Federal Accounting Standards Advisory Board

April 14, 2016

Memorandum

To: Members of the Board

Robin M. Gilliam

From: Robin Gilliam, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Insurance Programs: Comment Letters Received through March 29, 2016[1] – Tab B-2**

MEETING OBJECTIVE

The meeting objective is to make decisions on issues regarding Questions 1 and 2 in the exposure draft, *Insurance Programs*.

BRIEFING MATERIAL

This is Tab B-2 that accompanies Tab B-1 which was distributed to the board on Friday, April 8, 2016.

Attachment 2 provides an overall summary of responses and a list of issues identified with staff analysis and recommendations.

Attachment 3 provides the original exposure draft.

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of FASAB are determined only after extensive due process and deliberations.

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Attachment 2- Staff Analysis and Recommendations

Summary of Results

The summary of results analyzes the comments for questions 1 and 2:

> Q1. The definition for an insurance program (par. 9) identifies the fundamental nature of these programs. The substance and not the name of a program will determine if it is an insurance program and therefore subject to these standards.
>
> > **Do you agree or disagree with the definition of an insurance program? Please provide the rationale for your answer.**
>
> Q2. Additional new terms were introduced (par. 10–25) in order to provide definitions needed to consistently report on insurance programs.
>
> > **a. Do you agree or disagree with the proposed definition of each term? Please provide the rationale for your answer.**
> >
> > **b. Do you agree or disagree that the additional terms will assist insurance programs in producing consistent reporting? Please provide the rationale for your answer.**

After considering the comments, staff notes that the majority of respondents agreed with the proposals for the definitions, exclusions, and new terms. However, a number of respondents recommended edits and clarification that will be examined in detail in the next section.

Issues for the Board's Consideration

Certain issues identified by respondents resulted in areas that need to be revised and /or clarified within the Statement. Similar comments from respondents are grouped by issue below, along with the staff recommendation.

DEFINITIONS and EXCLUSIONS

1. **Definition of Insurance Program (par. 9)**—There were a number of respondents who were concerned with using the word insurance in the definition of insurance program. One respondent (#5 DOT) also suggested four essential characteristics to include in the definition. However, these were already captured in the insurance contract definition (par. 20). In addition, a respondent (#14 AGA) did not feel that the definition needed to specify non-loan guarantees. Therefore, staff recommends updating the insurance definition as follows:

   Insurance Program—"insurance program" is a general term used to refer to ~~an insurance or non-loan guarantee~~ a program authorized by law to provide a guarantee of financial~~ly~~ compensation~~e~~ to a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

   Question I: Does the Board approve the updated insurance program definition?

2. **Exclusions (par. 10)**—

   a. There were a number of respondents who either requested additional exclusions or clarification of the proposals in par. 10. They were particularly concerned with understanding the phrase "but whose missions are not by statute to provide insurance" in par. 10 exclusions e. f. and g.

      Some respondents also requested clarification of these standards for excluding third party indemnification. Therefore, staff recommends the following edits.

      10.e. Programs that self-insure for the risk of loss arising from their own activities. ~~self-insure their own activities, but whose missions are not by statute to provide insurance~~.

      10.f. Programs that process claims through an administrative or judicial process for people or organizations who claim they have been harmed by a government agency. ~~whose missions are not by statute to provide insurance for loss from an adverse event.~~

10.g. Programs that indemnify contractors, agreement partners, and other third parties for loss or damages incurred while or caused by working for a federal agency.[fn] ~~provide security against loss or damage contractual indemnification of another party, but whose missions are not by statute to provide insurance~~

Footnote for 10.g. These are administrative settlements for transactions with contractors under Federal Acquisition Regulation authorized indemnification clauses, and authorized indemnification clauses within other legally binding agreements, or first responders within programs that do not have a statutory insurance or guarantee mission.

b. One Respondent (#10 DOL) recommended an additional exclusion for worker compensation type programs, specifically FECA (the federal employees' compensation act) and EEOICPA (the energy employees occupational illness compensation program act). DOL also noted that some of these programs are still open to process claims (black lung), but there will be no additional claimants.

Staff agrees that these programs are not insurance programs and recommends adding the following exclusion:

10.h. Worker's or occupational illness compensation type programs that compensate current or former employees (or survivors) and certain third parties, for injuries and occupational diseases obtained while working for a federal agency.

c. One Respondent (#10 DOL) recommended that the following exclusion be added for:

Fiduciary Funds—as noted by respondent… The Federal government, in its fiduciary role, may not be liable for payments in the amount greater than the money or property deposited/belonging to the fiduciary fund...

Staff **does not recommend** this exclusion because fiduciary funds are not included in federal financial statement but are disclosed in the notes per SFFAS 31. Therefore, specifically exempting them from each Statement is unnecessary.

Question II: Does the Board approve the updated exclusions?

3. **Expected Cash Flow (par. 16)**—staff inadvertently left off the word "amounts" at the end of the definition. The edit will be made in the Statement.

4. **Incurred But Not Reported (IBNR) (par. 18)** —one respondent (#1 SSA) recommended editing the definition of IBNR for additional clarity. In addition, since exposing this draft for comments, staff noted that SFFAS 17, *Accounting for Social Insurance,* also refers to IBNR. In order to use IBRN as a general term throughout the standards, staff recommends the following edits:

   Claims "incurred but not reported (IBNR)" are estimated claims from ~~adverse~~ events that have occurred as of the end of the reporting period but have not yet been reported ~~to the insurance program~~ for settlement.

   Question III: Does the Board approve the updated IBNR definition?

5. **Insurance Claim (par. 19)** —one respondent (#15 NCUA) suggested that the definition of an insurance claim be inclusive of claims that are statutory-based rather than explicitly contract-based. Staff agrees and recommends the follow edits:

   An "insurance claim" is a formal request for payment for losses as authorized under the insurance arrangement ~~contract~~.

   Question IV: Does the Board approve the updated insurance claim definition?

6. **Insurance Contract (Contract) (par. 20)**—

   A number of respondents wanted to clarify the definition of an insurance contract, specifically for those programs that do not issue explicit contracts. Respondents also requested additional clarification and guidance for risk shared with a third party. Therefore, staff recommends the following edits:

   An "insurance arrangement (arrangement) ~~contract (contract)~~" is a general term used for an ~~agreement or~~ arrangement (which may be in statute, contract, or other agreement) between an insurance program and specific parties[2] such as but not limited to: individuals, state, local, or foreign governments, other federal agencies, or businesses to provide a guarantee of financial compensation for loss from an adverse event. An insurance arrangement ~~contract~~ may include and/or identify:

[2] Parties may be identified in statutes or explicit parties to an agreement.

a. the term the insurance arrangement ~~contract~~ is in-force,

b. the insurance program's responsibilities,

c. the risk assumed by the insurance program, such as:

i. all risk for covered losses,

ii. partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance,

iii. a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid, or

iv. risks shared with a third party.

d. the adverse event,

e. the insured party(ies) and their premium or funding requirements,

f. the beneficiary(ies) and their responsibilities for filing claims, and/or

g. the financial compensation.

Question V: Does the Board approve the updated insurance contract definition?

7. **Recoveries (par. 25)**—one respondent (#3 KPMG) suggested that FASAB not use the word we are defining—recovery— in the definition. Therefore, staff recommends the following edit:

"Recoveries" include monies ~~recouped or recovered from~~:

a. returned from another agency through an indemnification agreement,
b. returned from a third party or commercial insurance company to repay all or part of a loss originally paid for by the program,
c. recouped from the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or
d. adjustments made to previously paid insurance claims.

Question VI: Does the Board approve the updated recoveries definition?

8. **Exchange Transaction Insurance Programs Other Than Life Insurance (par. 15) and Nonexchange Transaction Insurance Programs (par. 23)**—one respondent (#3 KPMG) suggested that FASAB not use the word we are defining in the definition, i.e., exchange and nonexchange.

> 15. **Exchange Transaction Insurance Programs Other Than Life Insurance**—"exchange transaction insurance programs other than life insurance" cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions with the federal government as defined in SFFAS 7
>
> 23. **Nonexchange Transaction Insurance Programs**— "nonexchange transaction insurance programs" cover the risk of loss from adverse events through nonexchange transactions, as defined in SFFAS 7.

Another respondent (#8 NASA) wondered if the Board's intention was to revise the definition of nonexchange that is cited in SFFAS 5 which is different than the one in SFFAS 7. Per NASA:

> The FASAB standards appear to use two interpretations of the term "nonexchange". In SFFAS 5 the criteria listed is "a one way flows of resources or promises", while the criteria in SFFAS 7 focuses on the exercise of the Government's sovereign power to demand payments.
>
> The definition of nonexchange insurance programs appears to ignore the requirement in SFFAS 5 that the transaction represent a one way flow of resources or promises. The ED definition includes both a collection funds and a promise to pay if an adverse event occurs. If it is the Board's intention to revise the definition of nonexchange that is cited in SFFAS 5 then that should be made clear in this proposed standard.
>
> ***SFFAS 5 Paragraph 24 states "A nonexchange** transaction arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises.*
>
> ***SFFAS 7 Paragraph 2 states: "Nonexchange** revenues arise primarily from exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) but also include donations.*

The Board's intention was to define the categories in relation to the revenue standards (SFFAS 7). Note also that SFFAS 7 followed SFFAS 5. It discusses nonexchange transactions giving rise to nonexchange revenue using wording from SFFAS 5. Therefore, staff does not recommend a change to these definitions as their purpose is to direct the user to SFFAS 7 for the revenue definition. Staff will discuss this in the basis for conclusions.

Question VII: Does the Board agree with the staff's recommendation?

QUESTIONS FOR THE BOARD:

Question I: Does the Board approve the updated insurance program definition?

Question II: Does the Board approve the updated exclusions?

Question III: Does the Board approve the updated IBNR definition?

Question IV: Does the Board approve the updated insurance claim definition?

Question V: Does the Board approve the updated insurance contract definition?

Question VI: Does the Board approve the updated recoveries definition?

Question VII: Does the Board agree with the staff's recommendation?

NEXT STEPS

Continue analyzing the comments and providing recommendations for updates.

MEMBER FEEDBACK

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help me to prepare answers to your questions in order to make the meeting more productive. You can contact me by telephone at

202-512-7356 or by e-mail at gilliamr@fasab.gov with a cc to paynew@fasab.gov

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ATTACHMENT 3

INSURANCE PROGRAMS

EXPOSURE DRAFT

ISSUED DECEMBER 30, 2015

Federal Accounting Standards Advisory Board

INSURANCE PROGRAMS

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by March 29, 2016

December 30, 2015

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. The FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor the FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on the FASAB's website at: www.fasab.gov.

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Contact us:

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Federal Accounting Standards Advisory Board

December 30, 2015

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Insurance Programs*, are requested. Specific questions for your consideration start on page 6, but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response will be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by March 29, 2016.

All comments received by the FASAB are considered public information. These comments will be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, we ask that you please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax your comments to (202) 512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at (202)512-7350 to determine if your comments were received.

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft.

Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

Tom L. Allen

Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Board is proposing accounting standards for insurance programs. *Insurance programs* is a general term that includes insurance and non-loan guarantee programs that are authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

This Statement would define terms relating to insurance programs. The definitions would help to identify and classify insurance programs and related financial activities for financial reporting purposes.

This Statement would provide guidance for how and when insurance programs should recognize revenue, expenses, and liabilities. This Statement would provide guidance for estimating losses for remaining coverage when contracts provide coverage after the reporting date. This Statement would update disclosure guidance to encourage concise, meaningful, and transparent information. The proposed recognition, measurement, and disclosure guidance would provide for consistent reporting across all insurance programs.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This Statement is intended to improve federal financial reporting for insurance programs by providing concise, meaningful, and transparent information about the cost of insurance programs and the related liabilities. This information would inform readers regarding the operating performance of insurance programs and exposures to risk of loss related to adverse events. This information is essential to meeting the stewardship and operating performance objectives.

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QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board welcomes your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at **http://files.fasab.gov/pdffiles/insurance_programs_ed_comments.docx.** Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548

All responses are requested by March 29, 2016.

Q1. The definition for an insurance program (par. 9) identifies the fundamental nature of these programs. The substance and not the name of a program will determine if it is an insurance program and therefore subject to these standards.

Do you agree or disagree with the definition of an insurance program? Please provide the rationale for your answer.

Q2. Additional new terms were introduced (par. 10–25) in order to provide definitions needed to consistently report on insurance programs.

a. **Do you agree or disagree with the proposed definition of each term? Please provide the rationale for your answer.**

b. **Do you agree or disagree that the additional terms will assist insurance programs in producing consistent reporting? Please provide the rationale for your answer.**

Q3. Insurance Programs are to be classified in one of the three categories defined in par.15, 22, and 23: Exchange Transaction Insurance Programs other Than Life Insurance, Life Insurance Programs, and Nonexchange Transaction Insurance Programs.

Do you agree or disagree with these categories? Please provide the rationale for your answer.

Q4. New standards were introduced (par. 26-43) for exchange transaction insurance programs other than life insurance. These programs will be required to recognize a liability for losses on remaining coverage. The liability for losses on remaining coverage has been separated from the liability for unpaid claims to address the uncertain nature of losses on contracts open beyond the end of the reporting period. Insurance programs must first use the expected cash flow model to estimate these future losses. However, there are various methods to estimate cash flows and probabilities. To the extent that a method explicitly or implicitly incorporates the characteristics of expected cash flow, then its use is consistent with this Statement. One member expressed concern in that expected cash flow may be too limiting to allow other methods currently in use to continue to be used for estimating future cash flow in. (See Basis for Conclusion par. A17)

a. **Do you agree or disagree that the recognition guidance for exchange transaction insurance programs other than life insurance (par. 27-39) is clear and appropriate? Please provide the rationale for your answer.**

b. **Would the expected cash flow approach (par. 35-37) prevent use of any methods you believe should be used? Please provide the rationale for your answer.**

c. **Would the measurement standard (par. 35-37) allow the method currently used by your entity to estimate future losses continue to be used? Please provide the rationale for your answer.**

d. **Do you agree or disagree with the disclosures for the exchange transaction insurance programs other than life insurance (par. 40-43)? Please provide the rationale for your answer.**

Q5. New standards were introduced (par. 44–53) for nonexchange transaction insurance programs.

a. **Do you agree or disagree that the recognition guidance (par. 45-49) for nonexchange transaction insurance programs is clear and appropriate? Please provide the rationale for your answer.**

b. Do you agree or disagree with the disclosures for the nonexchange transaction insurance programs (par. 50-53)? Please provide the rationale for your answer.

Q6. New standards were introduced (par. 54–68) for life insurance programs.

a. Do you agree or disagree that the recognition guidance (par. 55-64) for life insurance programs is clear and appropriate? Please provide the rationale for your answer.

b. Do you agree or disagree with the disclosures for the life insurance programs (par. 65-68)? Please provide the rationale for your answer.

Q7. New disclosures were introduced (par. 69) for the consolidated financial report of the U.S. Government.

Do you agree or disagree with the disclosures applicable to the consolidated financial report of the U.S. Government (par.69)? Please provide the rationale for your answer.

Q8. The Board proposes that the requirements of this Statement are effective for reporting periods beginning after September 30, 2017.

Do you agree or disagree? Please provide the rationale for your answer.

INTRODUCTION

PURPOSE

1. This project was undertaken to ensure that the risk assumed through insurance programs is adequately reported in federal financial reports. The Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of The Federal Government*, provides standards applicable to insurance and guarantee (non-loan) programs and includes a requirement to report risk assumed. However, information provided about insurance programs is not comparable or informative. Further review found that it is challenging to determine the financial results and position of insurance programs.

2. In addition, the Board's conceptual framework now provides a definition of liability and describes measurement attributes that were not available when SFFAS 5 was developed. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements of Accrual-Basis Financial Statements*, defines liability as "a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording,* defines attributes of elements to be measured. This proposal seeks to adopt the most current concepts so that the accounting principles for insurance and non-loan guarantee liabilities provide comprehensive guidance for consistent reporting.

3. This Statement is intended to improve federal financial reporting for insurance programs by requiring concise, meaningful, and transparent information about the cost and related liabilities in order to understand the operating performance of insurance programs and exposures to risk of loss related to adverse events.

MATERIALITY

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

SCOPE

5. This Statement applies to federal entities that present general purpose federal financial reports (GPFFRs), including the consolidated financial report of the United States (U.S.) government (CFR), in conformance with generally accepted accounting principles (GAAP), as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

6. This Statement provides general principles that should guide preparers of GPFFRs in accounting for and reporting on revenue, related claims and liabilities, and losses and costs of insurance programs. Items such as revenue classification, direct loans and loan guarantees, borrowing, investing, and/or appropriations that are addressed in this Statement should be reported in accordance with other standards.

7. This Statement rescinds the section: Insurance and Guarantee Programs in SFFAS 5, *Accounting for Liabilities of The Federal Government, paragraphs 97-121.*

8. This Statement establishes three categories of insurance and related guidance: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs. In addition, there is a section providing government-wide disclosure requirements.

DEFINITIONS

Definitions in paragraphs 9-25 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

9. **Insurance Program**—"insurance program" is a general term used to refer to an insurance or non-loan guarantee program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

10. The following are excluded from insurance programs:

    a. Programs that administer direct loans and loan guarantees[1]

    b. Programs that qualify as social insurance[2]

[1] SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*

[2] SFFAS 17, *Accounting for Social Insurance* (including unemployment insurance)

c. Programs authorized to engage in disaster relief activities[3]

d. Entitlement programs

e. Programs that self-insure their own activities, but whose missions are not by statute to provide insurance[4]

f. Programs that process claims through an administrative or judicial process, but whose missions are not by statute to provide insurance[5]

g. Programs that provide security against loss or damage through contractual indemnification of another party, but whose missions are not by statute to provide insurance[6]

11. **Adverse Event**—an "adverse event" may be a single-occurring event or a series of events that cause losses to the beneficiary(ies) as identified in the insurance contract.

12. **Cash Surrender Value**—the "cash surrender value" is the sum of money an insurance company will return to the policyholder on a life insurance policy if the policy is cancelled before its maturity or the insured event (death) occurs.

13. **Claim Adjustment Expenses (CAE)**—"claim adjustment expenses (CAE)" are incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

14. **Contract Period**—"contract period" is the period over which adverse events that occur are covered.

15. **Exchange Transaction Insurance Programs Other Than Life Insurance**—"exchange transaction insurance programs other than life insurance" cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions with the federal government as defined in SFFAS 7.[7]

16. **Expected Cash Flow**—"expected cash flow" (also known as expected value (EV) in some accounting literature) refers to the sum of probability weighted amounts in a range of possible estimated.

[3] The Robert T. Stafford Disaster Relief and Emergency Assistance Act (Public Law 100-707), commonly referred to as the Stafford Act, is the act that authorizes and regulates disaster relief programs.

[4] GAO-05-265R, *Catalogue of Federal Insurance Activities, Enclosure IV: Description of Accounts With Federal Self-Insurance Activity*

[5] An example may include an administrative settlement or tort claim resulting from military events.

[6] These are administrative settlements for transactions with contractors under Federal Acquisition Regulation authorized indemnification clauses or first responders within programs that do not have a statutory insurance or guarantee mission.

[7] SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*

17. **In-Force**—"in-force" refers to contracts that are unexpired as of a given date.

18. **Incurred But Not Reported (IBNR)**—claims "incurred but not reported (IBNR)" are estimated claims from adverse events that have occurred as of the end of the reporting period but have not yet been reported to the insurance program for settlement.

19. **Insurance Claim**—an "insurance claim" is a formal request for payment for losses as authorized under the insurance contract.

20. **Insurance Contract (Contract)**—an "insurance contract (contract)" is a general term used for an explicit insurance or non-loan guarantee agreement or arrangement between an insurance program and specific parties such as but not limited to: individuals, state, local, or foreign governments, other federal agencies, or businesses. A contract may include and/or identify:

    a. the term the insurance contract is in-force,

    b. the insurance program's responsibilities,

    c. the risk assumed by the insurance program, such as:

        i. all risk for covered losses,

        ii. partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance, or

        iii. a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid.

    d. the adverse event,

    e. the insured party(ies) and their premium requirements,

    f. the beneficiary(ies) and their responsibilities for filing claims, and/or

    g. the financial compensation.

21. **Liability for Losses on Remaining Coverage**—the "liability for losses on remaining coverage" is an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open contract period.

22. **Life Insurance Programs**—"life insurance programs" cover the risk of loss from death of individuals.

23. **Nonexchange Transaction Insurance Programs**— "nonexchange transaction insurance programs" cover the risk of loss from adverse events through nonexchange transactions, as defined in SFFAS 7.

24. **Premiums**— "premiums" is a general term used to refer to exchange revenue[8] billed by insurance programs. Programs may refer to their exchange revenue by various terms including but not limited to premiums, assessments, and/or fees.

25. **Recoveries**—"recoveries" include monies recouped or recovered from:

    a. another agency through an indemnification agreement,

    b. a third party or commercial insurance company to repay all or part of a loss originally paid for by the program,

    c. the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or

    d. adjustments to previously paid insurance claims.

EXCHANGE TRANSACTION INSURANCE PROGRAMS OTHER THAN LIFE INSURANCE

26. Exchange transaction insurance programs other than life insurance collect premiums through contracts to cover the risk of loss from adverse events other than death of individuals.

RECOGNITION AND MEASUREMENT

REVENUE AND LIABILITY FOR UNEARNED PREMIUMS

27. Premiums should be recognized as revenue when earned over the period of the contract in proportion to insurance protection provided.

28. A liability for unearned premiums should be recognized for the amount of premiums collected and/or due by the end of the reporting period that have not yet been earned in proportion to the insurance protection to be provided during the remaining contract period.

LIABILITY FOR UNPAID INSURANCE CLAIMS

29. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

30. The estimated settlement amount includes:

[8] See SFFAS 7, par. 33, for the exchange revenue definition, and Appendix B: Guidance for the Classification of Transactions, par. 284, for the classification of exchange revenue insurance programs.

a. outflows to liquidate:

    i. claims that have been reported but not paid,

    ii. claims incurred but not reported (IBNR),

        (1) A series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[9]

        (2) Management should use judgment to determine if an adverse event creates an IBNR prior to the reporting date.

b. related estimated claim adjustment expenses, and

c. estimated inflows from recoveries not realized at the end of the reporting period.

    i. If estimated recoveries exceed the related claims for a group of contracts then recognition is limited to the amount of the related claims.[10]

    ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

31. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as claims expense.

32. Subsequent events are events or transactions that affect the basic information or required supplementary information (RSI) that occur subsequent to the end of the reporting period but before the financial report is issued.[11] According to SFFAS 39, subsequent events may be recognized or nonrecognized events. Recognized events provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates. Nonrecognized events provide evidence with respect to conditions that did not exist at the end of the reporting period, but arose subsequent to that date. Events or transactions occurring after the reporting period for which no information existed at the balance sheet date should be treated as nonrecognized events and should be considered for disclosure in accordance with SFFAS 39, par. 15.

[9] If a series of events causing loss begins prior to the reporting date and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for IBNR.

[10] Any amount expected to be recovered in excess of the recognized claim, which will result in a gain, should not be recognized until any contingencies relating to the recovery have been resolved because a contingent gain cannot be recognized until realized.

[11] SFFAS 39, *Subsequent Events*, par. 8

LIABILITY FOR LOSSES ON REMAINING COVERAGE

33. The liability for losses on remaining coverage as of the end of the reporting period represents the estimated amounts to be paid to settle future claims (including claim adjustment expenses) for the remaining open contract period less the sum of both related unearned premiums as of the end of the reporting period and future premiums.

34. Estimates should be determined by considering groups of contracts rather than individual contracts according to similar characteristics including contract duration.

35. An entity should estimate the amounts to be paid to settle future claims during the remaining open contract period using expected cash flow based on all available information existing at the balance sheet date, including experience with previous trends, and, as appropriate, the views of independent experts. Subsequent events should not be recognized but may be disclosed in accordance with SFFAS 39.

36. There are various methods to estimate cash flows and probabilities. To the extent that a method explicitly or implicitly incorporates the characteristics of expected cash flow, then its use is consistent with this Statement.

37. If using an expected cash flow method is not practical and appropriate, then an entity may estimate a single most-likely amount to be paid to settle future claims during the remaining open contract period.

38. If the effect of the time value of money is significant, for example, when settlement may occur over several years, then the estimated settlement amount should be discounted. (See SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates,* par. 28-32 for guidance on selecting discount rates.)

39. Adjustments to the liability for losses on remaining coverage should be recognized as a component of claims expense.

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

40. Materiality is an overarching consideration in financial reporting for information that should be presented regarding exchange transaction insurance programs other than life insurance. Materiality considers both quantitative and qualitative factors in selecting insurance portfolios,[12] and/or in aggregate for all remaining insurance portfolios, and/or individual insurance contracts. Acceptable quantitative factors may include whether certain groups of contracts are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of contracts is of immediate concern to constituents, politically sensitive, and/or controversial.

[12] Portfolios are groupings of insurance programs or contracts that have some meaningful relationship. The groupings may be based on contract period/duration, shared risks, management, customers, geographic regions, or other factors.

41. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR, such as the Debt Note to the Financial Statements.

Disclosures Applicable to Component Entity Reports

42. A narrative discussion should be provided to include the following information:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program.

    b. The gross cost of insurance programs and related premiums, appropriations used, and borrowing during the period, as well as the ability to repay borrowing.

    c. Investing activities

    d. Contract duration and renewal characteristics, such as non-cancelable or guaranteed renewals.

    e. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums, and any requirements to set premium prices that do not cover the full estimated cost to settle claims.

    f. The nature and magnitude of uncertainty in calculating the liability for losses on remaining coverage, including the basis and methods, trend information including the amounts of liability for losses on remaining coverage during the reporting period(s), and risk assumptions and factors used to estimate the amounts to be paid to settle future costs.

    g. The amount of coverage provided through insurance in-force at the end of the reporting period which represents the maximum risk exposure for the remaining contract period. An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

    h. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions.

43. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

    b. Incurred claims

    c. Payments to settle claims

    d. Recoveries and other adjustments

    e. Ending balance

NONEXCHANGE TRANSACTION INSURANCE PROGRAMS

44. Nonexchange insurance programs collect funds on demand and/or receive appropriations to cover the risk of loss from certain adverse events.

RECOGNITION AND MEASUREMENT

REVENUE

45. Nonexchange transaction insurance programs should apply general revenue recognition standards as found in SFFAS 7.

LIABILITY FOR UNPAID INSURANCE CLAIMS

46. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

47. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid,

        ii. claims incurred but not reported (IBNR),

(1) A series of events causing loss must be completed by the end of the reporting period to be considered an adverse event of the reporting period.[13]

(2) Management should use judgment to determine if an adverse event creates an IBNR prior to the reporting date.

b. related estimated claim adjustment expenses, and

c. estimated inflows from recoveries not realized at the end of the reporting period.

i. If estimated recoveries exceed the related claims for a specific portfolio then recognition is limited to the amount of the related claims.[14]

ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

48. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as claims expense.

49. Subsequent events are events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.[15] According to SFFAS 39, subsequent events may be recognized or nonrecognized events. Recognized events provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates. Nonrecognized events provide evidence with respect to conditions that did not exist at the end of the reporting period, but arose subsequent to that date. Events or transactions occurring after the reporting period for which no information existed at the balance sheet date should be treated as nonrecognized events and should be considered for disclosure in accordance with SFFAS 39, par.15.

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

50. Materiality is an overarching consideration in financial reporting for information that should be presented regarding nonexchange transaction insurance programs. Materiality considers both quantitative and qualitative factors in selecting insurance portfolios, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance contracts. Acceptable quantitative factors may include whether certain groups of contracts are accumulating large claim expenses or unpaid claim liability balances. Acceptable

[13] If a series of events causing loss begins prior to the reporting date, and additional pending events are required to result in losses, then it is not considered an adverse event and should not be included in the estimated settlement costs for IBNR.

[14] Any amount expected to be recovered in excess of the recognized claim, which will result in a gain, should not be recognized until any contingencies relating to the recovery have been resolved because a contingent gain cannot be recognized until realized.

[15] SFFAS 39, par. 8

qualitative factors may include whether a group of contracts is of immediate concern to constituents, politically sensitive, and/or controversial.

51. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

52. A narrative discussion should be provided to include the following information:

    a. What is insured or guaranteed, for whom, and what other government agencies and/or commercial insurance programs administer or assume risk for any part of the program.

    b. The gross cost of insurance programs and related nonexchange revenue collected, appropriations used, and borrowing during the period, as well as the ability to repay borrowing.

    c. Investing activities

    d. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions.

53. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

    a. Beginning balance

    b. Incurred claims

    c. Payments to settle claims

    d. Recoveries and other adjustments

    e. Ending balance

LIFE INSURANCE PROGRAMS

54. Life Insurance Programs collect premiums for life insurance contracts to cover the risk of loss from death of individuals.

RECOGNITION AND MEASUREMENT

REVENUE

55. Premiums should be recognized as revenue when due from policyholders.

LIABILITY FOR UNPAID INSURANCE CLAIMS

56. A liability for unpaid insurance claims should be recognized for adverse events that occurred before the end of the reporting period. The liability should be initially recorded at the estimated settlement amount and remeasured at the end of each reporting period.

57. The estimated settlement amount includes:

    a. outflows to liquidate:

        i. claims that have been reported but not paid,

        ii. claims incurred but not reported (IBNR),

    b. related estimated claim adjustment expenses, and

    c. estimated inflows from recoveries, such as monies recovered from improper payments, not realized at the end of the reporting period.

        i. If estimated recoveries exceed the related claims for a group of contracts then recognition is limited to the amount of the related claims.[16]

        ii. Recoveries should be recognized as reductions of claims, rather than as revenue.

58. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as claims expense.

[16] Any amount expected to be recovered in excess of the recognized claim, which will result in a gain, should not be recognized until any contingencies relating to the recovery have been resolved because a contingent gain cannot be recognized until realized.

LIABILITY FOR FUTURE POLICY BENEFITS

59. The liability for future policy benefits represents the expected present value of future claims to be paid to, or on behalf of, existing policyholders, less the expected present value of future net premiums to be collected from those policyholders.

60. Estimates should be determined by considering groups of contracts rather than individual contracts according to similar characteristics including contract duration.

61. The liability is estimated using appropriate financial and/or actuarial methods that include assumptions, such as estimates of expected investment yield, mortality, morbidity, terminations, and expenses. (See also SFFAS 33)

62. Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in which the changes occur.

63. The effects of changes in relevant law or policy would be recognized when those changes occur.

SUBSEQUENT EVENTS

64. Subsequent events: Events or transactions that affect the basic information or RSI that occur subsequent to the end of the reporting period but before the financial report is issued.[17] According to SFFAS 39, subsequent events may be recognized or nonrecognized events. Recognized events provide additional evidence with respect to conditions that existed at the end of the reporting period and affect the estimates. Nonrecognized events provide evidence with respect to conditions that did not exist at the end of the reporting period, but arose subsequent to that date. Events or transactions occurring after the reporting period for which no information existed at the balance sheet date should be treated as nonrecognized events and should be considered for disclosure in accordance with SFFAS 39, par 15.

[17] SFFAS 39, par. 8

DISCLOSURE REQUIREMENTS

Factors in Determining Disclosures

65. Materiality is an overarching consideration in financial reporting for information that should be presented regarding life insurance programs. Materiality considers both quantitative and qualitative factors in selecting insurance portfolios, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance contracts. Acceptable quantitative factors may include whether certain groups of contracts are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of contracts is of immediate concern to constituents, politically sensitive, and/or controversial.

66. Disclosures should be integrated so that concise, meaningful, and transparent information is provided in a comprehensive note regarding the insurance program and related balances, or by providing references to relevant notes elsewhere in the GPFFR but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

67. A narrative discussion should be provided to include the following information:

    a. The type of life insurance and specific characteristics of those products, such as when and how benefits are paid, for example, in dividends and/or at death or at a certain age, and what other government agencies and/or commercial insurance programs administer and/or assume risk for any part of the program.

    b. Premium pricing policies (in accordance with SFFAS 7, par. 46) including risk characteristics used in determining premiums, and requirements to set premium prices that do not cover the full estimated cost to settle claims.

    c. The gross cost of insurance programs and related premiums, appropriations used, and borrowing during the period, as well as the ability to repay borrowing.

    d. Investing activities

    e. The nature and magnitude of uncertainty in calculating the liability for future policy benefits, including the basis and methods, trend information, including the amounts of liability for future policy benefits during the reporting period(s), risk assumptions and factors, and actuarial assumptions used in determining the expected present value of future outflows and future premiums to be collected from those policyholders.

    i. The total value of life insurance policies issued—insurance in-force—at the end of the reporting period which represents the maximum risk exposure. An explanation should be included that avoids the misleading inference that there is

more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

f. The net cash surrender value of policies at the end of the reporting period, including appropriate information to aid in avoiding the misleading inference that there is a more than remote likelihood that 100% of all policies will cancel at the end of the reporting period.

g. Any event(s) that caused a material change in the amounts recognized during the reporting period, such as low probability high impact adverse events, changes in laws, and/or actuarial assumptions

68. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:

a. Beginning balance

b. Incurred claims

c. Payments to settle claims

d. Recoveries and other adjustments

e. Ending balance

DISCLOSURES APPLICABLE TO THE CONSOLIDATED FINANCIAL REPORT OF THE U.S. GOVERNMENT

69. The consolidated financial report of the U.S. Government should disclose the following information:[18]

    a. a broad description of insurance programs,

    b. a general reference to relevant component reporting entity reports,[19]

    c. the balance for insurance program liabilities,

    d. a narrative discussion of programs' ability or inability to repay any borrowing, and

    e. the amount of insurance in-force at the end of the reporting period which represents the maximum risk exposure. An explanation should be included that avoids the misleading inference that there is more than a remote likelihood that claims equal to the entire insurance in-force amount will be filed at the same time.

EFFECTIVE DATE

70. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017.

> The provisions of this Statement need not be applied to immaterial items.

[18] Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statement."

[19] The term "component reporting entity" is used to distinguish between the U.S. Federal government and its components. The U.S. Federal government is composed of organizations that manage resources and are responsible for operations. These include major departments and independent agencies, which are generally divided into sub organizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Some factors were given greater weight than other factors. The guidance enunciated in the Statement—not the material in this appendix—should govern the accounting for specific transactions, events or conditions.

PROJECT HISTORY

A1. The Board undertook this project to ensure that the risk assumed through insurance and non-loan guarantee programs is adequately reported in federal financial reports. SFFAS 5, *Accounting for Liabilities of The Federal Government*, provides standards applicable to insurance and guarantee (non-loan) programs (insurance programs). While SFFAS 5 includes a requirement to report risk assumed, the information provided about insurance programs is not comparable or informative. Further review found that it is challenging to determine the financial results and position of insurance programs.

A2. In addition, the Board's conceptual framework now provides a definition of liability and describes measurement attributes that were not available when SFFAS 5 was developed. SFFAC 5, *Definitions of Elements of Accrual-Basis Financial* Statements, defines liability as "a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording,* defines attributes of elements that may be measured. This proposal seeks to adopt the most current concepts so that the accounting principles for insurance and non-loan guarantee liabilities provide comprehensive guidance for consistent reporting.

A3. Project goals are to:

a. define federal insurance programs and related terms,
b. ensure consistent reporting for all insurance programs implemented by the federal government,
c. address measurement uncertainty regarding estimating losses on open contracts as of the end of the reporting period,
d. ensure disclosures address uncertainties and risk factors, and
e. provide for reporting on significant risks assumed in order to meet the stewardship and operating performance objectives of federal financial reporting

A4. A task force was formed to assist in developing the proposed standards for insurance and non-loan guarantee programs. Task force members included accounting, budget, and insurance subject matter experts from federal agencies and independent public accounting firms.

A5. The task force met several times over the course of the project, delivered an education session to members, and also exchanged numerous ideas and recommendations electronically. The task force views and recommendations were sought by staff in developing and describing alternatives to present to the Board during the development of these standards. The task force's assistance was essential and its views carefully considered by members during deliberations. The task force played an important role in the research and release of this exposure draft.

SCOPE

A6. This project addresses federal insurance and non-loan guarantee programs that use a variety of funding structures to manage the risk of loss from specific adverse events. The original title for this project was Insurance and Non-Loan Guarantee Programs.

A7. The term "non-loan guarantee" is currently included in the SFFAS 5 language, so that programs that guarantee settlement of losses for adverse events other than loan defaults are addressed by those standards regardless of the name of the program. However, research by the task force determined that the phrase "non-loan guarantee" is confusing to readers. Because non-loan guarantee programs meeting the new insurance program definition would be covered by this Statement, dropping the phrase "non-loan guarantee" from the title would avoid reader confusion but not otherwise change the scope of the project. Members agreed and renamed the project Insurance Programs.

A8. The various insurance program funding structures to cover the risk of losses may include collecting premiums to fully fund estimated losses, combining premiums that partially fund estimated losses with appropriations, authorizing borrowing to pay for losses not otherwise covered, or collecting assessments to provide reimbursement for losses in the event that an adverse event occurs. The funding structure does not affect whether a program qualifies as an insurance program but does affect classification.

KEY AREAS OF IMPROVEMENT

A9. SFFAS 5 resulted in inconsistent reporting among insurance programs due to the absence of definitions and use of words such as: possible loss, probable future events, measurable, and uncertainty. The Board considered existing concepts and standards for similar circumstances such as loan guarantees to identify options for improvement. The Board also considered task force testimony that insured events are often hard to project due to their high impact yet low probability nature and the lack of available data to predict them. As a result, the Board determined that current reporting could be improved through:

a. definitions of relevant terms,

b. guidance for revenue recognition and unearned premiums,

c. consistent recognition of liabilities including future loss estimates, and

d. structured disclosure requirements.

Definitions of Relevant Terms

A10. During the initial phase of the project, the Board determined that definitions of relevant terms would be necessary for consistent reporting. Board staff worked extensively with the task force to develop these definitions. The Board determined that the following provided the foundation for the definitions developed for this project.

a. Insurance Program—the definition for an insurance program identifies the fundamental nature of these federal programs. The substance – and not the name – of a program will determine if it is an insurance program and therefore subject to these standards. The Board also approved a list of excluded activities to provide clarity as to what is not an insurance program.

b. Adverse Event—each insurance program is responsible to settle losses that result from specific adverse events. The Board learned through an education session with the Federal Crop Insurance Corp (FCIC) that an adverse event may be a single event or a series of events. Therefore, an adverse event has not occurred until all of the events in a series occur.

c. Insurance Contract—the task force provided information that exchange transaction insurance programs and life insurance programs engage in an explicit agreement or arrangement. The definition of a contract includes the elements that these insurance programs may agree to in order to provide settlement of losses to beneficiaries.

d. Insurance Program Categories—the Board determined that an insurance program will fit into one of three categories. Each category processes different types of transactions that settle losses from specific adverse events. The categories are as follows:

   i. Exchange Transaction Insurance Programs Other than Life Insurance cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined by SFFAS 7.

   ii. Nonexchange Transaction Insurance Programs cover the risk of loss from adverse events through nonexchange transactions as defined by SFFAS 7.

   iii. Life Insurance Programs cover the risk of loss from death of individuals.

Revenue Recognition and Liability for Unearned Premiums:

A11. The standards found in SSFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* provide information to help the Board determine what type of transactions to include in each of the three insurance program categories. This Statement addresses revenue recognition that is unique to each category, but does not reiterate the revenue recognition standards. To address this, the Board added a general statement in the Scope section that refers the preparer to other standards when necessary.

A12. Exchange transaction insurance programs other than life insurance recognize revenue in proportion to the insurance protection to be provided. Any revenue collected but not earned prior to the end of the reporting period is recognized as unearned premiums.

a. The following is an example of revenue that is earned evenly over a 12-month contract period because insurance protection is provided evenly during the contract period. The premium of $1,200 is collected on July 1st. By September 30th, three months have been covered earning the exchange program $300. The remaining $900 is unearned because the remaining contract period is still open into the next fiscal year from October 1st through June 30th. The $900 is recognized separately on the balance sheet as unearned premium.

b. The following is an example of revenue that is earned for three equivalent national rallies scheduled to be held during a 12-month contract period. The premium of $1,500 is collected on July 1st. By September 30th, two of the three rallies have occurred, earning the exchange program $1,000. The remaining $500 is unearned because the third rally is not scheduled until December 20th, which is during the remaining contract period from October 1st through June 30th. The $500 is recognized separately on the balance sheet as unearned premium.

A13. Nonexchange transaction insurance programs do not recognize unearned premiums because they do not earn premiums. The Board believes that insurance programs in this category should apply general revenue recognition standards. Therefore, no specific revenue recognition guidance is provided in this Statement.

A14. Life insurance programs do not recognize unearned premiums. The Board believes that revenue from life insurance contracts should be recognized when due from policyholders because there is no better basis for determining when revenue is earned. Premiums are due and collected each pay period or on another recurring basis over the entire duration of the contract. In addition, the expected present value of future net premiums is deducted from the expected present value of future claims to arrive at the liability for future policy benefits.

Recognition of Liabilities and Measurement of Future Loss Estimates

A15. Liability for Unpaid Claims is recognized for all categories. Regardless of category, at the end of the reporting period insurance programs might be processing claims for losses due to adverse events that occurred by the end of the reporting period.

a. The amounts due for claims that have been submitted but not paid are included in the liability for unpaid claims.

b. There are also claims incurred but not reported. The amounts for these claims are not known and must be estimated for adverse events that occurred by the end of the reporting period. If an adverse event is a series of events not completed by the end of the reporting period, then the Board believes that these are not IBNR claims and should not be included in the liability for unpaid claims. Nonetheless, for exchange transaction insurance programs other than life insurance, such series would be considered in estimating a liability for losses on remaining coverage.

c. Claims adjustment expenses are costs directly related to settling claims from adverse events that occurred by the end of the reporting period. The Board believes that CAE should be included in the liability for unpaid claims for submitted and IBNR claims in order to recognize the full cost to settle claims.

A16. Recognition of a liability for losses on remaining coverage is required for exchange transaction insurance programs other than life insurance. Research by the task force determined that a program has a service obligation to pay for any losses caused by adverse events during the entire contract period.

a. The Board believes that separating that the liability for losses on remaining coverage from the liability from the unpaid claims portion will remove confusion created by the SFFAS 5 reference to general standards for contingencies and improves estimation and recognition of losses on remaining coverage.

b. The Board believes that programs should first use expected cash flow (also referred to as expected value in some accounting literature) to estimate the cost to settle claims on remaining coverage. This is an improvement over existing standards that provide for losses to be recognized when they are both probable and measurable.

c. According to the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 7, paragraphs 44-54, the use of probabilities is an essential element of the expected cash flow approach. However, some have questioned whether assigning probabilities to highly subjective estimates implies greater precision than in fact exists. Some also question whether the cost of obtaining additional information to assign probabilities will bring more reliability to the measurement. To address these concerns, FASB allows a variety of pricing tools and methods for developing an expected cash flow estimate.

d. There are a number of tools available to estimate an expected cash flow. Management may identify possible cash flows and assign each a probability consistent with the definition of expected cash flows. For more complex portfolios, more sophisticated tools may be needed to deal with the many variables affecting future claims. For example, the Department of Agriculture's Risk Management Agency oversees crop

insurance and relies upon a regression analysis[20] to estimate cash flows. The Department of Homeland Security's Federal Emergency Management Agency oversees flood insurance and relies on a lognormal distribution[21] to estimate cash flows. Such tools can be used to arrive at expected cash flow even though they are not as straight forward as the definition of expected cash flow implies.

e. Existing contingency standards provide guidance regarding estimates of a range of possible outcomes. The Board has not addressed the use of a range of possible outcomes when no outcome within the range is a better estimate than any other outcome. Under the expected cash flow method, the single average—or mid-point of the range—is the expected cash flow. Therefore, guidance regarding the range is not necessary.

f. The Board believes that if using an expected cash flow method is not practical and appropriate, then an entity may estimate a single most-likely amount to be paid to settle future claims during the remaining open contract period.

A17. A member expressed concern that the requirement to first use expected cash flows discussed in paragraph A16 was too limited and may inappropriately exclude estimates of cash flows calculated under other methods that better reflect estimated cash flows. Specifically, the member believes that the entity should be able to use any method that provides a reasonable estimate of cash flows, based on all available information existing at the balance sheet date, including experience with previous trends, and, as appropriate, the views of independent experts. Also, the member expressed concern that the focus on expected cash flows is narrower than measurement options allowed for other liabilities and that there was not a clear reason expressed for the different treatment in this proposed standard. The Board agreed to add question 4b to seek comments from respondents on the proposed methodology for calculating the liability for losses on remaining coverage.

A18. Recognition of a liability for future policy benefits is required for Life Insurance Programs. Future benefits and premiums are estimated using financial and/or actuarial methods, depending on the portfolio risk characteristics and contract duration. These amounts are discounted to the present value in order to recognize the liability for future benefits.

[20] Regression analysis is a statistical technique used to measure the extent to which a change in one quantity (variable) is accompanied by a change in some other quantity (variable). GAO, Aug 1, 1974-Case Study (CS-5), *Using Regression Analysis To Estimate Costs Published*, page 1.

[21] In statistics the best known distribution is the normal, the familiar bell-shaped curve which is symmetrical about its mean. Certain other distributions stem from the normal. For example… the lognormal distribution…A random variate x is lognormally distributed if the logarithm of x is normally distributed. In short, the distribution of x is itself lognormal when the distribution of log x is normal. A typical lognormal distribution is skewed to the right and has a lower bound such that the probability of x being less than this lower bound is exactly zero. Lester G. Telser, Review of the Lognormal Distribution, Journal of Farm Economics 41. No 1, Feb., 1959, page 161.

A19. Estimates for the liability for losses on remaining coverage and future policy benefits are recognized by groups of contracts with similar characteristics, including contract duration. The Board decided not to define "contract duration" due to the subjective nature of duration. For example, one insurance program might determine that a 36-month contract is short-duration, while another one assigns it to a long-duration group. Recognizing these liabilities by groups of contracts allows judgment by each insurance program in defining the duration of their contracts.

A20. Events or transactions occurring after the balance sheet date but before the financial report is issued are considered subsequent events. A subsequent event may or may not adjust the financial statements, depending on whether it is a recognized or nonrecognized event. SFFAS 39 provides more detailed guidance, including examples of recognized and nonrecognized subsequent events. Examples for a September 30th year end, November 15th financial statement publication date for insurance programs' subsequent events may include:

a. Recognized event: a claim which is settled (transaction) on October 30th for an amount significantly different from the liability recorded for an adverse event that occurred on September 20th would require adjustment to the financial statements.

b. Nonrecognized event: a major disaster that occurs on October 20th would not require an adjustment to the financial statements, but may require disclosure.

A21. Disclosures are required for each insurance program category to aid the reader in understanding the estimates and fiscal health of insurance programs in relation to the risk they assume for losses incurred due to adverse events.

a. Task force research informed the Board that current standards required presentation of similar information in multiple places (for example, notes and required supplementary information), which burdened the agencies and readers. In addition, disclosures were inconsistent among programs, making it difficult to determine the fiscal health—the amount of loss estimated versus the amount and funding types necessary to settle the actual losses—of individual programs as well as insurance programs at the government-wide level.

b. The Board believes that the updated disclosure will avoid duplication by allowing insurance programs to reference relevant notes.

c. For consistent reporting, the Board developed a schedule to reconcile the liability for unpaid claims that a number of insurance programs already produced. The Board reviewed the current schedules and consolidated relevant information for consistent reporting. All categories should report this schedule so readers receive consistent information.

d. The Board learned from the task force that there are low probability, high impact adverse events that, if they occur, can cause material financial losses. The

following are examples of hard to predict adverse events that cause substantial loss: a “Katrina” type of hurricane or political uprising in a country that completely disrupts American businesses. Therefore the Board requested that adverse events causing a material change in amounts for the reporting period be disclosed.

A22. Disclosures for the financial report of the U.S. Government should be reported at a high level of detail. The Board believes that detailed disclosures should be found at the component reporting entity level.

APPENDIX B: ABBREVIATIONS

CAE	Claim adjustment expense
CFR	Consolidated financial report of the U.S. Government
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IBNR	Incurred but not reported
OMB	Office of Management and Budget
RSI	Required supplementary information
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Adverse Event—may be a single-occurring event or a series of events that cause losses to the beneficiary (ies) as identified in the insurance contract.

Cash Surrender Value—is the sum of money an insurance company will return to the policyholder if the policy is cancelled before its maturity or the insured event (death) occurs.

Claim Adjustment Expenses (CAE)—incremental costs directly attributable to investigating, settling, and/or adjusting claims. An incremental cost is one that can result only when claims have been incurred. CAE include but are not limited to legal and adjuster's fees. CAE may be incurred through work performed by federal employees and/or contractors.

Contract Period—the period over which adverse events that occur are covered.

Entitlement Program—is a program in which the federal government becomes automatically obligated to provide benefits to members of a specific group who meet the requirements established by law.

Exchange Transaction Insurance Programs Other Than Life Insurance—cover the risk of loss from adverse events, other than death of individuals, involved in exchange transactions as defined in SFFAS 7.

Expected Cash Flow—(also known as expected value (EV) in some accounting literature) refers to the sum of probability weighted amounts in a range of possible estimated amounts.

In-Force—refers to contracts that are unexpired as of a given date.

Incurred But Not Reported (IBNR)—estimated claims from adverse events that have occurred as of the end of the reporting period, but have not yet been reported to the insurance program for settlement.

Insurance Claim—a formal request for payment for losses as authorized under the insurance contract.

Insurance Contract (Contract)—a general term used for an explicit insurance or non-loan guarantee agreement or arrangement between an insurance program and specific parties such as but not limited to: individuals, state, local, or foreign governments, other federal agencies, or businesses. A contract may include and/or identify: the term the insurance contract is in-force, the insurance program's responsibilities, the risk assumed by the insurance program, such as: all risk for covered losses, partial risk by filling a gap where commercial insurance companies are not able or willing to provide the insurance, or a timing risk wherein the insurance program provides compensation for losses in anticipation that future funding sources will be sufficient to cover all or part of past benefits paid; the adverse event, the insured party(ies) and their premium requirements, the beneficiary(ies) and their responsibilities for filing claims, and/or the financial compensation.

Insurance Program—is a general term used to refer to an insurance or non-loan guarantee program that is authorized by law to financially compensate a designated population of beneficiaries by accepting all or part of the risk for losses incurred as a result of an adverse event.

Liability for Losses on Remaining Coverage—an accrued obligation to beneficiaries attributable to coverage of insured events anticipated to occur after the end of the reporting period through the open contract period.

Life Insurance Programs—cover the risk of loss from death of individuals involved in exchange transactions as defined in SFFAS 7.

Nonexchange Transaction Insurance Programs— cover the risk of loss from adverse events through nonexchange transactions as defined in SFFAS 7.

Premiums—a general term used to refer to exchange revenue billed by insurance programs. Programs may refer to their exchange revenue by various terms including but not limited to premiums, assessments, and/or fees.

Recoveries—monies recouped or recovered from: another agency through an indemnification agreement, a third party or commercial insurance company to repay all or part of a loss originally paid for by the program, the sale of salvageable parts through acquisition and disposal or salvage of assets, and/or adjustments to previously paid insurance claims.

Settlement Amount— is the amount at which an asset can be realized or a liability can be liquidated.

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