohibition against obligations and expenditures in excess of available appropriations.[12] One of these is benefit payments that are entitlements and funded without the need of a regular appropriation. This would include Social Security benefit payments, which have been discussed, and the administrative expenses needed to make the benefit payments, even though those administrative expenses are funded with annual appropriations.

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[11] The Board has discussed the following criteria for constructive obligations: (1) by established pattern of past practices, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; (2) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and (3) the individual has relied on the expectation over a period of time. See staff paper dated April 15, 2004, page 10. Regarding the fourth criterion, "no realistic alternative but to settle the obligation in the future," there seemed to be support for adding it to the liability definition. However, the Board decided that the development of the framework and criteria for deciding which constructive obligations are liabilities and which are not should occur in the Elements Project.

[12] 5 Op. Off. Legal Counsel 1 (1981).

In short, Social Security is on "auto-pilot."[13] It will continue operating as designed unless there is a change in law. Most programs that involve non-exchange transactions are not on auto-pilot. Unlike Social Security that has permanent and indefinite budget authority, the other programs that were discussed at the last meeting (SSI, Medicaid, Food Stamps, TANF) require annual appropriations and reauthorization.

Some argue that there is no difference in practice between SSI, Medicaid, Food Stamps, TANF and other social assistance programs and Social Security with respect to appropriations. Even though annual appropriations are required for these programs, they argue that the total amount of benefits paid by these programs in a year is controlled by the authorizing legislation, which determines entitlement formulas, not by the annual appropriations. They cite the discussion of budgetary concepts in the *Analytical Perspectives*, which states:

> The authorizing legislation for [certain programs specifically identified in the Budget Enforcement Act] entitles beneficiaries to receive payment or otherwise obligates the Government to make payment and effectively determines the amount of budget authority required, even though the payments are funded by a subsequent appropriation.[14]

They argue that the appropriation for such programs is based on estimated needs given the formula specified in legislation. If that turns out to be insufficient, there is generally an "out." SSI, Medicaid, Food Stamps, and TANF have current indefinite authority for "such sums" as are needed for the fourth quarter of the fiscal year.

Staff concludes that the distinction in regard to appropriations is substantial, and that there are other reasons why most programs that involve non-exchange transactions are not on auto-pilot. Benefits for such programs are not based on work in covered employment; beneficiaries are not required to pay specific taxes; eligibility for long-term benefits is not establishment once. Also, these programs require means testing.

One of the characteristics of being "on auto pilot" mentioned above is that budget resources need to be provided in current law. However, staff notes that environmental liabilities are recognized even though they require subsequent appropriations in future years. This issue was addressed in SFFAS 5, which provides that, if budget authority has not been provided, a future outflow of resources might still be probable if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the liability definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.[15] The fact that a Federal program needs to have budgetary resources provided in the future would be insufficient, by itself, to disqualify it from being a liability.

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[13] To date the Board has discussed certain selected Social Security program characteristics. The staff asks in Issue 1, page 10, whether these characteristics are sufficient to create a present obligation. It is reasonable to ask why focus on these characteristics and not others. The staff is seeking the Board's direction with respect to whether these are the characteristics that distinguish Social Security and possibly other social insurance programs from other Federal programs for accounting purposes.

[14] *Analytical Perspectives, FY 2005,* p. 385.

[15] SFFAS 5, par. 33.

Under Alternative A, a present obligation would exist for Social Security, and an obligating event would occur with work in covered employment and the assessment of payroll taxes. Earnings in covered employment determine future benefits (and current payroll taxes). Arguably, the work in covered employment combined with current law constitutes a past non-exchange transaction sufficient to constitute a present obligation. The transaction would meet the definition of a non-exchange transaction. FASAB *Consolidated Glossary* (*Glossary*) defines a "non-exchange transaction" as follows: "a transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return." The PSC notes that "social benefits" within the scope of its Invitation to Comment (ITC), *Accounting for Social Policies*, are commonly referred to as "non-exchange" social benefits. The PSC defines a non-exchange transaction in a way similar to other standard-setters, including FASAB (except FASAB does not mention "approximately equal value"): a transaction where an entity either receives value from another entity without directly giving approximately equal value in exchange or gives value to another entity without directly receiving approximately equal value in exchange.

Further evidence of the present obligation is that the benefits that are associated with work in covered employment are, ultimately, collectible from the Government. The Government is liable for past periods of eligibility where payment has not been made, such as when a beneficiary had not received payments to which he was entitled between the period of reaching eligibility and the date of his death, where his estate seeks payment.

Working in covered employment and paying taxes are two conditions and as those conditions are met, a liability accrues. However, a liability would not need to be funded to be accrued. The structure of the program would create a liability, whether funded or not.

Uncertainty regarding the future benefit payments, the number of participants who will ultimately collect benefits, the amount thereof, etc., would be reflected in the measurement of the liability amount at the reporting date.

Work in Covered Employment – 40 Quarters in Covered Employment (QC): Non-exchange Transaction

Alternatively, some would prefer to focus on 40 QC instead of workforce entry. The basis for conclusion would be the same as immediately above. The difference is that no cost would accumulate until 40 QCs are worked. At that point a present obligation would exist for the cost of the past 10 years – 40 QCs – and cost accumulation would commence. The 40 QC of accumulated benefits could be recognized immediately or amortized over a fixed number of years like "past service cost" for a pension plan. However, some argue that such amortization is not consistent with a principled-based approach to standard-setting. In any case, the basis for recognition at 40 QC would be that at that point the participants' future benefits are "locked in." All the participant has to do is to stay alive; and, if there are eligible survivors, not even that. Actuarial assumptions would be used to measure the cost and liability.

A similar approach is proposed under this alternative for Disability Insurance (DI). An obligating event occurs when work in covered employment begins, or when sufficient QCs have been accumulated for full eligibility. DI benefits are based on credits from work in covered employment. The monthly disability benefits are based on the OASDI earnings record of the insured worker.

Issues Related to Alternative A

Issue 1: Does the Board consider these characteristics, individually or collectively, sufficient to create a present obligation?

- *The program benefits, financing, etc., are provided in current law and current policy.*
- *The benefits are based on work in covered employment and wages earned therein.*
- *The participant is required to pay specific, dedicated taxes.*
- *Permanent and indefinite budget authority has been provided to use the payroll taxes without further Congressional action.*
- *The program is not means tested.*

Issue 2: Does the Board agree that benefits accumulate with work in covered employment and the assessment of dedicated payroll taxes?

Issue 3: Is the assessment of payroll taxes necessary or would benefits accumulate regardless of the assessment of payroll taxes?

Issue 4: Does the Board wish to alter the classification of Social Security as a non-exchange transaction? (Note that the issue of whether the payroll taxes would also be reclassified would be added in future discussions if the Board wishes to pursue reclassification.)

Issue 5: And the "bottom line" – Does the Board want Alternative A to be developed further?

Alternative B – Work in Covered Employment – Workforce Entry: Exchange or Exchange-like Transaction

At the August meeting several members indicated an interest in exploring an exchange transaction rationale for accumulating benefits. Arguably an exchange or exchange-like transaction occurs with work in covered employment and the payment of payroll taxes that creates a present obligation.

Like Alternative A, Alternative B – "work in covered employment – workforce entry: exchange or exchange-like transaction" – the obligating event would result in a benefit obligation accumulating as work occurs in covered employment. (Again, see Appendix I for the bar graph illustrating the accumulation of benefits.) The liability on the balance sheet would represent the present value of (1) all benefits to be paid to retirees and (2) the benefits attributable to current workers cumulative work in covered employment as of the reporting date. (Again, see Appendices J and K; and also especially the pro forma illustrations of statements of net cost, changes in financial position, and balance sheet for this alternative is at Appendix M.) The accumulated benefit measure or obligation would be similar to the familiar ABO and PBO.

What Would Be the Basis for Concluding that an Expense and a Liability Should Be Accumulated or Accrued as Work Occurs in Covered Employment, beginning with Workforce Entry, as an Exchange or Exchange-like Transaction?

Standard-setters define exchange/non-exchange transactions similarly. Citing FASB Concepts Statement 6, the FASAB *Glossary* defines "transaction" as follows: "a particular kind of external event involving the transfer of something of value concerning two or more entities. The transfer may be a two way or one way flow of resources or of promises to provide resources." And the FASAB *Glossary* defines an "exchange transaction," without citation, as follows: "a transaction that arises when each party to the transaction sacrifices value and receives value in return."

For GASB the difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.[16] In International Public Sector Accounting Standards (IPSAS) 9, *Revenue from Exchange Transactions …*, par. 5, PSC defines an exchange transaction as a transaction where the entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to the other party.

[16] [16] GASBS 33, fn1.

The Elements Project also will be raising the issue of whether consideration should be given to the concept of an "exchange-like" transaction. That is, whether some transactions of the federal government are neither wholly exchange transactions nor wholly nonexchange transactions, but have some features of each. If so, how should those transactions be classified, and how, if at all, would they affect the definition of a liability? The Board's consideration of this issue in the Elements Project will affect the SILP.

Analogies with types of exchange transactions may be useful in assessing whether Social Security has predominant exchange or exchange-like characteristics. From one perspective, the Social Security payroll taxes are exchanged for protection against the risk of old age without minimum pension income, and for survivors and disability. The insured event – old age, survivor, disability – must occur for the Social Security participant to receive payments.

Regarding old-age pensions, there is a relationship between the amount paid and the benefit received. As mentioned above, a worker's actual covered earnings each year are "indexed" to account for changes in "national average wages" since the year the earnings were received. SSA calculates a worker's average monthly indexed earnings during the 35 years in which the worker earned the most. If a worker has less than 35 years of earnings, SSA averages in years of zero earnings to bring the number of years to 35. SSA applies a formula to these earnings to arrive at the worker's basic benefit. Also, retirees receive an annual COLA.

Uncertainty regarding the future benefit payments, the number of participants who will ultimately collect benefits, the amount thereof, etc., would be reflected in the measurement of the liability amount at the reporting date.

Issues Related to Alternative B

Issue 6: Does "exchange-like" notion avoid the "slippery slope" that may be present with non-exchanges due to the difficulty of distinguishing between programs?

Issue 7: Must exchange-like transactions be voluntary? Some argue, for example, that the seizure of property via eminent domain and the payment of fair value for it is an "exchange" or "exchange-like;" others say it would be non-exchange.

Issue 8: Does the Board want Alternative B developed further?

Alternative C – Full Eligibility: Non-exchange Obligating Event

> ***Box #2***
> ***PSC ITC – Option 1 – Satisfy all eligibility criteria***
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> *In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual satisfies all eligibility criteria.*
>
> *In the case of ongoing benefits which are subject to regular satisfaction of eligibility criteria, the maximum amount of the present obligation is the benefit that the individual is entitled to from the current point in time until the next point in time at which eligibility criteria must be satisfied.*
>
> *Where validation of eligibility criteria is required only once, the present obligation is for all future benefits to be provided to that individual as a result of that validation.*

Under this alternative, a constructive obligation would exist and become a present obligation when the obligating event of full eligibility occurs. The obligating event is a non-exchange transaction.

Obligating event would occur when participant first reaches full eligibility, which for OASI is 62 years old, and generally is after 40 quarters of work in covered employment for DI. The eligibility criteria would need to be satisfied only once and the present obligation would be all future benefits to be provided as a result. The PSC ITC *Social Policies* presented this obligating event as Option 1, "Satisfied all eligibility criteria" (see Box 2), which the PSC Steering Committee majority favored. However, it may be that the Steering Committee viewed "staying alive" as a criterion, which would result in a due and payable amount. The ITC said explicitly that under Option 1 "individuals can cease to meet eligibility criteria at any point in time (due to death or failing to meet income or asset tests) so there is no constructive obligation for future pension benefits beyond the current entitlement."[17] Doubt arises, however, over the meaning of "current entitlement" because the paragraph goes on to state that the application of Option 1 may also lead to recognition of an amount of pension benefits in excess of amounts due and payable, i.e., for benefits to be paid from the current point in time until the next validation period, where a jurisdiction requires infrequent validation of eligibility. Similarly, some have argued that the Social Security participant's eligibility is short-term because he or she must stay alive to collect benefits and therefore "staying alive" is a criterion and the due and payable liability is the liability. The staff views the "full eligibility" approach as a longer-range estimate than due and payable. Mortality would be factored into the measurement of the liability. (See the pro forma illustrations of statements of net cost, changes in financial position, and balance sheet for this alternative is at Appendix N. See Appendix O for the same illustration except that the amount is displayed as a new financial statement element; Appendix P presents splits the amount between a liability and a new element, with the latter representing amounts for which beneficiaries are not fully eligible. Thus, Appendices O and P are intended to illustrate display options as much as liability recognition points.)

[17] PSC ITC par. 8.13.

What Would Be the Basis for Concluding that an Expense and a Liability Should Be Recognized when a Participant Is Fully Eligible?

The basis for concluding that a constructive obligation exists is similar to Alternative A above. Social Security might represent a constructive obligation, based on the program's characteristics. The constructive obligation arguably becomes a "present obligation" when the obligating event of full eligibility occurs.

The choice of this obligating event is based on the non-exchange nature of the transaction. All eligibility criteria are satisfied at this point. The provision of benefits is virtually certain. Given demographic averages and the low probability of enormous changes in expected payments once an individual is fully eligible, measure is arguably both relevant and reliable for recognition and measurement on the federal balance sheet.

Issues Related to Alternative C

The issues for Alternative C include some of those listed under Alternative A because both Alternative A and C are based on the notion the Social Security program predominantly involve nonexchange transactions

Issue 9: Does the Board consider the characteristics of the Social Security program, individually or collectively, sufficient to create a present obligation when the participant is fully eligible?

Issue 10: Does the Board consider this recognition point superior in reliability or relevant to the workforce entry recognition point?

Issue 11: Does the Board want Alternative C developed further?

Summary of Issues

Issues Related to Alternative A

Issue 1: Does the Board consider these characteristics, individually or collectively, sufficient to create a present obligation?

- *The program benefits, financing, etc., are provided in current law and current policy.*
- *The benefits are based on work in covered employment and wages earned therein.*
- *The participant is required to pay specific, dedicated taxes.*
- *Permanent and indefinite budget authority has been provided to use the payroll taxes without further Congressional action.*
- *The program is not means tested.*

Issue 2: Does the Board agree that benefits accumulate with work in covered employment and the assessment of dedicated payroll taxes?

Issue 3: Is the assessment of payroll taxes necessary or would benefits accumulate regardless of the assessment of payroll taxes?

Issue 4: Does the Board wish to alter the classification of Social Security as a non-exchange transaction? (Note that the issue of whether the payroll taxes would also be reclassified would be added in future discussions if the Board wishes to pursue reclassification.)

Issue 5: And the "bottom line" – Does the Board want Alternative A to be developed further?

Issues Related to Alternative B

Issue 6: Does "exchange-like" notion avoid the "slippery slope" that may be present with non-exchanges due to the difficulty of distinguishing between programs?

Issue 7: Must exchange-like transactions be voluntary? Some argue, for example, that the seizure of property via eminent domain and the payment of fair value for it is an "exchange" or "exchange-like;" others say it would be non-exchange.

Issue 8: Does the Board want Alternative B developed further?

Issues Related to Alternative C

The issues for Alternative C include some of those listed under Alternative A because both Alternative A and C are based on the notion the Social Security program predominantly involve nonexchange transactions

Issue 9: Does the Board consider the characteristics of the Social Security program, individually or collectively, sufficient to create a present obligation when the participant is fully eligible?

Issue 10: Does the Board consider this recognition point superior in reliability or relevant to the workforce entry recognition point?

Issue 11: Does the Board want Alternative C developed further?

Part II – Objective of Financial Reporting

The following section provides a preliminary discussion of possible objectives for reporting a liability greater than due and payable. Is offered for the Board's consideration at the October meeting or at future meetings. The staff assumes that the eventual basis for conclusions for a new accounting standard on social insurance would discuss the Board's view regarding the objective of the reporting.

Many measures of sustainability are published, e.g., close actuarial balance over 75 years,[18] future cash flow (in dollars and percentage of GDP and taxable payroll) crossover point, Trust Fund exhaustion, return on investment, dependency ratio. In SFFAS 5 the Board concluded that "due and payable" was the appropriate point for liability recognition and cash outlay (plus or minus the change in the liability) was the appropriate expense from non-exchange transactions. Appendix S presents the pros and cons for reporting an obligation for Social Insurance programs, from the SFFAS 17 basis for conclusions.[19]

The following is a discussion of possible rationales for reporting a benefit liability greater than due and payable.

- Financial Position and Inter-period Equity

The balance sheet is one component of financial position. It provides an accounting perspective. As stated in the August staff memo,[20] the concept of financial position is that of a point-in-time snapshot of an entity's economic resources and the claims on those resources, based on the entity's transaction or "core" data, as adjusted for environmental factors.[21] There are obviously other, very necessary and well-publicized perspectives. Most would agree that accrual accounting is a useful and important aspect of evaluating the financial status of Social Security, albeit not the only way or even, some would argue, not the most important way.[22] Staff believes it is reasonable to conclude that accrual accounting is a foundation for assessing financial position or inter-period equity, but does not purport to make such assessments itself.

Transaction data assigned to a period that has elapsed are "recognized" in the operating statement, e.g., as an expense or revenue of that period. Transaction data pertaining to the future are recognized in the balance sheet as assets and liabilities.[23]

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[18] As described in the 2004 Trustees' Report, the long-range test of close actuarial balance is essentially a comparison of income and cost rates over 75 years. The test is met if the difference between income and cost is zero or not negative by more than a fixed percentage. See pages 60-61.
[19] Staff memorandum dated February 18, 2004, p. 45.
[20] Staff memorandum dated August 12, 2004, pp. 10-11.
[21] SFFAC 1, par. 178. See endnote A for selections from SFFAC 1 used for this staff discussion.
[22] See, for example, Robert L. Clark, "Liabilities, Debts, Revenues, and Expenditures: Accounting for the Actuarial Balance of Social Security," *Harvard Journal on Legislation*, vol. 41, p. 170; and Diamond, Peter, and Peter Orszag, "Accrual Accounting for Social Security," *Harvard Journal on Legislation*, vol. 41, p. 183.
[23] SFFAC 1, par. 169.

Financial position is more limited in scope than "financial condition." SFFAC 1 states that:

> Indicators of financial position, measured on an accrual basis, are the starting point for reporting on financial condition but must be supplemented in a variety of ways. For example, subobjective 3B[24] might imply reporting, among other things, a current law budget projection under a range of alternative assumptions. Reports intended to achieve subobjective 3C might disclose, among other things, the contribution that the government is making to national wealth by financing assets that are not federally owned, such as research and development, education and training, and state-owned infrastructure. Information on trends in total national wealth and income is also important.[25]

Financial position and inter-period equity are related concepts. The FASAB Objectives (SFFAC 1, par. 137) state that

> [a]ssessing whether the government's financial position improved or deteriorated over the period is important not only because it has financial implications but also because it has social and political implications. This is because analysis of why financial position improved or deteriorated helps to explain whether financial burdens were passed on by current-year taxpayers to future-year taxpayers without related benefits. The latter notion is sometimes referred to as "interperiod equity."

The balance sheet and statement of net cost are primary means of communication. Accruing an expense and accumulating a liability on the Federal balance sheet as workers perform under Social Security arguably would focus management's attention on the economic cost of the program rather than merely the cash outlays. It would focus attention on the claims being accumulated from current activity that are being passed on to future periods or, for the "full eligibility" alternative, on claims originating in past periods that will almost certainly need to be paid in future periods.

Arguably, an approach where benefits accumulate or accrue results in the economic cost of the benefits being associated with the period in which the commitment is made and in spreading such cost over the working lives of the participants.

- Inter-generational Equity

Inter-period equity and inter-generational equity are related, although the latter is a more complex notion. Jagadeesh Gokhale has offered two measures of sustainability: the "fiscal imbalance" (FI) and the "generational imbalance" (GI).[26] The FI equals the current

[24] SFFAC 1, Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. 3B: Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. 3C: Whether government operations have contributed to the nation's current and future well-being.

[25] SFFAC 1, par. 145.

[26] See Gokhale, Jagadeesh, and Kent Smetters, "Fiscal and Generational Imbalances: New Budget Measures For New Budget Priorities," (Washington, DC, AEI Press, 2003.

federal debt held by the public, plus the present value of all future federal non-interest spending, minus the present value of all future federal receipts. The FI measures how much fiscal policy must be changed in order to be sustainable; a sustainable fiscal policy requires FI to be zero. The GI measures how much of the FI is caused, in particular, by past and current generations. It equals the present value of projected outlays paid to generations currently alive, less the present value of projected tax revenues from the same generations and the program's current assets.

The GI is similar to the closed group population on the SOSI. The closed group refers to "current participants," defined as those participants age 15 and over on January 1 of a valuation year. The ABO or PBO would differ from any closed group – or open group – measure that included benefits attributable to future work in covered employment and payroll taxes to be paid in the future. The "open group" refers to all participants in the system over a specified time period, e.g., 75 years, either currently in the system or projected to be. The ABO or PBO would include only benefits accumulated as of the reporting date.

Mr. Gokhale believes the GI measure captures the redistributive effect of policies. For example, under a policy where current benefits were increased along with off-setting future payroll taxes, the GI measure would increase even though FI would not change. Therefore, he asserts that the FI and GI measures taken together comprise a powerful analytical tool for policymakers, enabling them to make more informed decisions.

The SOSI presents information about inter-generational equity. The total for the SOSI represents an open group estimate over a 75-year horizon that is important for assessing sustainability, and the subtotals provide an inter-generational perspective: closed group estimates for three cohorts – participants 62 and over, participants 15-61, and future participants – over a 75-year horizon. The subtotals articulate the extent to which Social Security resources on hand and to be provided are sufficient to pay the benefits payable in the future under current law by cohort. Assuming the status quo, it provides a measure of the payroll taxes needed from future participants to fund benefits at current levels to current participants.

However, the SOSI does not include all contributions paid by and on behalf of or benefits received by participants before the measurement date, so it would not be a complete measure of the intergenerational transfer.[27] Some might argue that either an ABO or a closed group measure on the balance sheet would imply a greater intergenerational equity deficiency than actually exists because it would not reflect the amount of contributions paid by and on behalf of current participants, or benefits received by them, before the measurement date.

And, unlike an ABO or PBO or other measures of benefit accrued as of the reporting date, the SOSI present values include benefits attributable to future work in covered employment and payroll taxes to be paid in the future.

[27] Laurence J. Kotlikoff has written extensively on inter-generational accounting. His latest book is *The Coming Generational Storm: What You Need to Know About America's Economic Future*, (Cambridge: The MIT Press, 2004).

- Sustainability of Social Security and/or the Government as a Whole

Would an ABO or PBO tell us anything about sustainability? Staff has cited above the FASB definitions of the ABO and PBO.

Some assert that an ABO or PBO or other accrued actuarial liability does not measure solvency or sustainability. Sustainability obviously can be and is discussed in terms of both the Social Security program and the fiscal policy of the Government as a whole. The United States Budget contains one such explicit discussion in the stewardship chapter of *Analytical Perspectives*.[28] The United Kingdom's *Long-term Public Finance Report: Fiscal Sustainability with An Aging Population*,[29] contains another such discussion.

Analytical Perspectives notes that the Budget is an essential tool for allocating resources but more information is needed to fully evaluate the Government's financial decisions. The stewardship presentation in the Budget offers longer-range measures. The chapter notes the absence of a "bottom line" for governments means that an array of information and complementary perspectives is required. The section includes information that would appear on a balance sheet as well as 75-year projections of unified budget receipts and outlays and a discussion of what is gained socially and economically from Government programs. OMB notes that the information in the stewardship chapter is especially intended to meet the broad interests of economists and others in evaluating trends over time, including both past and future trends; and that the annual *Financial Report of the United States Government* presents related information, but from a different perspective.

> The *Financial Report* includes a standard business-type balance sheet. The assets and liabilities on that balance sheet are all based on transactions that have already occurred. … The *Report* also includes a Statement of Social Insurance and it reviews a substantial body of information on the condition and sustainability of the Government's social insurance programs. However, the *Report* does not try to extend that review to the condition or sustainability of the Government as a whole, which is the main focus of this chapter.[30]

The United Kingdom's *Long-term Public Finance Report* defines sustainability as the ability to meet obligations when they arise in the future and thus it would depend on the government's future revenue. It sets out some different approaches to assessing the sustainability of government finances, including "the accruals-based balance sheet" prepared for the government as a whole. It states that

> Accrual accounts aim to record what has happened to an entity during a specified period, and how management has performed. They therefore look at past transactions and the extent to which these have already committed future funding flows. Accrual accounts

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[28] *Budget of the United States Government, FY 2005, Analytical Perspective*s, pp. 181-206. (http://www.whitehouse.gov/omb/budget/fy2005)
[29] (http://search.treasury.gov.uk/search?p=Q&ts=treasury&mainresult=mt_mainresult_yes&w=Long-term+public+finance+report).
[30] *Analytical Perspectives, FY 2005*, p. 182.

> therefore provide a fuller picture of an entity's position than a simple cash statement by including all of that entity's assets and liabilities. …
>
> The Government recognized that the introduction of accruals accounting could significantly enhance the framework for planning, controlling and accounting for departmental expenditure, and improve the quality of information on the public sector. …

The *Long-term Public Finance Report* asserts that a fundamental limitation of accrual accounting: it is essentially backward looking. It excludes future revenues and liabilities except those liabilities that result from past events. This reflects the origin of accrual accounting with business enterprises and their uncertain futures, a limitation that is much less applicable to governments as a result of the sovereign "right to tax" and ongoing commitment to provide services. "These are much more certain than in the private sector but still do not meet the criteria for inclusion in a GAAP-based measure. The omission of these future cash flows and the fact that it is a snapshot at a particular moment in a year, limits the use of a balance sheet in assessing long-term fiscal sustainability. This limitation is widely recognized."[31]

Others would disagree with this view. They would say that accrual accounting is about the present. It shows the assets and liabilities that an entity has now, the present, as a result of past events and adjusted for future events that are likely to affect the quantity or value of those present assets and liabilities. They would argue that accrual accounting is a progress report on how we got to where we are and where we stand in relation to the projections of management and others who may have been too optimistic about the future. Some argue that accrual accounting provides basic information for those who want to assess sustainability or inter-period equity or inter-generational equity, but it does not itself purport to make such assessments. Some argue that accrual accounting is a kind of "truth serum" for those who made economic predictions in the past and a "reality bracer" for those who want to predict the future.

Some have argued that the most useful information about sustainability is presented in the statement of social insurance and the accompanying information, which used to be RSSI and is now RSI, e.g., annual ratios of benefits and taxes to GDP and taxable income, long-range cash flow projections, crossover points, the year the Trust Fund is exhausted, the dependency ratio. This information shows the extent to which Social Security resources on hand and to be provided over the next 75 years are sufficient to pay the benefits payable in the future under current law.

Some assert that accrual accounting tells us nothing about Social Security's long-run sustainability. "Whether Social Security will need parametric changes in order to remain sustainable depends on the infinite-horizon open-group obligation…."[32]

On the other hand, a measure of the present value of accumulated – however that was done – Social Security costs arguably would assist in assessing the sustainability of the

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[31] *Long-term Public Finance Report*, Dec. 2003, p. 22.
[32] Smetters, Kent, "The Inadequacies of Accrual Accounting for Social Security," *Harvard Journal on Legislation*, vol. 41, p. 216

program in terms of future taxpayers' willingness and ability to bear the implicit tax burden. If the burden is too great, taxpayers will be unable and therefore unwilling to bear the burden. However, Kent Smetters has argued an ABO/PBO would overestimate the true liability that is being passed on to future generations because it fails to net out the future taxes that will be paid by younger and richer workers in excess of their future benefits. Others would assert instead the ABO/PBO reports the assets and liabilities that an entity has now, the present, as a result of past events and adjusted for future events.

The fact that Social Security is compulsory and therefore that the program is guaranteed a stream of new participants indefinitely into the future affects sustainability. Some long-range sustainability measures take this financing into account. Some argue that without some indication of the implicit tax burden suggested by such a measure, an ABO/PBO would serve no useful purpose in assessing sustainability, and in fact might lead to incorrect conclusions. They argue that presenting a measure in terms of the percentage of taxable payroll and/or the GDP, as is currently required by SFFAS 17 as supplemental stewardship information, is the proper approach.

Also, some argue that a large ABO/PBO or other closed group liability on the balance sheet might incorrectly lead readers to assume that the deficiency (because of its size) is an indication that Social Security cannot be sustained. They argue that the correct perspective to consider Social Security is the open group, pay-as-you-go perspective. For example, a current focus has been the year 2042, the year the *2004 OASDI Report* projects that Social Security will be able to pay only 73 percent of benefits. Some might argue this does not represent insolvency because it may become politically acceptable to draw the other 27 percent from the general fund because (1) the Government is spending less, and/or (2) taking in more taxes because the economy grew faster than projected, and/or (3) the Government can borrow because it paid down the national debt from 2004 to 2042, then Social Security is sustainable after 2042.

Moreover, some argue that – despite the obvious elements of advanced funding in terms of the Trust Fund entity itself – Social Security is mainly financed on a pay-as-you-go basis, and will, by definition, have a deficiency when only current participants are considered. Pay-as-you-go programs require future workers to finance current participants' benefit payments in the same way that the latter have financed prior participants' benefits. This is would be true unless current participants were taxed at levels so as to equal their benefits, even after taking into consideration the program's "horizontal" redistribution within generations; that is, redistribution within an age or generational cohort.[33]

[33] Also see the recent CBO Long-Range Fiscal Policy Brief, "How Pension Financing Affects Returns to Different Generations," dated Sept. 22, 2004, which discusses the inter-generational effects of pay-as-you-go versus funded pension systems. www.cbo.gov/showdoc.cfm?index=5822&sequence=0&from=7

Some have also argued that ABO/PBO-type a balance sheet measure incorrectly suggests that current participants have rights superior to those of future program participants; or, that the current participants have legal rights to current benefit levels.

Appendix A – Social Security Administration Balance Sheet, Sept. 30, 2003

Consolidated Balance Sheets as of September 30, 2003 and September 30, 2002

	(Dollars in Millions)	
Assets	**2003**	2002 Reclassified
Intragovernmental:		
Fund Balance with Treasury (Note 4)	$ **2,310**	$ 2,098
Investments (Note 5)	**1,484,219**	1,329,045
Interest Receivable, Net (Note 6)	**20,933**	20,262
Accounts Receivable, Net (Note 6)	**872**	751
Total Intragovernmental	**1,508,334**	1,352,156
Accounts Receivable, Net (Notes 3 and 6)	**5,830**	5,692
Property, Plant and Equipment, Net (Note 7)	**909**	690
Other	**6**	4
Total Assets	$ **1,515,079**	$ 1,358,542
Liabilities (Note 8)		
Intragovernmental:		
Accrued Railroad Retirement Interchange	$ **3,767**	$ 3,713
Accounts Payable	**6,410**	7,024
Other	**110**	124
Total Intragovernmental	**10,287**	10,861
Benefits Due and Payable	**49,487**	47,684
Accounts Payable	**387**	494
Other	**1,133**	1,142
Total	**61,294**	60,181
Net Position		
Unexpended Appropriations	**705**	794
Cumulative Results of Operations	**1,453,080**	1,297,567
Total Net Position	**1,453,785**	1,298,361
Total Liabilities and Net Position	$ **1,515,079**	$ 1,358,542

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Appendix B – Social Security Administration Statement of Net Cost, Sept. 30, 2003

Consolidated Statements of Net Cost for the Years Ended September 30, 2003 and September 30, 2002

	(Dollars in Millions)	
	2003	2002
OASI Program		
Benefit Payments	$ **397,654**	$ 385,777
Operating Expenses (Note 9)	**2,481**	2,299
Total Cost of OASI Program	**400,135**	388,076
Less: Exchange Revenues (Notes 10 and 11)	**7**	8
Net Cost of OASI Program	**400,128**	388,068
DI Program		
Benefit Payments	**69,800**	66,964
Operating Expenses (Note 9)	**2,045**	1,953
Total Cost of DI Program	**71,845**	68,917
Less: Exchange Revenues (Notes 10 and 11)	**7**	7
Net Cost of DI Program	**71,838**	68,910
SSI Program		
Benefit Payments	**33,217**	30,239
Operating Expenses (Note 9)	**2,789**	2,788
Total Cost of SSI Program	**36,006**	33,027
Less: Exchange Revenues (Notes 10 and 11)	**265**	278
Net Cost of SSI Program	**35,741**	32,749
Other		
Benefit Payments	**429**	458
Operating Expenses (Note 9)	**1,292**	1,251
Total Cost of Other	**1,721**	1,709
Less: Exchange Revenues (Notes 10 and 11)	**9**	10
Net Cost of Other	**1,712**	1,699
Total Net Cost		
Benefit Payments	**501,100**	483,438
Operating Expenses (Note 9)	**8,607**	8,291
Total Cost	**509,707**	491,729
Less: Exchange Revenues (Notes 10 and 11)	**288**	303
Total Net Cost	$ **509,419**	$ 491,426

The accompanying notes are an integral part of these financial statements.

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Appendix C – Social Security Administration Statement of Changes in Net Position, Sept. 30, 2003

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Consolidated Statements of Changes in Net Position for the Years Ended September 30, 2003 and September 30, 2002

	(Dollars in Millions)			
	2003		2002	
	Cumulative Results of Operations	**Unexpended Appropriations**	Cumulative Results of Operations	Unexpended Appropriations
Net Position, Beginning Balance	**$ 1,297,567**	**$ 794**	$ 1,140,966	$ 3,528
Budgetary Financing Sources (other than Exchange Revenues)				
Appropriations Received		**48,822**		46,400
Other Adjustments	**0**	**(128)**	(8)	(12)
Appropriations Used	**48,783**	**(48,783)**	49,122	(49,122)
Tax Revenues (Note 12)	**546,808**		537,733	
Interest Revenues	**84,220**		78,614	
Transfers-In/Out (Note 13)				
Trust Fund Draws and Other - In	**1,244**		1,138	
Trust Fund Draws and Other - Out	**(12,814)**		(15,323)	
Railroad Retirement Interchange	**(3,802)**		(3,686)	
Net Transfers-In/Out	**(15,372)**		(17,871)	
Other Budgetary Financing Sources	**87**		81	
Other Financing Sources				
Other Revenue	**9**		5	
Imputed Financing Sources (Note 14)	**397**		351	
Total Financing Sources	**664,932**	**(89)**	648,027	(2,734)
Net Cost of Operations	**509,419**		491,426	
Ending Balances	**$ 1,453,080**	**$ 705**	$ 1,297,567	$ 794

The accompanying notes are an integral part of these financial statements.

2

Appendix D – Social Security Administration Statement of Social Insurance, Sept. 30, 2003

Statement of Social Insurance
Old-Age, Survivors and Disability Insurance
75-Year Projection as of January 1, 2003
(In billions)

		Estimates from Prior Years			
	2003	2002	2001	2000	1999
Actuarial present value[1] for the 75-year projection period of estimated future income (excluding interest)[2] received from or on behalf of:					
Current participants[3] who, at the start of projection period:					
Have not yet attained retirement eligibility age (Ages 15-61)	$13,576	$13,048	$12,349	$11,335	$10,325
Have attained retirement eligibility age (Age 62 and over)	359	348	309	266	235
Those expected to become participants (Under Age 15)[4]	12,213	11,893	11,035	10,088	9,033
All participants	26,147	25,289	23,693	21,688	19,593
Actuarial present value[1] for the 75-year projection period of estimated future cost[5] for or on behalf of:					
Current participants[3] who, at the start of projection period:					
Have not yet attained retirement eligibility age (Ages 15-61)	21,015	20,210	18,944	17,217	15,676
Have attained retirement eligibility age (Age 62 and over)	4,662	4,402	4,255	4,020	3,856
Those expected to become participants (Under Age 15)[4]	5,398	5,240	4,700	4,297	3,758
All participants	31,075	29,851	27,899	25,534	23,291
Actuarial present value[1] for the 75-year projection period of estimated future excess of income (excluding interest) over cost	-$4,927	-$4,562	-$4,207	-$3,845	-$3,698
Trust fund assets[6] at start of period	1,378	1,213	1,049	896	763
Actuarial present value[1] for the 75-year projection period of estimated future excess[7] of income (excluding interest) and Trust fund assets at start of period over cost	-$3,550	-$3,350	-$3,157	-$2,949	-$2,935

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Appendix E – Governmentwide Balance Sheet and Footnote 13 Re “Benefits Due & Payable,” Sept. 30, 2003

United States Government Balance Sheets as of September 30, 2003, and September 30, 2002

(In billions of dollars)	2003	2002
Assets:		
Cash and other monetary assets (Note 2)	119.6	141.6
Accounts receivable, net (Note 3)	33.8	32.0
Loans receivable, net (Note 4)	221.1	219.2
Taxes receivable, net (Note 5)	22.9	21.4
Inventories and related property, net (Note 6)	241.2	192.2
Property, plant, and equipment, net (Note 7)	658.2	324.7
Other assets (Note 8)	97.1	65.4
Total assets	1,393.9	996.5
Liabilities:		
Accounts payable (Note 9)	62.2	55.8
Federal debt securities held by the public and accrued interest (Note 10)	3,944.9	3,573.2
Federal employee and veteran benefits payable (Note 11)	3,880.0	3,589.4
Environmental and disposal liabilities (Note 12)	249.9	273.0
Benefits due and payable (Note 13)	100.0	95.3
Loan guarantee liabilities (Note 4)	34.6	28.1
Other liabilities (Note 14)	227.0	201.9
Total liabilities	8,498.6	7,816.7
Contingent liabilities (Note 18) and Commitments (Note 19)		
Net position	(7,104.7)	(6,820.2)
Total liabilities and net position	1,393.9	996.5

Appendix E – Governmentwide Balance Sheet and Footnote 13 Re "Benefits Due & Payable," Sept. 30, 2003

Note 13. Benefits Due and Payable

These amounts are the benefits owed to program recipients or medical service providers as of the fiscal yearend that have not been paid. For a description of the programs, see the Stewardship Responsibilities section under Stewardship Information.

Benefits Due and Payable as of September 30

(In billions of dollars)	2003	2002
Federal Old-Age and Survivors Insurance	35.9	34.1
Grants to States for Medicaid	17.8	16.3
Federal Disability Insurance	12.0	12.2
Federal Supplementary Medical Insurance (Medicare Part B)	15.3	14.1
Federal Hospital Insurance (Medicare Part A)	15.0	14.1
Unemployment insurance	1.5	2.1
Supplemental security income	1.5	1.4
Railroad retirement	0.8	0.8
Other benefits	0.2	0.2
Total benefits due and payable	100.0	95.3

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Appendix F – Governmentwide Statement of Net Cost, Sept. 30, 2003

United States Government
Statements of Net Cost
for the Years Ended September 30, 2003, and September 30, 2002

(In billions of dollars)	Gross Cost 2003	Earned Revenue 2003	Net Cost 2003	Gross Cost 2002	Earned Revenue 2002	Net Cost 2002
Department of Agriculture[1]	95.6	10.7	84.9	80.5	9.6	70.9
Department of Commerce[1]	8.8	1.3	7.5	7.4	1.2	6.2
Department of Defense[1]	562.4	12.5	549.9	420.4	13.9	406.5
Department of Education	59.0	5.0	54.0	49.9	4.8	45.1
Department of Energy[1]	2.0	5.3	(3.3)	(3.0)	4.8	(7.8)
Department of Health & Human Services[1]	542.6	29.7	512.9	499.9	27.0	472.9
Department of Homeland Security	27.5	2.6	24.9	*	*	*
Department of Housing & Urban Development	44.1	2.0	42.1	36.3	2.2	34.1
Department of the Interior	16.0	4.7	11.3	15.0	0.7	14.3
Department of Justice[1]	30.7	1.3	29.4	29.5	2.3	27.2
Department of Labor	68.1	-	68.1	64.7	-	64.7
Department of State	12.7	1.4	11.3	10.9	0.9	10.0
Department of Transportation[1]	64.2	1.2	63.0	65.4	1.6	63.8
Department of the Treasury[1]	75.0	2.6	72.4	66.0	3.6	62.4
Interest on Treasury securities held by the public	156.8	-	156.8	175.4	-	175.4
Department of Veterans Affairs	175.7	2.1	173.6	218.4	2.6	215.8
U.S. Agency for International Development	10.3	0.1	10.2	8.0	-	8.0
Environmental Protection Agency	9.5	0.4	9.1	8.2	0.5	7.7
Federal Emergency Management Agency[1]	2.5	0.8	1.7	6.2	1.8	4.4
General Services Administration[1]	0.8	0.3	0.5	(0.1)	0.3	(0.4)
National Aeronautics & Space Administration	12.9	0.1	12.8	14.7	0.1	14.6
National Science Foundation	4.8	-	4.8	4.2	-	4.2
U.S. Nuclear Regulatory Commission	0.7	0.5	0.2	0.6	0.4	0.2
Office of Personnel Management	0.3	-	0.3	0.2	-	0.2
Small Business Administration	3.8	0.7	3.1	1.3	0.5	0.8
Social Security Administration	512.6	0.3	512.3	492.9	0.3	492.6
Export-Import Bank of the United States	0.1	0.3	(0.2)	(1.2)	0.3	(1.5)
Federal Communications Commission	7.1	1.2	5.9	6.8	1.1	5.7
Federal Deposit Insurance Corporation	(0.2)	0.2	(0.4)	1.8	0.7	1.1
National Credit Union Administration	0.2	0.5	(0.3)	0.2	0.5	(0.3)
Pension Benefit Guaranty Corporation	12.3	1.2	11.1	12.7	0.9	11.8
Railroad Retirement Board	9.6	-	9.6	9.3	-	9.3
Tennessee Valley Authority	8.2	7.0	1.2	7.9	6.8	1.1
United States Postal Service	81.5	67.6	13.9	83.1	66.4	16.7
All other entities	32.1	1.2	30.9	22.8	0.8	22.0
Total	2,650.3	164.8	2,485.5	2,416.3	156.6	2,259.7

[1] These agencies reorganized and transferred various programs and operations to the newly created Department of Homeland Security.
* 2002 numbers have not been restated (see Note 1A—Reporting Entity).

The accompanying notes are an integral part of these financial statements.

1

Appendix G – Governmentwide Statement of Operations and Changes in Net Position, Sept. 30, 2003

United States Government
Statements of Operations and Changes in Net Position
for the Years Ended September 30, 2003, and September 30, 2002

(In billions of dollars)	2003	2002
Revenue:		
Individual income tax and tax withholdings	1,481.3	1,538.6
Corporation income taxes	128.2	143.7
Unemployment taxes	31.2	26.2
Excise taxes	67.6	67.9
Estate and gift taxes	21.9	26.4
Customs duties	19.0	18.3
Other taxes and receipts	39.8	49.3
Miscellaneous earned revenues	7.0	7.3
Total revenue	1,796.0	1,877.7
Less net cost of Government operations	2,485.5	2,259.7
Unreconciled transactions affecting the change in net position (Note 16)	24.5	17.1
Net operating cost	(665.0)	(364.9)
Net position, beginning of period	(6,820.2)	(6,458.8)
Change in accounting principle (Note 17)	383.1	
Prior period adjustments (Note 17)	(2.6)	3.5
Net operating cost	(665.0)	(364.9)
Net position, end of period	(7,104.7)	(6,820.2)

The accompanying notes are an integral part of these financial statements.

1

Appendix H – Governmentwide Statement of Social Insurance, Sept. 30, 2003

United States Government
Statements of Social Insurance
Present Value of Long-Range Actuarial Projections

(In billions of dollars)	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security):				
Contributions and Earmarked Taxes from:				
Participants who have attained age 62	359	348	309	266
Participants ages 15-61	13,576	13,048	12,349	11,335
Future participants (under age 15 and births during period)	12,213	11,893	11,035	10,088
All current and future participants	26,147	25,289	23,693	21,689
Expenditures for Scheduled Future Benefits for:				
Participants who have attained age 62	4,662	4,401	4,256	4,020
Participants ages 15-61	21,015	20,210	18,944	17,217
Future participants (under age 15 and births during period)	5,398	5,240	4,700	4,297
All current and future participants	31,075	29,851	27,900	25,534
Present value of future expenditures less future revenue	4,927[1]	4,562[2]	4,207[3]	3,845[4]
Federal Hospital Insurance (Medicare Part A):				
Contributions and Earmarked Taxes from:				
Participants who have attained eligibility age	128	125	113	97
Participants who have not attained eligibility age	4,510	4,408	4,136	3,757
Future participants	3,773	3,753	3,507	3,179
All current and future participants	8,411	8,286	7,756	7,033
Expenditures for Scheduled Future Benefits for:				
Participants who have attained eligibility age	1,897	1,747	1,693	1,681
Participants who have not attained eligibility age	10,028	9,195	8,568	6,702
Future participants	2,653	2,470	2,225	1,349
All current and future participants	14,577	13,412	12,487	9,732
Present value of future expenditures less future revenue	6,166[1]	5,126[2]	4,730[3]	2,699[4]
Federal Supplementary Medical Insurance (Medicare Part B):				
Premiums:				
Participants who have attained eligibility age	284	252	258	234
Participants who have not attained eligibility age	2,148	1,856	1,845	1,527
Future participants	688	600	593	404
All current and future participants	3,120	2,708	2,696	2,165
Expenditures for Scheduled Future Benefits for:				
Participants who have attained eligibility age	1,306	1,132	1,159	1,051
Participants who have not attained eligibility age	8,845	7,463	7,415	6,094
Future participants	2,622	2,238	2,206	1,514
All current and future participants	12,773	10,833	10,780	8,659
Present value of future expenditures less future revenue	9,653[1]	8,125[2]	8,084[3]	6,494[4]
Railroad Retirement *present value of future expenditures less future revenue*	22[1]	20[2]	19[5]	8[6]
Black Lung (Part C) *present value of future expenditures less future revenue*	(4)[7]	(5)[8]	(4)[9]	(4)[10]

[1] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[2] The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
[3] The projection period is 1/1/2001 - 12/31/2075 and the valuation date is 1/1/2001.
[4] The projection period is 1/1/2000 - 12/31/2074 and the valuation date is 1/1/2000.
[5] The projection period is 1/1/2001 - 12/31/2076 and the valuation date is 1/1/2001.
[6] The projection period is 9/30/2000 - 12/31/2073 and the valuation date is 12/31/1998.
[7] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 6/30/2003.
[8] The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 6/30/2002.
[9] The projection period is 9/30/2001 - 9/30/2040 and the valuation date is 6/30/2001.
[10] The projection period is 9/30/2000 - 9/30/2040 and the valuation date is 6/30/2000.

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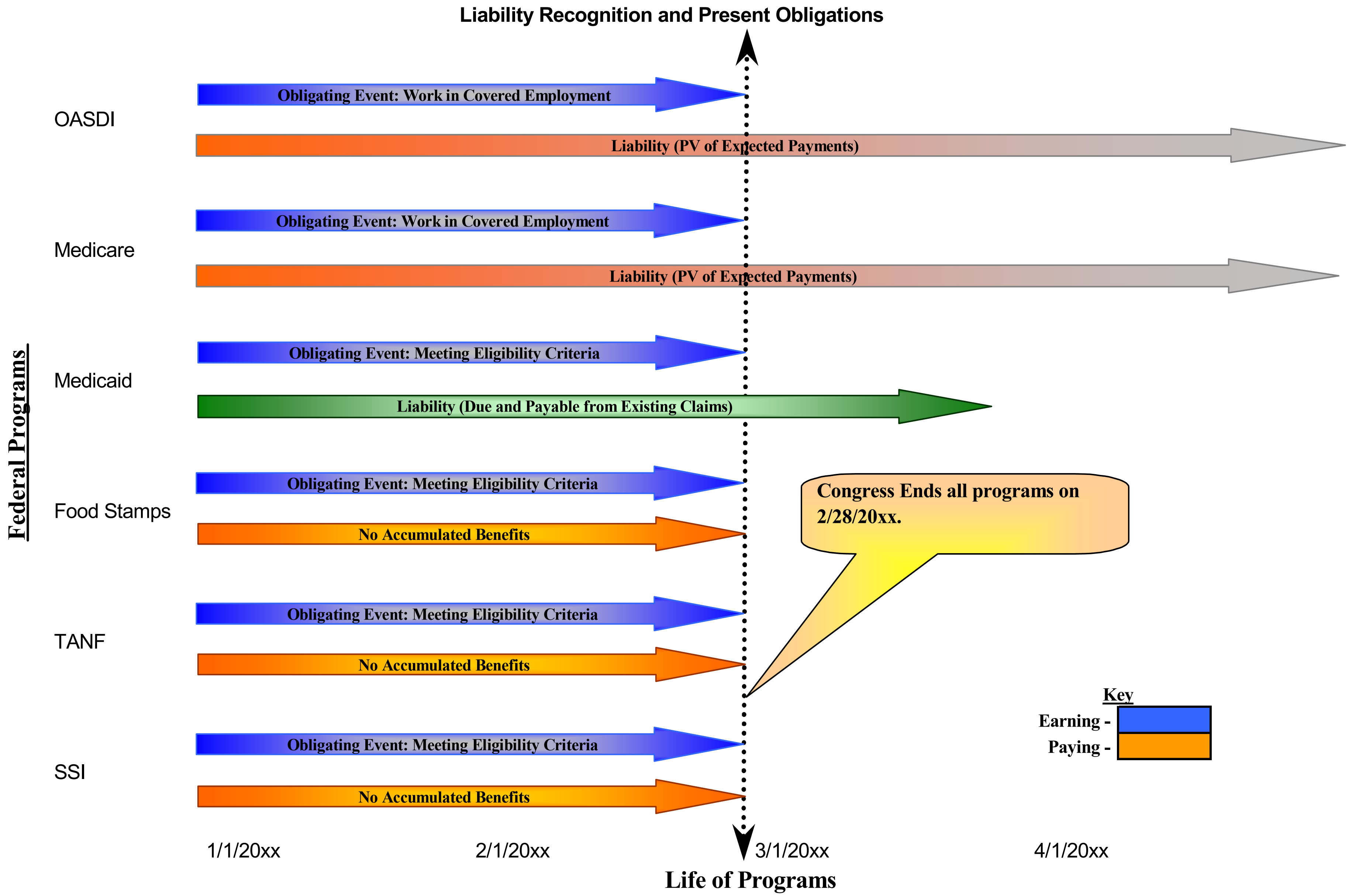
Appendix I – Liability Recognition and Present Obligations

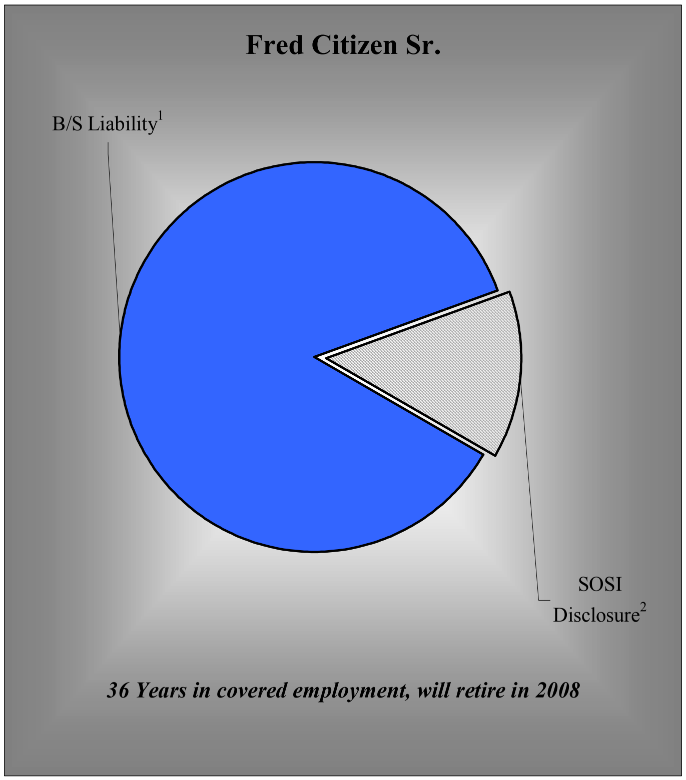
1

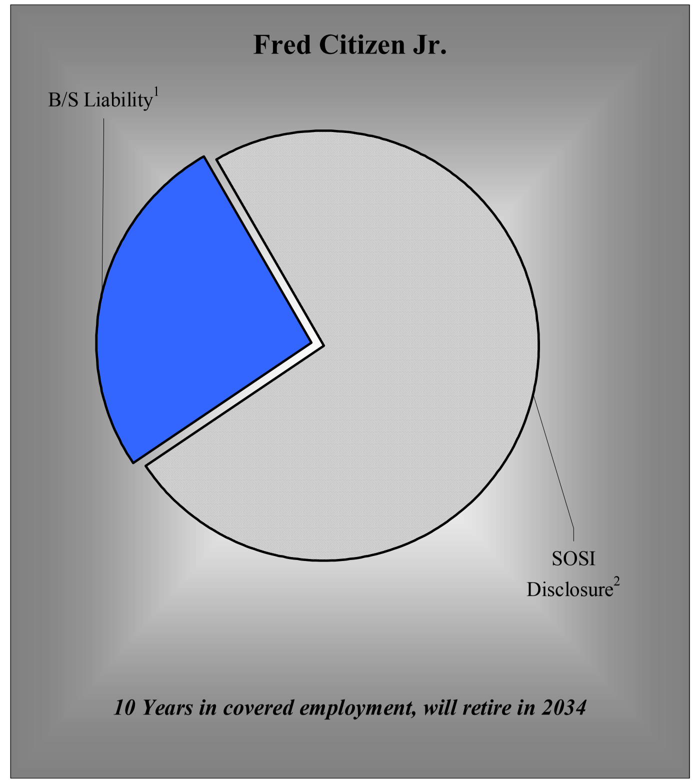


Appendix J – Balance Sheet and SOSI Treatment

1

Balance Sheet and SOSI Treatment



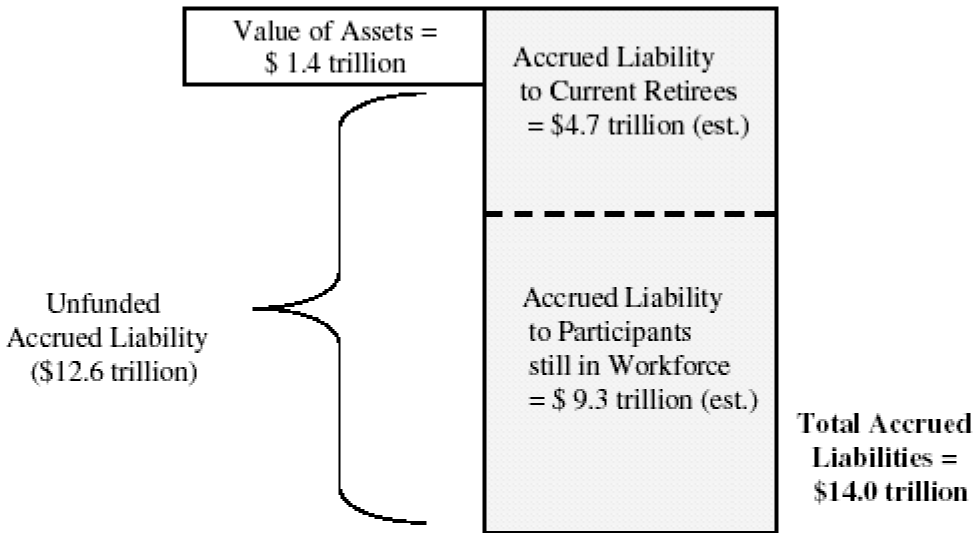


1. Balance Sheet Liability is equal to the present value of future benefits scheduled to be paid based on past earnings as of balance sheet date
2. Disclosure in Statement of Social Insurance is equal to present value of benefits to be paid based on lifetime earnings.

Appendix K – Howell Jackson "GAAP- Balance Sheet" and Income Statement for Trust Fund, Dec. 31, 2002

GAAP-style Balance Sheet of Social Security Trust Funds

(Dec. 31, 2002)



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Income Statement for Trust Funds (est.)

(Jan. 1, 2002 through Dec. 31, 2002)

Revenues	
Payroll Taxes [known]	$ 532.5 billion
Income from Taxation [known]	$ 14.2 billion
Interest on Trust Fund Assets [known]	$ 80.4 billion
	$ 627.1 billion
Expenses	
Administrative Expenses [known]	($ 4.2 billion)
Other Costs [known]	($ 3.7 billion)
Interest Charge [derived]	($ 786.9 billion)
Net Accrual of Liabilities [derived]	($ 299.8 billion)
	($ 1,094.6 billion)
Profit (Loss) from Operations	**($ 467.5 billion)**

3

Appendix L – Pro Forma Financial Statements with ABO-like Liability – Non-Exchange Transaction

1

SSA Pro-forma Balance Sheet
as of September 30, 2003

	(Dollars in Millions)	
Assets	**2003 (rev)**	**2003**
Intragovernmental Assets	1,508,334	1,508,334
Other Assets	6,745	6,745
Total Assets	$ 1,515,079	$ 1,515,079
Liabilities (Note 8)		
Intragovernmental Liabilities	10,287	10,287
Other Liabilities	51,007	51,007
OASDI Benefit Liability	**6,000,000**	
Total Liabilities	6,061,294	61,294
Net Position	(4,546,215)	$ 1,453,785
Total Liabilities and Net Position	$ 1,515,079	$ 1,515,079

OASDI Obligations equals benefits accumulated based on current salaries and wages. Similar to FASB ABO.

Change in Accounting Practice for prior years of service to adjust Net Position.

SSA Pro-forma Statement of Changes in Net Position
For the Years Ended September 30, 2003

	2003 (rev)		2003	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
Net Postion, Beginning Balance	$ 1,297,567	$ 794	$ 1,297,567	$ 794
Prior Period Adjustments	**$ (4,934,000)**		$ -	
Beginning Balance as Adjusted	$ (3,636,433)		1,297,567	
Appropriations Received		48,822	-	48,822
Other Adjustments	-	(128)	-	(128)
AppropriationsUsed	48,783	(48,783)	48,783	(48,783)
Tax Revenues (Note 12)	546,808		546,808	
Interest Revenues	84,220		84,220	
Net Transfers In/Out	(15,372)		(15,372)	
	87		87	
Other Financing Sources	406		406	
Total Financing Sources	664,932	(89)	664,932	(89)
Net Cost of Operations	1,575,419		509,419	
Ending Balances	$ (4,546,920)	$ 705	$ 1,453,080	$ 705

Appendix M – Pro Forma Financial Statements with ABO-like Liability – Exchange Transaction

United States Government Pro-forma Balance Sheet
As of September 30, 2003 and September 30, 2002

(in billions of dollars)	**2003 (rev)**	2003
Total Assets	1,393.9	1,393.9
Liabilities	8498.6	8,498.6
OASDI Benefit Liability	**6,000.0**	
Total Liabilities	14,498.6	8,498.6
Net Position	(13,104.7)	(7,104.7)
Total Liabilities and Net Position	1,393.9	1,393.9

OASDI Liability equals benefits accumulated based on current salaries and wages. Similar to FASB ABO.

Governmentwide Net Position reduced due to excess of liabilities over assets.

United States Government Pro-forma Statement of Net Cost
For the Years ending September 30, 2003

	2003 (rev)			2003		
(in billions of dollars)	**Gross Cost**	**Earned Revenue**	**Net Cost**	Gross Cost	Earned Revenue	Net Cost
All Other entities	2,137.7	164.5	1,973.2	2,137.7	164.5	1,973.2
Social Security Administration	55.2	0.3	54.9	512.6	0.3	512.3
OASDI	**1,612.9**	**546.9**	**1,066.0**	-	-	-
Total	3,805.8	711.7	3,094.1	2,650.3	164.8	2,485.5

United States Government Pro-forma Statements of Operations and Changes in Net Position
For the Years ending September 30, 2003

(in billions of dollars)	**2003 (rev)**	2003
Total Revenue	1,796.0	1,796.0
Less: Net Cost of Government Operations	3,094.1	2,485.5
Unreconciled Transactions Affecting the Change in Net Position (Note 16)	24.5	24.5
Net Operating Cost	(1,273.6)	(665.0)
Net Position, Beginning of Period	(6,820.2)	(6,820.2)
Changes in Accounting Principle (Note 17)		
OASDI Liability	**(5,391.4)**	
Other	383.1	383.1
Prior Period Adjustments (Note 17)	(2.6)	(2.6)
Net Operating Costs	(1,273.6)	(665.0)
Net Position, End of Period	(13,104.7)	(7,104.7)

Annual accumulation of Benefits would increase Governmentwide Costs. (Service Cost) Does not include Cash outlays, that is included in SSA line item already. OASDI taxes paid are considered Earned revenue. Cash Outlays are not included in Costs.

Change in Accounting Principle would include the charge to Net Position in the first year due to new standard.

Appendix N – Pro Forma Financial Statements with Full Eligibility or "Minimum" Liability – Non-Exchange Transaction

United States Government Pro-forma Balance Sheet
As of September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Assets	1,393.9	1,393.9
Other Liabilities	8,498.6	8,498.6
OASDI Benefits Liability	**4,662.0**	
Total Liabilities	13,160.6	
Contingent Liabilities (Note 18) and Commitments (Note 19)		
Net Position	(11,766.7)	(7,104.7)
Total Liabilities and Net Position	1,393.9	1,393.9

OASDI Benefits Liability equal benefits due to individuals with full eligibility.

Governmentwide Net Position reduced due to excess of liabilities and obligations over assets.

United States Government Pro-forma Statement of Net Cost
For the Years ending September 30, 2003 and September 30, 2002

	2003 (rev)			2003		
(in billions of dollars)	Gross Cost	Earned Revenue	Net Cost	Gross Cost	Earned Revenue	Net Cost
All Other entities	2,137.7	164.5	1,973.2	2,137.7	164.5	1,973.2
Social Security Administration	55.2	0.3	54.9	512.6	0.3	512.3
OASDI	**640.0**		**640.0**			
Total	2,832.9	164.8	2,668.1	2,650.3	164.8	2,485.5

Represents all costs; including service cost attributed to current period, actuarial gains/losses, and interest on the PV obligation.

United States Government Pro-forma Statements of Operations and Changes in Net Position
For the Years ending September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Revenue	1,796.0	1,796.0
Less: Net Cost of Government Operations	2,668.1	2,485.5
Unreconciled Transactions Affecting the Change in Net Position (Note 16)	24.5	24.5
Net Operating Cost	(847.6)	(665.0)
Net Position, Beginning of Period	(6,820.2)	(6,820.2)
Change in Accounting Principle (Note 17)		
OASDI Liability	**(4,479.4)**	
Other	383.1	383.1
Prior Period Adjustments (Note 17)	(2.6)	(2.6)
Net Operating Costs	(847.6)	(665.0)
Net Position, End of Period	(11,766.7)	(7,104.7)

Change in Accounting Principle would include the charge to Net Position in the first year due to new standard.

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Appendix O – Pro Forma Financial Statements with Full Eligibility Amount as a New Element – Non-Exchange Transaction

United States Government Pro-forma Balance Sheet
As of September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Assets	1,393.9	1,393.9
Total Liabilities	8,498.6	8,498.6
Contingent Liabilities (Note 18) and Commitments (Note 19)		
OASDI Obligations	**4,662.0**	
Net Position	(11,766.7)	(7,104.7)
Total Liabilities and Net Position	1,393.9	1,393.9

OASDI Obligations equal benefits due to individuals with full eligibility. Obligations would be a new element on the Balance Sheet.

Governmentwide Net Position reduced due to excess of liabilities and obligations over assets.

United States Government Pro-forma Statement of Net Cost
For the Years ending September 30, 2003 and September 30, 2002

	2003 (rev)			2003		
(in billions of dollars)	Gross Cost	Earned Revenue	Net Cost	Gross Cost	Earned Revenue	Net Cost
All Other entities	2,137.7	164.5	1,973.2	2,137.7	164.5	1,973.2
Social Security Administration	55.2	0.3	54.9	512.6	0.3	512.3
OASDI	**640.0**		**640.0**			
Total	2,832.9	164.8	2,668.1	2,650.3	164.8	2,485.5

Represents all costs; including service cost attributed to current period, actuarial gains/losses, and interest on the PV obligation.

United States Government Pro-forma Statements of Operations and Changes in Net Position
For the Years ending September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Revenue	1,796.0	1,796.0
Less: Net Cost of Government Operations	2,668.1	2,485.5
Unreconciled Transactions Affecting the Change in Net Position (Note 16)	24.5	24.5
Net Operating Cost	(847.6)	(665.0)
Net Position, Beginning of Period	(6,820.2)	(6,820.2)
Change in Accounting Principle (Note 17)		
OASDI Obligation	**(4,479.4)**	
Other	383.1	383.1
Prior Period Adjustments (Note 17)	(2.6)	(2.6)
Net Operating Costs	(847.6)	(665.0)
Net Position, End of Period	(11,766.7)	(7,104.7)

Change in Accounting Principle would include the charge to Net Position in the first year due to new standard.

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Appendix P – Pro Forma Financial Statements with Full Eligibility or "Minimum" Liability AND a New Element– Non-Exchange Transaction

United States Government Pro-forma Balance Sheet
As of September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Assets	1,393.9	1,393.9
Liabilities	8,498.6	8,498.6
OASDI Benefit Liability	**4,500.0**	
Total Liabilities	12,998.6	8,498.6
Contingent Liabilities (Note 18) and Commitments (Note 19)		
OASDI Benefit Obligations	**2,000.0**	
Net Position	(13,604.7)	(7,104.7)
Total Liabilities and Net Position	1,393.9	1,393.9

OASDI Benefits Payable are benefits the government will pay out in future periods, due to work in covered in employment.

OASDI obligation line would be new element to capture those benefits which may be payable in the future but beneficiaries are not yet fully eligible.

Governmentwide Net Position reduced due to excess of liabilities and obligations over assets.

United States Government Pro-forma Statement of Net Cost
For the Years ending September 30, 2003 and September 30, 2002

	2003 (rev)			2003		
(in billions of dollars)	Gross Cost	Earned Revenue	Net Cost	Gross Cost	Earned Revenue	Net Cost
All Other entities	2,137.7	164.5	1,973.2	2,137.7	164.5	1,973.2
Social Security Administration	512.6	0.3	512.3	512.6	0.3	512.3
OASDI	**1,066.0**		**1,066.0**			
Total	3,716.3	164.8	3,551.5	2,650.3	164.8	2,485.5

Represents all costs; including service cost attributed to current period, actuarial gains/losses, and interest on the PV obligation.

United States Government Pro-forma Statements of Operations and Changes in Net Position
For the Years ending September 30, 2003 and September 30, 2002

(in billions of dollars)	2003 (rev)	2003
Total Revenue	1,796.0	1,796.0
Less: Net Cost of Government Operations	3,551.5	2,485.5
Unreconciled Transactions Affecting the Change in Net Position (Note 16)	24.5	24.5
Net Operating Cost	(1,731.0)	(665.0)
Net Position, Beginning of Period	(6,820.2)	(6,820.2)
Changes in Accounting Principle (Note 17)		
OASDI Obligation	**(5,434.0)**	
Other	383.1	383.1
Prior Period Adjustments (Note 17)	(2.6)	(2.6)
Net Operating Costs	(1,731.0)	(665.0)
Net Position, End of Period	(13,604.7)	(7,104.7)

Change in Accounting Principle would include the charge to Net Position in the first year due to new standard.

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Appendix Q – Social Insurance Program Characteristics

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	OASI	DI	Medicare			Medicaid	Food Stamps	SSI	TANF (formerly Aid to Families w/ Children)
			HI Part A	SMI Part B	PDP Part D				
Means Tested?	[34], [35]	See OASI note 13		√ [36]		√	√	√	√
Eligibility based on work in covered employment?	√	√	√	√	√				
Financed with dedicated collections?	√	√	√	√[1]	√				
Financed with general funds?	[37]	See OASI note	See OASI note	√	√	√	√	√	√
Financed with user fees?				√	√	√			

[34] Based on income, some people must pay income tax on their Social Security benefits. These people have substantial income in addition to Social Security benefits (such as wages, self-employment, interest, dividends and other taxable income that you have to report on your tax return). Combined income between $25,000 and $34,000 for individual filers ($32,000-$44,000 for joint filers) subjects 50 percent of Social Security benefits to income tax. "Combined income" is the sum of adjusted gross income plus nontaxable interest plus one-half of your Social Security benefits. Up to 85 percent of Social Security benefits are subject to income tax if combined income is above $34,000 ($44,000 for joint filers). No one pays taxes on more than 85 percent of his or her Social Security benefits and some pay on a smaller amount, based on these IRS rules. Income tax on Social Security benefits is credited to the Social Security fund.

[35] For beneficiaries under full retirement age (FRA) who start getting Social Security payments, $1 in benefits is deducted for each $2 earned above the annual limit. For 2004 that limit is $11,640. The earliest age that Social Security retirement benefits can be received remains 62 even though the FRA is rising. In the year the beneficiary reaches his or her FRA, $1 in benefits is deducted for each $3 earned above a different limit, but only counting earnings before the month FRA is reached. For 2004, this limit is $31,080. There is no limit on earnings starting with the month FRA is reached.

[36] On December 8, 2003, President Bush signed into law the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003* (Public Law 108-173). The law creates a voluntary prescription drug benefit program (Part D) for all individuals eligible for Medicare under which they will pay a monthly premium for coverage in helping them purchase prescription drugs. Part D is effective January 1, 2006. The law establishes a transitional drug discount card, includes provisions for combating fraud, waste, and abuse in the Medicare program, and makes revisions in existing Parts A and B of Medicare including provisions relating to rural health care, inpatient hospital services, skilled nursing facility services and home health care. The law also reduces the Medicare Part B premium subsidies for certain individuals and establishes tax-free Medical Savings Accounts. The law requires, beginning in 2007, that Part B Medicare beneficiaries with modified adjusted gross incomes over $80,000 for an individual and $160,000 for a married couple pay a higher Part B premium than individuals with lesser incomes. The amount of the increased premium will be based on ranges of income specified in the law. For example, an individual with modified adjusted gross income between $100,000 and $150,000 would pay a higher Part B premium than an individual with income between $80,000 and $100,000.

[37] OASI, DI, and HI receive payments from the general fund – the taxes on OASI and DI benefits. The taxes are general fund income tax receipts, but with amounts equal to the tax on certain benefits (as defined by law) required to be paid by the general fund to the trust funds. The receipts by the trust funds are dedicated collections to these trust funds but paid out of the general fund rather than "directly" by the public.

Appendix Q – Social Insurance Program Characteristics

	OASI	DI	Medicare			Medicaid	Food Stamps	SSI	TANF (formerly Aid to Families w/ Children)
			HI Part A	SMI Part B	PDP Part D				
Investment authority re surplus funds?	√	√	√	√					
Budget authority ("A" = annual, "MY" = multi-year, "PI" = permanent and indefinite, "TI" = temporary and indefinite. NY = "no year")?	PI	PI	PI	PI		NY/ TI [38]	A[39]	NY[40]	[41]

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38 While Medicaid is permanently authorized and there is no cap on the amount of matching federal funding to be provided, Medicaid is still appropriated every year. The annual appropriation language from P.L. 108-199 regarding the 2004 annual Medicaid appropriations is as follows: "CENTERS FOR MEDICARE AND MEDICAID SERVICES GRANTS TO STATES FOR MEDICAID: For carrying out, except as otherwise provided, titles XI and XIX of the Social Security Act, $130,892,197,000, to remain available until expended. For making, after May 31, 2004, payments to States under title XIX of the Social Security Act for the last quarter of fiscal year 2004 for unanticipated costs, incurred for the current fiscal year, such sums as may be necessary. For making payments to States or in the case of section 1928 on behalf of States under title XIX of the Social Security Act for the first quarter of fiscal year 2005, $58,416,275,000, to remain available until expended. Payment under title XIX may be made for any quarter with respect to a State plan or plan amendment in effect during such quarter, if submitted in or prior to such quarter and approved in that or any subsequent quarter."

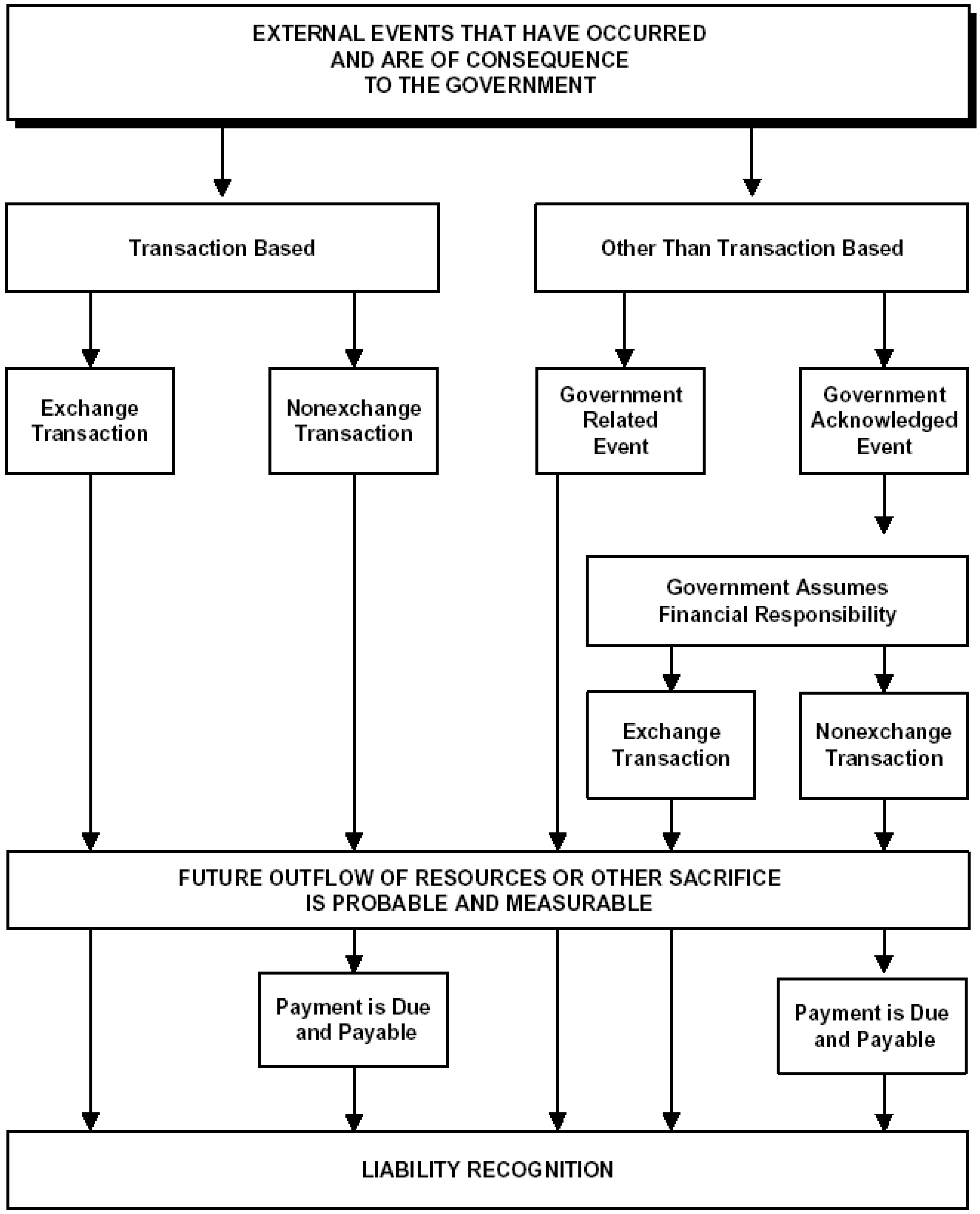
39 While the Food Stamp program is permanently authorized by legislation, annual one-year appropriations are provided (note: funds made available for Employment and Training remain available until expended).

40 Per Public Law 18-199, appropriated amounts are to remain available until expended. However, funds provided to a state in the fiscal year and not obligated by the state during the year shall be returned to Treasury.

41 Public Law 108-262 temporarily reauthorized TANF from June 30, 2004 through September 30, 2004, and appropriated such sums as may be necessary for the fourth quarter of FY 2004.

Appendix R – SFFAS 5, Figure 1, Liability Recognition Summary

Figure 1: Liability Recognition Summary



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Pros and Cons of Reporting an SI Obligation, from SFFAS 17, Basis for Conclusions

Point and counter-point analysis of past arguments for and against reporting a liability and/or a long-term obligation for Social Insurance (SI) programs, from SFFAS 17, basis for conclusions.

Support for	Opposition to
“Exchange vs. nonexchange” irrelevant – The distinction between exchange and non-exchange transactions is not relevant to the liability recognition or supplementary reporting issue. Most of the financial reporting community in the United States have adopted a different standard than exchange or nonexchange. The FASB concept statements adopt an “asset/liability” perspective. [SFFAS 17, par. 73, 78]	
Conceptually, it’s an exchange transaction – If the exchange/nonexchange distinction is relevant, then the SI programs possess characteristics that make the transactions predominantly exchanges. The characteristics, taken together, cause the criteria for recognizing a liability to be met long before payments are due and payable. Those characteristics are: 1. The contributory nature of the program (i.e., benefits are predicated to some extent on prior payments). 2. Time in covered employment. 3. Government sponsorship. 4. Benefits prescribed in law. 5. Specific accounting entity (e.g., the trust fund) and long-range financing. These characteristics, in conjunction with the historical experience and political climate affecting the SI programs, create obligations and societal expectations that make the outflow of resources highly probable — far more than 50 percent. [SFFAS 17, par. 73-5]	**Conceptually, it’s a nonexchange transaction** – SI programs do not result in exchange transactions. They are income transfers financed primarily by compulsory earmarked taxes and also, in certain cases, general revenues of the government. [SFFAS 12, par. 65] The political nature of the commitment is critical. Its terms can be and are changed by the Congress to maintain actuarial balance. See Flemming, Secretary of HEW v.Nestor. [SFFAS 12, par. 65]
The benefits are paid for – SI programs, as distinguished from general assistance programs, require the payment of taxes in order	**The payments are compulsory** -- With SI programs the government uses its sovereign power to require payment of

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Point and counter-point analysis of past arguments for and against reporting a liability and/or a long-term obligation for Social Insurance (SI) programs, from SFFAS 17, basis for conclusions.

Support for	Opposition to
to establish an “insured status” before an individual is eligible for benefits. This is often referred to as an “earned right to benefits.” In addition, most such programs have an element of individual equity in their benefit formulas whereby greater levels of taxes result in greater levels of benefits — although Medicare HI is a notable exception. Moreover, both the participant and the employer sacrifice value in anticipation of future benefit. Not only do the participants anticipate retirement benefits as a result of these sacrifices, many employers, including the Federal Government, build in the value of Social Security benefits when designing retirement plans. SFFAS 17, par. 75] **<u>Constructive liabilities</u>** – SI programs are constructive liabilities and users of financial statements are accustomed to seeing such liabilities quantified in financial statements or in notes to the statements. [SFFAS 17, par. 76]	taxes that it dedicates to finance benefits. The individual beneficiaries of these programs are receiving payments that may be indirect and disproportionate to the taxes paid by them or on their behalf. These programs transfer payment between and/or among generations. [SFFAS 17,par. 66-7]

Pros and Cons of Reporting an SI Obligation, from SFFAS 17, Basis for Conclusions

Point and counter-point analysis of past arguments for and against reporting a liability and/or a long-term obligation for Social Insurance (SI) programs, from SFFAS 17, basis for conclusions.

Support for	Opposition to
	The annual cash outflow is the critical information – The critical issue is the period to which a particular cost or expense relates. A significant determination in accounting is to decide in which period a transaction should be recognized as an expense. Social insurance benefits, like other non-exchange transactions, should be recognized as expenses in the time period when they are paid or are due and payable, and not earlier when a participant has covered wages. Future social insurance benefits constitute program costs of future periods, notwithstanding that they may be for the purpose of carrying out responsibilities that the government has already assumed. [SFFAS 17, par. 70]
A liability measure is essential -- It is inherently misleading to fail to quantify the size of the promise that is continually being made and on which people are told they can rely. While many who support liability-type disclosure agree the open group data are desirable to aid in assessing the sustainability of social insurance programs, they also believe that an assessment of the financial condition of the program — and the Federal Government — is not possible absent liability or closed group data. [SFFAS 17, par. 79]	**A liability measure is meaningless** -- Given the nature of the Federal Government and of social insurance, liability-type measures of the social insurance obligation (e.g., the closed group measure...) are meaningless or even potentially misleading. In particular, this information would not be useful to assess sustainability. It ignores the pay-as-you-go financing, excludes future earmarked taxes from future participants, and results in such an enormous actuarial present value that it may needlessly scare those unfamiliar with the debate. Such measures could imply that the current participants have a right to benefits superior to future participants. [SFFAS 17, par. 71-2]
The closed group measure is essential – The closed group number is a measure of the intergenerational transfer implicit in the	**There's too much uncertainty --** The level of future benefit payments is too uncertain for accrual as a liability. Congress

Pros and Cons of Reporting an SI Obligation, from SFFAS 17, Basis for Conclusions

Point and counter-point analysis of past arguments for and against reporting a liability and/or a long-term obligation for Social Insurance (SI) programs, from SFFAS 17, basis for conclusions.	
Support for	Opposition to
program under its current terms and that this number should be reported. The failure to disclose this number makes these programs look healthier than they are and thus may lead to poor decisions about consumption and saving by Congress and by citizens. A closed group measure that treats social insurance benefits as earned annually would help users to understand the extent to which social insurance programs have committed future-year taxpayers to finance amounts earned by participants as of a given point in time. [SFFAS 17, par. 77]	can and does alter, amend, or repeal provisions, and benefit payments that might be made in the future are dependent on highly uncertain economic and demographic variables. [SFFAS 17, par. 68-9]

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