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Comment letters on Proposed Statement of Position “Auditing the Statement of Social Insurance”

American Institute of Certified Public Accountants. Social Insurance Task Force

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List of Respondents to the Proposed Statement of Position “*Auditing the Statement of Social Insurance*”

<u>Letter number</u>	<u>Commentator</u>	<u>Affiliation</u>
1.	Steven Schaeffer	Social Security Administration Office of the Inspector General
2.	Dale Sopper and Stephen Goss	Social Security Administration
3.	Daniel Kovlak	KPMG
4.	Richard Foster	Office of the Actuary
5.	Joseph Vengrin	Department of Health & Human Services
6.	Jeffrey Steinhoff	General Accounting Office

CL #1

**Social Security Administration
Office Of The Inspector General
Office Of Audit
Correspondence Control Sheet**

Due Date: (Out Of This Office)

Monday, March 29, 2004

Date Assigned

Monday, March 08, 2004

Control Numbers: Office Of Audit - 04-0112
IG Control No.:

Summary Of Incoming Document

From: Judith Sherinsky
Technical Manager, AICPA, Audit . . .
Subject: Invitation to Comment on "Auditing the Statement of Social Insurance"

CIN Number:

Comments / Instructions:

Prepare response for Steve to send via email and send to Pam Kilgallon.

Prepare Reply
for the Signature Of: **Steven L. Schaeffer**
Addressed To: **Sharon Macey (smacey@aicpa.org)**
Date Correspondence Signed: _____

Action Assigned To:
Nordhoff

Summary Comments of Action Taken:

Date Initials

Date Printed: 3/8/04
File Code: AI-1

Date Control Closed:

v

SOCIAL SECURITY ADMINISTRATION
OFFICE OF THE INSPECTOR GENERAL

COMMENTS ON AICPA'S EXPOSURE DRAFT
PROPOSED STATEMENT OF POSITION
AUDITING THE STATEMENT OF SOCIAL INSURANCE
MARCH 5, 2004

The Social Security Administration Office of the Inspector General is pleased to submit the following preliminary comments on the exposure draft of audit guidance for the Statement of Social Insurance.

Paragraph

1. 2.a.3 – add “Individuals expected to become participants under current law.”
2. 2.d.(2) – Does the reference “closed group” refer to the groups described in 2.a.? If so, reference should be noted in 2.a. as to the 3 groups collectively called the “closed group.”
3. 4. – add “E. Government wide.”
4. 12. – The auditor should obtain knowledge about the program and its business operations.
5. 25.a. - Control environment considerations should also include outside environmental factors such as the political climate surrounding social insurance programs, budget limitations, and economic conditions. Additionally, relationship and related party affiliations of outside boards (trustees) should be considered as the board members are appointed by the President and the board disseminates information to the public.
6. 33.a. – Read the Agency’s program actuary’s actuarial report.
7. 36. & 9.a – There needs to be a discussion on how to evaluate assumptions used by the agency under audit that were developed by an external party. Has the recent FASAB Exposure Draft on Presentation of Assumptions Amending SFFAS 25 been considered?
8. Adequacy of disclosures section – the relationship of actuaries to the board (trustees) should be disclosed since the board relies on actuary supplied data for discussion and decision-making.

CL#2



SOCIAL SECURITY

MAY - 3 2004

Sharon Macey
Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Macey:

Attached are comments from the Social Security Administration (SSA) on the recently-exposed draft of a proposed Statement of Position (SOP) entitled *Auditing the Statement of Social Insurance*.

As the entity most directly affected by the proposed SOP, we continue to object to the use of the phrase "review of the process used to develop assumptions." The phrase should be changed to "review the assumptions used by the agency for reasonableness." The process leading up to and including the development of the assumptions used by SSA in its Statement of Social Insurance (SOSI) is entirely within the domain of the SSA Trustees. The Trustees, as a group, with their staff, discuss, modify and ultimately agree upon assumptions for the projections presented in their annual report to Congress. The Trustees' deliberations are distinct and separate from the work of the Agency in preparing the SOSI. The proposed change would make it clear that the scope of the audit work related to assumptions is post-Trustees Report.

Additionally, throughout the document there are references to demographic and economic assumptions included in the SOSI as management's "best estimate." The SOP should clarify that management's best estimate refers to those external inputs from the Board of Trustees that have been "deemed to be reasonable" by the Agency (entity).

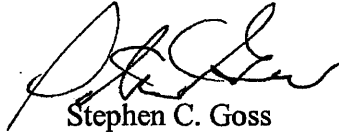
Due to the delay in the release of the proposed SOP for comment, we urge the Social Insurance Task Force of the AICPA's Audit Standards Board to work with the Federal Accounting Standards Advisory Board to delay the effective date of the Statement of Federal Financial Accounting Standard No. 25 at least 1 year, until 2006 or later, to allow adequate time to properly prepare for full implementation while deliberations on the proposed audit standards continue.

Please feel free to contact us if we can provide any additional information.

Sincerely,



Dale W. Sopper
Deputy Commissioner
for Finance, Assessment and Management
Social Security Administration



Stephen C. Goss
Chief Actuary
Social Security Administration

Attachment

SOCIAL SECURITY ADMINISTRATION (SSA)

COMMENTS ON THE EXPOSURE DRAFT OF THE PROPOSED STATEMENT OF POSITION AUDITING THE STATEMENT OF SOCIAL INSURANCE

**CIRCULATED BY THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC
ACCOUNTANTS (AICPA) ON MARCH 5, 2004**

General Comments:

- Since there was a 2 month delay in the release of this exposure draft, we continue to have great concern as to the effective date of Statement of Federal Financial Accounting Standard (SFFAS) No. 25 and the impact it will have on SSA's preparation for the audit. Therefore, we again ask that the Social Insurance Task Force of the AICPA's Audit Standards Board work with us in requesting that the Federal Accounting Standards Advisory Board (FASAB) delay the effective date of SFFAS No. 25 at least 1 year, until 2006 or later, to allow adequate time to properly prepare for full implementation. In addition to the delayed exposure, the complexity of the issues and the recent exposure by the FASAB of an amendment to SFFAS No. 25 make clear that additional time will be required to assure that both the agencies and the auditors will be able to prepare adequately for implementation of the new and important requirement.
- SSA continues to object to the use of the phrase "review of the process used to develop assumptions." This phrase should be changed to "review the assumptions used by the agency for reasonableness." This would make it clear that the scope of the audit work related to assumptions is post-Trustee Report. The process leading up to and including the development of the assumptions is entirely within the domain of the Trustees who, as a group, with their staff, discuss, modify and ultimately agree on these assumptions for the projections presented in their annual report to Congress. The Trustees' deliberations are statutorily established and are distinct and separate from the work of the Agency in developing the Statement of Social Insurance (SOSI). The assumptions developed by the Trustees and their staff are thus external inputs to the Agency's work on the SOSI. As such, the auditors should not review the Trustees' development process for assumptions that are ultimately used by the Agency for the Statement of Social Insurance.
- The draft Statement of Position (SOP) and FASAB SFFAS No. 17 make reference to demographic and economic assumptions used in the SOSI as management's "best estimate." The SOP should clarify that management's best estimate refers to those external inputs from the Board of Trustees that have been "deemed to be reasonable" by the Agency (entity). Paragraph 39. b. and footnote 14 of the draft (7Aa of the Appendix) properly state, "the assumptions are established by an external board of trustees and provided to the agency." The Chief Actuary of Social Security attests to the reasonableness of the assumptions in the Trustees Report.

Specific Comments:

- ¶ 2. a. and 2. d. – “Retirement age” should be changed to be consistent with the term and concept used in SSA’s SOSI contained in its Performance and Accountability Report (PAR), “retirement eligibility age” (which is age 62).
- ¶ 2. b. and 2. c. – “Benefit payments” and “expenditures” are used to indicate program costs (benefits scheduled to be paid under present law plus other expenses). It would be better to use the word “cost” (accompanied by its definition) as used in SSA’s SOSI contained in its PAR.
- ¶ 5. – As explained in the 3rd general comment above, SSA believes that the requirement that “management must determine its best estimate” should be clarified to mean “an estimate that management deems to be reasonable.” Management accepts as a reasonable external input the intermediate assumptions developed by the Trustees for their latest annual report to the Congress. The Trustees determined these to be their best estimate of expected future experience. For the purpose of projections and assumptions about the future, the concept of “mode” has no relevance.
- ¶ 8. d. (2) – SSA continues to object to the use of the phrase “review of the process used to develop assumptions.” This phrase should be changed to “review the assumptions used by the agency for reasonableness.” This would make it clear that the scope of the audit work related to assumptions is post-Trustee Report. The process leading up to and including the development of the assumptions is entirely within the domain of the Trustees who, as a group with their staff, discuss, modify and ultimately agree on these assumptions for the projections presented in their annual report to Congress. The Trustees’ deliberations are statutorily established and are distinct and separate from the work of the Agency in developing the SOSI. The assumptions developed by the Trustees and their staff are thus external inputs to the Agency’s work on the SOSI.
- ¶ 9. – Note: The closing sentence of this paragraph seems to address the comment immediately above for paragraph 8. d. (2). It appropriately *excludes* the work of the Trustees.
- ¶ 11. a. (4) – This item and footnote # 4 related to this item is inaccurate. The wording of paragraph 11. a. (4) should read, “...commissioned by the Agency, the appropriate Advisory Board or the Trustees....” The Board of Trustees is not a review group and should not be cited as an example. The wording of the footnote could be changed to, “An example of an external review group would be a technical review panel commissioned by the Social Security Advisory Board. The Advisory Board is a 7-member independent, bipartisan board

created by Congress and appointed by the President and the Congress to advise the President, the Congress and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income programs.”

- ¶ 13. – This item should clarify that the “changes to law and regulations” are those laws already *enacted* and those regulations *published in final form*.
- ¶ 14. c. – The phrase “entity activities” should exclude the activities of the Trustees’ and their staff in preparation of the Trustees Report. Thus, all audit activities should begin after the Trustees Report is issued.
- ¶ 18. – This sentence should be modified to read, “If the actuary who has prepared or reviewed the actuarial valuation of the social insurance program is employed or managed by the agency operating that program, it is necessary for the auditor to obtain the services of an outside, *qualified* actuary to assist the auditor in performing the audit procedures that assess the actuary’s methods and assumptions and enable the auditor to determine whether the findings are not unreasonable.” Footnote 6 should likewise be modified to read, “Although SAS 73 does not preclude the auditor from using the work of a specialist who is related to the client, because of the significance of the estimates of income and expenditures to the statement of social insurance, and the complexity and subjectivity involved in developing such estimates, auditing estimates in the statement of social insurance requires the use of an outside, *qualified* actuary, that is, a *qualified* actuary who is not employed or managed by the agency. If the auditor has the requisite *actuarial qualifications*, knowledge and experience in actuarial science, the auditor may serve as the actuary. If the auditor does not possess the level of competence in actuarial science to qualify as an actuary, the auditor should use the work of an outside, *qualified* actuary.”
- ¶ 19. Replace “authorities” with “experts.”
- ¶ 31. – The heading of this section is “Performing Substantive Procedures.” However, the procedures and tests described here would best be characterized as “Tests of Controls.”
- ¶ 33. a. – The actuarial report referenced in this paragraph is limited to one page of the Annual Trustees’ Report.
- ¶ 37 – This paragraph needs to be revised to reflect the fact that FASAB has produced an exposure draft to amend SFFAS No. 25 to require footnote disclosure of *key* assumptions. SSA can support the proposed treatment of footnote disclosure of key assumptions only if the audit standards make clear that the auditor’s consideration of these key assumptions does not include a review of the process to develop the assumptions. As explained in the

comment related to paragraph 8. d. (2), the process of developing assumptions is separate, distinct and external to the use of the estimates by the Agency in producing the SOSI.

- ¶ 38. a. – See the 3rd general comment above about estimates deemed to be reasonable and the comments referenced to paragraphs 5., 8. d. (2) and 9. Also, see more appropriate wording already contained in the exposure draft at 39b, 7A (footnote 14) and 9Aj. In addition, regarding “future changes mandated by law”, see the comment above referenced to paragraph 13. It should be made explicit that this means laws that “*have been enacted.*”
- ¶ 38. c. – It is inaccurate to state that, “*Management* is responsible for the assumptions....” The Trustees are responsible for the assumptions. See the 3rd general comment and the comments referenced to paragraphs 5., 8. d. (2), 9. and 38. a.
- ¶ 39. a. – Footnote 12 -- The quote attributed to the FASAB suggests a conclusion that a reader might not draw. For example, there are options other than infusing new taxes to fund benefits, e.g., reduction of benefits. We suggest deleting the FASAB quote or replacing it with a phrase such as, “Users of the financial statements are likely interested in the magnitude of the unfunded obligation of the Social Security program.”
- ¶ 41 and 42 – These paragraphs indicate that the proposed SOP has taken a different position on AU sec. 508 by allowing that “...an auditor should consider whether it is appropriate to express a *qualified* opinion on SOSI...” The earlier draft had specifically precluded a qualified opinion on SOSI. There continues to be a hint that a qualified opinion on SOSI is inappropriate in the last sentence of paragraph 41. This is an important issue that needs to be clarified.

SSA suggests that because the SOSI does not articulate with the other financial statements, as properly stated in paragraph 42, it would not be inappropriate or misleading to readers of the financial statements for a qualified opinion to be issued on the SOSI for reasons such as a departure from generally accepted accounting principles, unreasonable underlying assumptions or a scope limitation.

Additionally, paragraph 42 says, “... an auditor may issue a qualified, adverse, or disclaimer of opinion on the statement of social insurance and express a different opinion on the other financial statements”. To avoid any possible misunderstanding, the paragraph should also allow for the opposite possibility, that “...*an auditor may issue an unqualified opinion on the statement of social insurance and express a qualified, adverse or disclaimer of opinion on the other financial statements.*” This follows from the reasoning of the paragraph and is presumably intended, but it should be explicitly stated.

- ¶ 6A. – Change “accounting estimate” to “estimate.”
- ¶ 7A. – This paragraph and related footnote 14 seem to address SSA’s concerns about the assumptions developed by the Trustees. (See also the 3rd general comment and comments referenced to paragraphs 8. d. (2), 9, 38. a. and 38. c.) Because of the importance of this issue, the clarity provided by the appendix should also be reflected in the statement itself at the referenced paragraphs.
- ¶ 8A. a. – Change “agency” to “Office of the Chief Actuary” to clarify the source of the documentation related to assumptions.
- ¶ 8A. b. – Delete this item. It refers to the development of the assumptions, a task performed by the Trustees, a group external to the Agency.
- ¶ 9A. a. – The source of the assumptions used in the SOSI is the Trustees. It is therefore inappropriate to “evaluate” the trustees as this paragraph suggests. Replace this language with “Identify the assumptions used and evaluate the reasonableness of those assumptions.”
- ¶ 9A. b. – Change to, “Determine whether assumptions are reasonable based on available data and other related information available at the time the assumptions were developed.”
- ¶ 9A. f. – Delete this item. The intent is the same as the suggested language for 9A. b. above.
- ¶ 9A. h. – Delete this item. It is repetitive of the suggested language for 9A. a. and 9A. b.
- ¶ 9A. i. – Revise this language to read, “Evaluate whether any of the significant assumptions are so subjective that no reasonably objective basis could exist to support *or to question* the use of the assumption.”

CL#3



2001 M Street, NW
Washington, DC 20036

Telephone 202 533 3000
Fax 202 533 8500

May 3, 2004

Sharon Macey
Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY
10036-8775

Subject: Response to the AICPA Exposure Draft, Proposed Statement of Position,
Auditing the Statement of Social Insurance, dated March 5, 2004

Dear Ms. Macey:

We are pleased to have the opportunity to provide our comments on the Exposure Draft, Proposed Statement of Position, *Auditing the Statement of Social Insurance*, dated March 5, 2004 (the "ED"), issued by the American Institute of CPAs (AICPA).

In general, we agree with the ED. However, paragraphs .36 and .37 may change as a result of the recent Exposure Draft issued by the FASAB on the *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*. If the FASAB exposure draft is approved, paragraphs .36 and .37 should be revised to reflect that.

We question why the example auditor's reports in paragraphs 40 through 42 only addresses 2 years of audited information, while 5 years are required to be presented in the Statement of Social Insurance. We believe that the ED should include an example auditor's report that expresses an opinion on the 5 years, and an example auditor's report to be issued when there is a change in auditors during that 5 year period.

If additional information or clarification is needed regarding our comments, please contact me at (202) 533-6072, John Hummel at (202) 533-3008, or Diane Dudley at (202) 533-3002.

Very truly yours,

Daniel L. Kovlak
Partner



**Comments by the Office of the Actuary, CMS, on the Exposure Draft
of the Statement of Position for Auditing the Statement of Social Insurance**

General comments:

1. The exposure draft describes a procedure for auditing the estimates presented in the “Statement of Social Insurance.” The guidelines seem to disregard the fact that these estimates are first produced on behalf of the Board of Trustees, and then used by CMS (and SSA) in the Statement of Social Insurance. The draft guidelines also seem to be in conflict with the fact that the Board sets the assumptions, not CMS or SSA. The draft describes the Board as reviewers of the estimates. We think the standard should be tailored to better reflect the actual process that prevails at CMS and SSA.
2. The draft statement of position describes appropriate audit standards for the estimated present values of Medicare revenues and expenditures for the long range, and for the difference between them—sometimes referred to as the program’s “unfunded obligations.” In practice, the existence and magnitude of these amounts have no impact on current-year financial operations. Despite the uncertain and theoretical nature of these projected amounts, the draft statement of position calls for a very comprehensive and detailed audit. If, for example, such amounts were to be considered formal liabilities of the U.S. government, and if changes in such amounts were to be formally amortized through current-year financial transactions, it is not clear that an audit of their determination could be more comprehensive than the one specified in the exposure draft for the projected unfunded obligations, which are not liabilities. Thus, it strikes us that the proposed standards may be more comprehensive than necessary in view of the more limited purpose of the amounts shown in the current statement of social insurance.
3. The exposure draft is not always clear on what constitutes “management.” In numerous places, management is responsible for the selection of assumptions and estimation methods, which would seem to imply that the program actuary is included in management (since other agency officials generally do not have the technical expertise to develop assumptions and methods for actuarial projections). In other places (e.g., paragraph 33c), “management, not the actuary, is responsible for the assumptions made and methods used,” which suggests that the actuary is not part of management. Clarification would be helpful.

Specific comments:

1. On the “Summary” page, in the sixth bullet point, the phrase “in certain circumstances” should be removed. It will be necessary in all cases to obtain the services of an outside actuary. Elsewhere in the draft it is made more certain that an outside actuary is to be used (e.g., page 14 contains several references).
2. Paragraphs 5 and 10b indicate that the statement of social insurance and its associated estimates are to be prepared in accordance with generally accepted accounting

principles. For social insurance programs, are these principles fully described in SFFAS 17, or are there other requirements in addition?

3. Paragraph 6c refers to the use of sufficient data. What happens when sufficient data are not available—for example, in the case of a new Medicare benefit for which no prior experience is available? We recommend using “best available” rather than “sufficient.”
4. Paragraph 7d cites an example of a model. It is a little confusing because the example is more of an estimate than a model from our perspective.
5. The footnote to paragraph 11a4 refers to the Trustees as an external review group. The footnote should either be dropped or corrected to refer to the independent expert panels of actuaries and economists periodically convened by the Medicare Board of Trustees and Social Security Advisory Board to review the assumptions and methods underlying the Trustees Report projections.
6. Paragraph 13 says that the auditor should consider changes to laws and regulations. Does this refer to legislative changes enacted since the prior year, or does it mean anticipating future changes in legislation?
7. Paragraph 14c suggests that auditors observe the entity activities and operations used to prepare the statement of social insurance. While the scope and timing of this requirement are not clear, we would object to having the audit take place concurrent with the production of the Trustees Report. From a workload standpoint, this would not be possible, since the report is completed under an extremely tight schedule. Moreover, it is not clear that the Trustees would authorize such a practice.
8. What is the “entity’s board of directors, management, and other personnel,” as referred to in paragraph 24? In the case of the CMS financial statement, is it the Board of Trustees, the Centers for Medicare & Medicaid Services, or the Office of the Actuary? (See also our general comment about the process.)
9. Paragraph 27 is unclear.
10. It isn’t clear which “actuarial report” is referred to in paragraph 33a.
11. What is the “report” that is referred to in paragraph 35?
12. Paragraph 37 seems contradictory to SFFAS 25. As the exposure draft states, “SFFAS No. 25 does not specifically require disclosure of the significant assumptions in the notes to the statement of social insurance.” Per SFFAS 25, such “other information” is to be included in Required Supplementary Information except to the extent that the preparer elects to include it in the notes to the Basic Information. However, paragraph 37 directs that “the auditor should conclude that disclosure is inadequate if management does not elect to disclose significant assumptions in the notes to the financial statements.”

13. Paragraph 38a refers to “management’s best estimates.” The estimates presented in the CMS statement of social insurance are, in fact, the Medicare Board of Trustees’ best estimates. In this paragraph and in other places throughout the draft, it would be more appropriate to say that management believes the estimates are *reasonable*. This standard (i) would better reflect the use of external estimates, (ii) would match other requirements in the exposure draft, and (iii) would be consistent with the statutory requirement for actuarial certification of the Trustees’ projections.
14. What is the definition of “accounting estimates,” as referred to in paragraphs 8b and 38h?
15. The footnote to paragraph 7Aa of the appendix discusses the role of an external board of trustees and states “In such circumstances, the auditor’s procedures generally would focus on testing the work performed by the agency’s actuary in reviewing the assumptions developed by the board of trustees.” As noted in our general comments, it would be helpful if the audit standard more directly recognized the source and nature of the projections used in the CMS and SSA financial statements and provided more thorough guidance on this specific circumstance as a direct part of the standard.

Office of the Actuary
Centers for Medicare & Medicaid Services
May 3, 2004

From: Vengrin, Joseph (OIG/OAS)
Sent: Tuesday, May 04, 2004 4:09 PM
To: Hammond, Jerry (OIG/OAS); Holmberg, Eric (OIG/OAS); Vengrin, Joseph (OIG/OAS)

Ms. Sharon Macey,

The Department of Health and Human Services, Office of Inspector General appreciates the opportunity to comment on the AICPA exposure draft of the proposed Statement of Position (SOP) entitled, "Auditing the Statement of Social Insurance." We reviewed the SOP in conjunction with the Federal Accounting Standards Board's exposure draft, which proposes to amend Statement of Federal Financial Accounting Standards 25, "Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment," to require significant assumptions underlying the Statement of Social Insurance. Our comments are as follows:

External References. OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, as well as OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements* do not recognize the Statement on Social Insurance as a principal financial statement. Both bulletins will need to be amended prior to the issuance of the proposed AICPA statement of position since both bulletins are referenced in the AICPA's illustrative Independent Auditor's Report.

Paragraph 9c. According to section 9, the auditor should use one or a combination of the following approaches to evaluate the reasonableness of the estimates: review and test the process used, develop and independent expectation of the estimate, and review subsequent events or transactions occurring prior to the completion of fieldwork. We do not believe that reviewing the subsequent events alone would provide sufficient evidential matter to evaluate the reasonableness of management's estimate. The entire SOSI is a forecasted estimate (prospective); however, SAS 57, "Auditing Accounting Estimates," was developed to audit current line item information (retrospective) in the financial statements. Subsequent events indicate the potential impact for the current 12-month period, but may not provide enough information to evaluate the impact over a 75-year period. Consequently, using subsequent events as the sole basis to evaluate SOSI is inappropriate. We recommend that item 9 (c) be revised to "review subsequent events and transactions occurring prior to the completion of fieldwork."

Paragraphs 20, 21 & 40. When considering materiality, the SOP states: "Auditors generally considers materiality in the context of the financial statements taken as a whole." This statement is consistent with the fourth standard of reporting and the language in paragraph 3 of the Independent Auditors Report. However, section 21 states: "For certain federal agencies, amounts reported in the Statement Of Social Insurance may significantly exceed the amounts reported in the other basic financial statements. In such cases, it would not be appropriate to establish a single materiality threshold for the entire set of financial statements. Instead, the auditor should use a separate materiality level when planning and performing the audit of the statement of social insurance and related disclosures."

Further clarification needed between basic financial statements and SOSI– § 40, paragraph three reports that the financial statements “present fairly, in all material respects”, the financial position of XYZ Social Insurance Agency. The Auditor’s opinion as noted in § 20 utilizes judgments in context of the financial statements taken as a whole. However, as noted above, there will be significant differences in materiality thresholds between the historic financial statements, i.e., Balance Sheet, and Statement of Net Cost and the SOSI. There are drastic differences between periods covered by the historic statements which are on a fiscal year basis as compared to the SOSI which presents a 75 year project of the estimated future income to be received and estimated future expenditures to be paid. We are most concerned that the standard opinion gives the uninformed reader a false impression of comparability among the financial statements. In fact, very different facts are communicated in the historic financial statements and the SOSI and very different materiality basis used in reaching conclusions. This confusion is further compounded by the fourth paragraph in the opinion which correctly notes that because of the large number of factors that affect the SOSI, future events and circumstances cannot be know with certainty, there will be differences between the estimates in the statement of SOSI and those differences may material. Within two paragraphs, readers of the opinion, have been told that the financial statements are presented fairly but, beware, there ***will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.*** Congress and the Public will be thoroughly confused on the Auditor’s conclusion and how they should interpret the financial statements.

Paragraph 39. In a traditional financial statement audit, AU §341.02 requires the auditor to give consideration to the going concern concept for a period not to exceed one year beyond the date of the financial statements. For SOSI, which represents a 75-year forecast, should the going concern consideration be extended to a longer period? For example, should it be extended to the 10-year period covered by the Medicare Trustees’ Report (HHS) or the 75-year period covered by the statement itself?

The HHS 2004 Boards of Trustees Annual Report of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds reported that the Hospital Insurance Trust Fund financial status has deteriorated significantly. The Report states that asset exhaustion is projected to occur in 2019 under the current law as compared to 2026 in last year's report. Further, the Trustees report notes that to "bring the HI program into long-range financial balance would require very substantial increases in revenues and/or reductions in benefits."

AU §341.10 notes that when, after considering management's plans, the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider the possible effects on the financial statements and the adequacy of the related disclosure. Further, AU §341.12 notes that if the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report

should include an explanatory paragraph (following the opinion paragraph) to reflect that conclusion. Section 39 of the SOP needs to specifically address the issue of going concern when projections show the HI trust fund will be exhausted. What is an appropriate period time to be considered under the going concern concept for SOSI?

If you have questions regarding our comments, please contact me.

Joseph E. Vengrin
Assistant Inspector General
for Financial Statement Audits
HHS/OIG
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**HHS' Comments on the Exposure Draft of the Audit of the
Statement of Social Insurance**

General comments:

1. The exposure draft describes a procedure for auditing the estimates presented in the "Statement of Social Insurance." The guidelines seem to disregard the fact that these estimates are first produced on behalf of the Board of Trustees, and then used by CMS (and SSA) in the Statement of Social Insurance. The draft guidelines also seem to be in conflict with the fact that the Board sets the assumptions, not CMS or SSA. The draft describes the Board as reviewers of the estimates. We think the standard should be tailored to better reflect the actual process that prevails at CMS and SSA.
2. The draft statement of position describes appropriate audit standards for the estimated present values of Medicare revenues and expenditures for the long range, and for the difference between them—sometimes referred to as the program's "unfunded obligations." In practice, the existence and magnitude of these amounts have no impact on current-year financial operations. Despite the uncertain and theoretical nature of these projected amounts, the draft statement of position calls for a very comprehensive and detailed audit. If, for example, such amounts were to be considered formal liabilities of the U.S. government, and if changes in such amounts were to be formally amortized through current-year financial transactions, it is not clear that an audit of their determination could be more comprehensive than the one specified in the exposure draft for the projected unfunded obligations, which are not liabilities. Thus, it strikes us that the proposed standards may be more comprehensive than necessary in view of the more limited purpose of the amounts shown in the current statement of social insurance.
3. The exposure draft is not always clear on what constitutes "management." In numerous places, management is responsible for the selection of assumptions and estimation methods, which would seem to imply that the program actuary is included in management (since other agency officials generally do not have the technical expertise to develop assumptions and methods for actuarial projections). In other places (e.g., paragraph 33c), "management, not the actuary, is responsible for the assumptions made and methods used," which suggests that the actuary is not part of management. Clarification would be helpful.

Specific comments:

1. On the "Summary" page, in the sixth bullet point, the phrase "in certain circumstances" should be removed. It will be necessary in all cases to obtain the services of an outside actuary. Elsewhere in the draft it is made more certain that an outside actuary is to be used (e.g., page 14 contains several references).
2. Paragraphs 5 and 10b indicate that the statement of social insurance and its associated estimates are to be prepared in accordance with generally accepted accounting

principles. For social insurance programs, are these principles fully described in SFFAS 17, or are there other requirements in addition?

3. Paragraph 6c refers to the use of sufficient data. What happens when sufficient data are not available—for example, in the case of a new Medicare benefit for which no prior experience is available? We recommend using “best available” rather than “sufficient.”
4. Paragraph 7d cites an example of a model. It is a little confusing because the example is more of an estimate than a model from our perspective.
5. The footnote to paragraph 11a4 refers to the Trustees as an external review group. The footnote should either be dropped or corrected to refer to the independent expert panels of actuaries and economists periodically convened by the Medicare Board of Trustees and Social Security Advisory Board to review the assumptions and methods underlying the Trustees Report projections.
6. Paragraph 13 says that the auditor should consider changes to laws and regulations. Does this refer to legislative changes enacted since the prior year, or does it mean anticipating future changes in legislation?
7. Paragraph 14c suggests that auditors observe the entity activities and operations used to prepare the statement of social insurance. While the scope and timing of this requirement are not clear, we would object to having the audit take place concurrent with the production of the Trustees Report. From a workload standpoint, this would not be possible, since the report is completed under an extremely tight schedule. Moreover, it is not clear that the Trustees would authorize such a practice.
8. What is the “entity’s board of directors, management, and other personnel,” as referred to in paragraph 24? In the case of the CMS financial statement, is it the Board of Trustees, the Centers for Medicare & Medicaid Services, or the Office of the Actuary? (See also our general comment about the process.)
9. Paragraph 27 is unclear.
10. It isn’t clear which “actuarial report” is referred to in paragraph 33a.
11. What is the “report” that is referred to in paragraph 35?
12. Paragraph 37 seems contradictory to SFFAS 25. As the exposure draft states, “SFFAS No. 25 does not specifically require disclosure of the significant assumptions in the notes to the statement of social insurance.” Per SFFAS 25, such “other information” is to be included in Required Supplementary Information except to the extent that the preparer elects to include it in the notes to the Basic Information. However, paragraph 37 directs that “the auditor should conclude that disclosure is inadequate if management does not elect to disclose significant assumptions in the notes to the financial statements.”

13. Paragraph 38a refers to “management’s best estimates.” The estimates presented in the CMS statement of social insurance are, in fact, the Medicare Board of Trustees’ best estimates. In this paragraph and in other places throughout the draft, it would be more appropriate to say that management believes the estimates are *reasonable*. This standard (i) would better reflect the use of external estimates, (ii) would match other requirements in the exposure draft, and (iii) would be consistent with the statutory requirement for actuarial certification of the Trustees’ projections.
14. What is the definition of “accounting estimates,” as referred to in paragraphs 8b and 38h?
15. The footnote to paragraph 7Aa of the appendix discusses the role of an external board of trustees and states “In such circumstances, the auditor’s procedures generally would focus on testing the work performed by the agency’s actuary in reviewing the assumptions developed by the board of trustees.” As noted in our general comments, it would be helpful if the audit standard more directly recognized the source and nature of the projections used in the CMS and SSA financial statements and provided more thorough guidance on this specific circumstance as a direct part of the standard.



G A O

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

May 17, 2004

Ms. Sharon Macey
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft on the proposed Statement of Position entitled *Auditing the Statement of Social Insurance*

Dear Ms. Macey:

This letter provides the U.S. General Accounting Office's (GAO) comments on the AICPA's Exposure Draft (ED) of the proposed Statement of Position (SOP) entitled *Auditing the Statement of Social Insurance*. We appreciate the opportunity to have had GAO representatives participate as members of the Social Insurance Task Force that prepared the ED and are pleased to contribute further to the deliberative process by providing comments on the ED.

Overall, the proposed SOP provides excellent audit guidance, including descriptions of management's and the auditor's respective responsibilities. In particular, the illustrative controls and audit procedures listed in the appendix provide auditors with practical guidance for assessing control risks; determining the nature, timing, and extent of audit procedures; and deciding when and how to use the services of an independent actuary.

As you finalize the SOP, we offer suggestions to further clarify and emphasize the auditor's responsibilities in the following areas:

- (1) considering materiality in planning and performing the audit,
- (2) assessing whether the actuary is independent of the audited entity,
- (3) determining the scope of assistance provided by an independent actuary,
- (4) documenting the procedures performed with the assistance of an independent actuary, and
- (5) using alternative approaches to evaluate the reasonableness of the estimates.

We also offer two suggestions of a technical nature to enhance consistency with the language of existing auditing standards.

As the principal auditor of the federal government's consolidated financial statements (CFS), we must be able to use the work performed by other independent auditors on the financial statements of various federal agencies. Our suggestions relate to matters that could affect our ability to use such work.

Considering Materiality in Planning and Performing the Audit

The auditor must use professional judgment in determining materiality levels, taking into consideration, among other factors, the expectations of the users of the financial statements. We agree with the proposed SOP that, where amounts in the statement of social insurance significantly exceed those in other financial statements, it is appropriate to use a separate materiality level in auditing the statement of social insurance.

The proposed SOP correctly notes that the *Financial Audit Manual* issued jointly by GAO and the President's Council for Integrity and Efficiency indicates that total expenses may be an appropriate materiality base for purposes of establishing materiality where expenditures are important. However, the proposed SOP goes on to state that "[a]ccordingly, the auditor generally would be expected to use the actuarial present value of the estimated future expenditures paid to or on behalf of program participants as the materiality base for the statement of social insurance and related disclosures."

The present value of estimated future expenditures, contributions and earmarked taxes, and the net social insurance obligation are relevant to the auditor's considerations about materiality. However, for social insurance programs that have significant net projected long-term fiscal shortfalls that call into question the sustainability of the programs, we believe that users of the statements of social insurance significantly focus on the net social insurance obligation, as they consider the government's ability to make promised future social insurance payments. This focus is apparent, for example, in the Management's Discussion and Analysis section of the CFS related to the federal government's consolidated statement of social insurance for fiscal year 2003. Further, it is a focus of the *2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* and in news media accounts about net shortfalls in the federal government's major social insurance programs.

Accordingly, we suggest that the last two sentences of paragraph 21 of the proposed SOP be changed to require that the auditor consider the net social insurance obligation, rather than the actuarial present value of the estimated future expenditures paid to or on behalf of program participants, as the materiality base for these types of social insurance programs. We propose the following language to replace those two sentences:

"The Financial Audit Manual issued jointly by the GAO and the President's Council for Integrity and Efficiency (section 230) discusses materiality considerations. [Footnote: The Financial Audit Manual is available at the

Web site www.gao.gov.] The present value of estimated future expenditures, contributions and earmarked taxes, and the net social insurance obligation are relevant to the auditor's considerations about materiality. For a social insurance program that has a significant net projected long-term fiscal shortfall that calls into question the sustainability of the program, users of the statement of social insurance may focus on the present value of estimated future expenditures net of the present value of estimated future contributions and earmarked taxes. In such cases, the auditor generally would be expected to use this net social insurance obligation amount as the materiality base."

Assessing Whether the Actuary is Independent of the Audited Entity

The proposed SOP would require the auditor to obtain the services of an outside actuary if the auditor is not qualified to serve as an actuary. Paragraph 18 defines an outside actuary as an actuary who is not employed or managed by the agency operating the social insurance program. We strongly agree with this proposed requirement and the underlying rationale. However, because audits of federal agency statements of social insurance must be performed in accordance with U.S. generally accepted government auditing standards (GAGAS), the actuary must be independent of the audited entity.¹ GAGAS provides independence requirements and examples of personal, external, and organizational impairments to independence for auditors and their specialists that go beyond being employed or managed by the audited entity.

Accordingly, we suggest that the final SOP state that the actuary must meet the independence requirements of GAGAS. We propose that paragraph 18 of the proposed SOP be reworded to read as follows:

"If the actuary who has prepared or reviewed the actuarial valuation of the social insurance program was engaged by the agency administering that program, it is necessary for the auditor to obtain the services of an independent actuary to assist the auditor in performing auditing procedures that assess the agency actuary's methods, assumptions, and estimates, and aid the auditor in determining whether the agency actuary's findings are not unreasonable in the circumstances. [Footnote 6 of the proposed SOP is not reprinted here; however, see our related comment in the following paragraph.] Government Auditing Standards: 2003 Revision (GAO-03-673G), which is applicable to audits of statements of social insurance, provides independence requirements and examples of personal, external, and organizational impairments to independence."

We also suggest that similar conforming changes be made in footnote 6 to paragraph 18 of the proposed SOP and throughout the SOP.

¹U.S. General Accounting Office, *Government Auditing Standards: 2003 Revision* (GAO-03-673G), paragraph 3.06.

Determining the Scope of Assistance Provided by an Independent Actuary

Because of the significance of the actuarial estimates and the complexity and professional judgment involved in developing them, the auditor generally will need the assistance of an independent actuary in performing various procedures during all phases of the audit. Further, as discussed in paragraph 7 of the proposed SOP, the various elements – factors, data, models, and assumptions – used to develop social insurance estimates are closely interrelated and may not be separable. As a result, the auditor generally will also need the independent actuary’s assistance to perform procedures related to all elements of the estimates. In the section that describes the auditor’s responsibilities, we believe that the proposed requirement to use such actuarial services² should be further clarified to emphasize that it applies to all phases of the audit and all elements of the estimates.

Accordingly, we suggest that the following paragraph be added immediately after paragraph 10 of the proposed SOP:

“As discussed in paragraph 18, it is necessary for the auditor to obtain the services of an independent actuary to assist the auditor in planning and performing auditing procedures, if the auditor does not possess the level of competence in actuarial science to qualify as an actuary. Generally, the auditor will need the assistance of an independent actuary in performing various procedures during all phases of the audit and related to all elements of the estimates.”

We also suggest that similar conforming changes be made in paragraph 18 and throughout the SOP.

Documenting the Procedures Performed With the Assistance of an Independent Actuary

Because of the significance of (1) the statement of social insurance and (2) the independent actuary’s assistance in performing various procedures in all phases of the audit, it is important that the auditor document the nature and scope of the auditor’s use of the independent actuary and related results. As the principal auditor of the CFS, in particular, we need to have a clear understanding of the basis for agency auditors’ conclusions. For these reasons, and to help ensure that auditors meet the audit documentation requirements of GAGAS,³ we believe that the final SOP should emphasize the need for the auditor to document these matters.

Accordingly, we suggest that the following paragraph be added immediately after paragraph 18 of the proposed SOP:

²If the auditor has the requisite knowledge and experience in actuarial science related to social insurance, the auditor may serve as the actuary.

³U.S. General Accounting Office, *Government Auditing Standards: 2003 Revision* (GAO-03-673G), paragraphs 4.22 through 4.26.

“The auditor should document (1) the specific audit procedures that were performed with the assistance of an independent actuary, and the related findings and conclusions, (2) the relationship between the procedures performed with the assistance of an independent actuary and the auditor’s assessments of audit risk and materiality, and (3) all other significant matters related to the objectives and scope of the independent actuary’s work, including any limitations on the independent actuary’s procedures.”

Using Alternative Approaches to Evaluate the Reasonableness of the Estimates

Paragraph 9 of the proposed SOP states that the most practicable and effective approach to auditing the statement of social insurance is primarily to review and test the process used by management. Further, paragraph 28 states that “the complexity and subjectivity of the estimates, the volume of data involved, and the importance of controls would make performing only substantive tests an ineffective strategy” to audit the statement of social insurance.

We agree that reviewing and testing the process used by management can be the most efficient approach, and, if internal controls for the statement of social insurance are effective, this approach can be effective. However, where the auditor finds that internal controls related to the social insurance estimates are ineffective, generally only a substantive testing approach such as developing an independent expectation of the estimate, or portions of the estimate, can be effective to obtain sufficient, competent evidence to support an unqualified opinion. We recognize that, in the current environment, such an approach may not be practicable as a comprehensive strategy to audit a large, complex social insurance program that has ineffective internal controls. Yet, this may be a practicable approach for a smaller, less complex social insurance program or for a portion of a large, complex program. For example, if internal controls related to a particular category of participants are ineffective, it may be practicable to develop an independent expectation about the projected benefits due to the participants in that category.

Accordingly, we suggest that the last sentence of paragraph 9 of the proposed SOP be replaced by the following language:

“In auditing the statement of social insurance, if internal controls over the estimation process are effective, the most practicable and efficient approach may be to review and test the process used by management. However, if the auditor finds that internal controls over the estimation process are ineffective, the auditor should consider whether it is practicable to (1) develop an independent expectation of the estimate, or portions of the estimate, to corroborate management’s estimate or (2) otherwise obtain competent evidence from outside the audited agency’s process that would be sufficient to support the assertions in the statement of social insurance. If it is not practicable to mitigate the effects of the ineffective internal

controls through substantive procedures such as these, then the audit report on the statement of social insurance should be modified.”

We also suggest that similar conforming changes be made in paragraph 31 of the proposed SOP and that paragraph 28 be reworded, in part, to state that “... *the complexity and subjectivity of the estimates, the volume of data involved, and the importance of controls may make performing only substantive tests an impracticable strategy...*”

Other Technical Matters

First, we suggest that the word “accordance” in the first sentence of paragraph 5 be changed to “conformity” to enhance consistency with the language in existing reporting standards.

Second, paragraph 18 of the proposed SOP states that “... It is necessary for the auditor to obtain the services of an outside actuary to assist the auditor in performing auditing procedures that assess the [agency] actuary’s methods and assumptions and enable the auditor to determine whether the [agency actuary’s] findings are not unreasonable.” To enhance consistency with paragraph 12 of Statement on Auditing Standards No. 73, *Using the Work of a Specialist*, we suggest that the phrase “in the circumstances” be added to the end of paragraph 18 (as we reflected in our suggested wording for paragraph 18 in the section above entitled *Assessing Whether the Actuary is Independent of the Audited Entity*).

We appreciate your consideration of our comments and would be pleased to further discuss these issues with you at your convenience. Please contact Mr. Gary Engel, Director, Financial Management and Assurance, at (202) 512-8815 if you have any questions. I can be reached at (202) 512-2600.

Sincerely yours,



Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance