Federal Financial Management:
Federal Accounting Standards
Advisory Board Meeting

Office of Federal Financial Management
December 2014
Federal Financial Management Objectives

• Improve the quality, utility, and transparency of financial information

• Protect against and reduce waste, fraud, and abuse

• Help agencies maximize the impact of their limited financial resources

*OFFM's mission is to support the effective and transparent use of Federal financial resources.*
FY 2014 Agency Audit Results

- Currently, 20 of the 24 CFO Act agencies have received a clean audit opinion
- There has been an approximate 50% decline in auditor-identified material weaknesses from Fiscal Year 2000
- The total number of FMFIA material weaknesses currently reported is 25
- There were 9 management assessed non-compliance with one or more of the three FFMIA requirements
- There were 10 auditors assessed non-compliance with one or more of the three FFMIA requirements
Benchmarking Administrative Services

How We Got Here
• The President's Management Agenda highlighted the need for a common set of benchmarks to measure the performance and efficiency of government operations
• With PMC sponsorship, the CxO Councils developed metrics designed to improve cost-effectiveness and service levels in five mission-support functions: Acquisition, Financial Management, Human Capital, IT Management and Real Property
• In Spring 2014, the CxO Councils partnered with CFO Act agencies and their bureaus to collect >30,000 new data points for nearly forty benchmarking metrics across the five functions

Why This Is Valuable for Data-Driven Decisions
• PMC members and agency CxOs now have a robust toolkit to jump-start conversations and analyze data for decisions such as:
  – How efficiently is my function providing services compared to peer agencies?
  – How do our agency's bureaus compare to each other on administrative costs and performance?
  – Are certain processes that we currently provide in-house good candidates for consolidation or shared services?
• The CxO Councils will serve as a "collaboration hub" for identifying common challenges and sharing effective practices across agencies
Benchmarking: Next Steps

<table>
<thead>
<tr>
<th>Key Milestones</th>
<th>Milestone Due Date</th>
<th>Milestone status</th>
<th>Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workgroups for each function refine original set of Efficiency metrics and</td>
<td>November/December 2014</td>
<td>On track</td>
<td>GSA, OMB, OPM</td>
</tr>
<tr>
<td>select Effectiveness metrics to measure service quality and customer</td>
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<tr>
<td>satisfaction with mission-support functions</td>
<td></td>
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<tr>
<td>GSA, OMB and OPM collect Round 1 of Effectiveness metrics and Round 2 of</td>
<td>January/February 2015</td>
<td>On track</td>
<td>GSA, OMB, OPM</td>
</tr>
<tr>
<td>Efficiency metrics</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Finance, HR and IT Management workgroups collect operational quality</td>
<td>March 2015</td>
<td>On track</td>
<td>GSA, OMB, OPM</td>
</tr>
<tr>
<td>metrics and customer satisfaction measures from Federal shared service</td>
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<tr>
<td>providers, to inform agency decisions on shared services adoption*</td>
<td></td>
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<td></td>
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<tr>
<td>OMB, GSA and OPM work with CxO Councils to review Effectiveness and Efficiency</td>
<td>September 2015</td>
<td>On track</td>
<td>GSA, OMB, OPM</td>
</tr>
<tr>
<td>benchmark results for each function, identify the drivers of top</td>
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<tr>
<td>performance and share leading practices government-wide**</td>
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</tbody>
</table>

* Previous milestone was divided into two separate milestones for this report, to reflect different timelines for collecting cost/efficiency metrics versus quality and customer satisfaction measures from Federal shared service providers.

** Previous milestone was divided into two separate milestones for this report; CxO Councils prefer to wait until quality and customer satisfaction results are available (to go with existing efficiency benchmarks) before drawing conclusions about top performers and sharing best practices government-wide.
Financial Shared Services

“USDA joins the ranks of the financial shared service providers”

“Four shared services providers named”
# Shared Services CAP Goal

<table>
<thead>
<tr>
<th>Sub-Goal</th>
<th>Actions to Achieve Impact</th>
<th>Key Indicators</th>
</tr>
</thead>
</table>
| **Marketplace Development:** Enhance the capabilities and capacity of the shared service providers | • Identify opportunities for sharing between providers to reduce duplication of effort.  
  • Solicit private sector input on ways to expand capabilities of shared service providers through Requests for Information (RFIs) and “Industry Days.”  
  • Establish working group of CFOs and Shared Service providers to update Shared Service governance for larger customers.  
  • Working group will develop principles for Government-wide shared service governance.  
  • Individual shared service providers and customers will establish updated governance principles for their individual operations.  
  • Formalize and document marketplace oversight by Treasury and OMB.  
  • Review potential “quick-wins” for shared functions outside of core accounting (e-invoicing, centralized receivables, centralized loan collections, etc.). | **Year One**  
  • # of migrations to shared providers : total # of migrations  
  • % of Departments using shared services for some core administrative function (FM, HR, IT, etc.).  
  • Customer satisfaction survey results  
  **Years Two and Three**  
  • Increase in shared services adoption among 24 CFO Act agencies for individual processes  
  • Improvements in satisfaction results from customers  
  • Total # of Financial Management Systems in the Federal Government  
  • % of Departments using shared services for some core administrative function |
**Shared Services Accomplishments**

<table>
<thead>
<tr>
<th>Actions to Achieve Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Completed:</strong></td>
</tr>
<tr>
<td>✓ Developed standard criteria for financial management Federal Shared Service Provider (FSSP) applications</td>
</tr>
<tr>
<td>✓ Designated four financial management Shared Service Providers (Treasury ARC, Transportation ESC, Interior IBC, Agriculture NFC)</td>
</tr>
<tr>
<td>✓ Solicited private sector input on ways to expand capabilities of shared service providers through two Requests for Information (RFIs) and an “Industry Day”</td>
</tr>
<tr>
<td>✓ Established working group of CFOs and Shared Service providers to craft governance for customer and provider expectations in an O&amp;M environment</td>
</tr>
<tr>
<td>✓ Formalized and documented Federal Marketplace governance by Treasury and OMB</td>
</tr>
<tr>
<td>✓ Highlighted shared services in over 10 sessions at the American Government Accountants Conference in July and other forums in the past year</td>
</tr>
<tr>
<td>✓ Entered three new agencies into the “Needs Identification” phase of the FAME process</td>
</tr>
<tr>
<td>✓ Treasury recommended Government-wide e-invoicing strategy to OMB</td>
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<tr>
<td>✓ Hosted Lessons Learned Day – FSSPs collaborated with CFO agencies to share and adopt lessons learned from large financial management implementations</td>
</tr>
<tr>
<td>✓ Kicked off the Entrepreneurs-In-Residence Program – provide industry expertise to FSSPs for opportunities to scale organizations to address multiple large customers</td>
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<tr>
<td><strong>Ongoing:</strong></td>
</tr>
<tr>
<td>✓ Support successful migrations of cabinet-level agencies to shared service providers, including DHS Components, HUD, Labor</td>
</tr>
</tbody>
</table>
OMB A-123 Update

• Working closely with GAO’s Green Book Update
• OMB is revising Circular A-123 for the first time since 2004
• Draft being developed with agency help—we are still working through an initial draft
• Our vision: transform and evolve existing internal control compliance frameworks so that it creates a more value added, integrated, risk based, and less burdensome set of requirements for agencies. The revised guidance will:

  – Clarify technical terminology to ensure that program managers can understand and use internal controls properly;
  – Replace “check the box” compliance approaches with risk management based approaches to reduce compliance burdens and support program controls;
  – Introduce Enterprise Risk Management (ERM); and
  – Evolve internal controls beyond financial reporting.
Enterprise Risk Management

Goal: Consolidate risk management and FMFIA activities through risk priority and increase emphasis on non-financial areas, such as strategic and programmatic areas.

Value Proposition: Elevate agencies to the enterprise risk management level in relation to achieving their strategic objectives.

Actions: In July 2014, OFFM initiated government-wide interviews with a select group of agency leaders to capture the best and promising practices in ERM.
Federal Spending Transparency

- **Quality**: Improving data integrity
- **Completeness**: Expanding the focus to include obligations and expenditures
- **Functionality**: Providing a one-stop location for all Federal spending
- **Utility**: Linking spending information to program activity
Data Act Implementation

• **Implementation of FFATA section 3&4 will occur in 3 high-level phases:**
  – Define data elements
    • What are the required data elements and what are the standard definitions?
    • Workstream: Data Definition Standards
  – Define source of data
    • What are the linkages between the required data elements?
    • Where does the data exist and what is the authoritative source?
    • Workstream: Blueprint/Roadmap between data elements
  – Define method of exchanging the data and publishing the data
    • How will we access the data? How will the data be displayed?
    • Workstream: Data Exchange Standards

• **Pilot to reduce administrative reporting burden – DATA Act Sec. 5**
  – Led by OMB with tactical implementation support from HHS
  – Responsible for leading the pilot to standardize required recipient financial reporting to eliminate duplication

• **Data analytics – DATA Act Sec. 6**
  – Led by Treasury
  – Responsible for establishing a data analytics center and developing a strategy to transfer assets from the Recovery Accountability Transparency Board’s Recover Operations Center
Data Act Accomplishments

• Establishment of a Government-wide Governance Structure (Summer 2014)

• Development of a DATA Act Implementation Plan (Summer 2014)

• Improving USAspending.gov’s Interface and Developing Data Exchanges, Establishing USAspending.gov Data Standards, and Designing Grants & Contracts Reporting Streamlining Pilot (Summer/Fall 2014)

• Release of Federal Spending Transparency Commitments in the United States Open Government National Act Plan (Fall 2014)
GRANTS REFORM
Eliminating Duplicative and Conflicting Guidance

Then:

- A-102 & A-89
- A-87
- A-133 & A-50

INSERT YOUR STATE OR AGENCY HERE

- A-110
- A-21

Now: All OMB guidance streamlined in 2 CFR 200
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MEMORANDUM

Date December 14, 2014
To: Members of the Federal Accounting Standards Advisory Board
From: Anthony McCann
Subject: Presentation on Statement of Budgetary Resources

As the time for presentations on December 17th is short, I thought I would provide a background memorandum for the Board. I have divided my comments into categories – Purpose; Audience; Definitions, Terms and Concepts; Responses to Questions and Conclusions.

I would add that many of my comments parallel the observations in the briefing materials provided to the Board.

I. PURPOSE

The briefing materials and the Statement of Federal Financial Accounting Concepts, indicate that the preparation of the Statement of Budgetary Resources has two, seemingly conflicting, purposes.

SFFAC paragraph 64 indicate that SBR information is available elsewhere (presumably in traditional budget documents, trustee reports, etc.). It then goes on to note that “…the information needs auditor involvement to provide users with a level of assurance regarding its reliability.” Thus, one purpose seems to be the certification of the validity of the data.

The briefing materials also go on to cite SFFAC 7, paragraphs 77-8 and infer that a second purpose is for the SBR to provide an alternative source of information for users. As noted in section II (Audience) below, if the information cannot be disaggregated at least to the level of the Budget Appendix, the budget justifications and other base documents such as trustee reports, etc., its utility as a source document for budget formulation and execution and information for wider audiences is severely limited.

II. AUDIENCE

If I understand the premise of the SBR, it is to reach a “general audience” – an audience with a general interest in federal governmental activity and, at best, a passing knowledge of terms and processes.

My own experience in both the executive and legislative branches is that those who are interested, at all, in governmental budgeting and finance are interested in particular programs. These programs may affect their business or economic situation, their personal lives, their status as part of various groups with the society or their political views. They all, however want to know either how much money is spent on a particular program (Ryan White AIDS Funding, Education funding in the Department of Veterans Affairs) or the funds available for a particular activity, usually encompassing many programs (funding for AIDS Treatment, total education funding available to veterans).
The information in the SBR/SOS for departments or agencies is simply at too high a level of aggregation and there is no indication of how it relates to more granular data at the program, account, subaccount or PPA\(^1\) level.

### III. DEFINITIONS, TERMS AND CONCEPTS

We have a very complex federal government. There are at least 14 different forms of appropriations each with different rules and implications for budget execution. As noted in the briefing materials, there are over $800 billion in grants to state and local governments and other entities, and grants are the primary tool to fund domestic programs. Often these funds flow through several levels and agencies before reaching the final service provider.

The danger is that efforts to simplify data to make it more understandable aggregates it to levels that make it less understandable, more confusing and more misleading. Knowledgeable audiences might be persuaded to use the data for decision making or as part of the translation of data to their respective audiences or constituencies. However, the misuse of terminology and concepts or the creation of terms to apply to overly aggregated totals substantially undermines the credibility of financial reporting vis-à-vis traditional budget data sources.

**A. Obligations and Outlays (Spending)**

The portion of the federal budget that is annually appropriated and some mandatory accounts are obligation based. For many mandatory accounts, the budget is, essentially outlay driven. The source of data on “spending” in the SBR seems to be a combination of these two concepts.

With $800+ Billion in grants, the problem becomes far more complex. A common situation presents itself when the administration and/or interest groups argue for a funding level based on the dire need of a subset of Americans due to disease, health status, economic status etc. They insist that a specific amount is the absolute minimum needed and that even then, it is insufficient. Subsequently, the amount is appropriated and obligated properly to the initial grantees. However, in the first year, only 40% if the funds are actually spent by the grantees/subgrantees and maybe in the 2\(^{nd}\) year only 60%-70%. What number tells the public more – the amount obligated or the amount actually outlayed to provide the service?

The attempt to avoid dealing with obligations and outlays confuses rather than informs.

**B. Outlays**

The chart from the President’s budget on page 6 of the briefing materials has been a feature of the document for many decades – dating back to the use of “M” accounts that allowed pooling of obligated, but unexpended funds. However, the National Defense Authorization Act for Fiscal Year 1991 (31 U.S.C. § 1552(a)) states:

> After the end of the period of availability for obligation of a fixed appropriation account...the account shall retain its fiscal year identity.... [Emphasis added]

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\(^1\) “Programs, Projects and Activities”
Thus financial systems are able (or should be able) to associate a particular outlay with its original obligation and audits should assure that this practice is carried out.

Secondly, in budgeting, “outlays” are always an estimate and in only the rarest of cases are limitations placed on the amount outlayed.

C. “Undelivered orders”

“Undelivered orders” is a particularly pernicious term. It is inconsistent with the GAO Redbook term – “Unexpended Balance.” It creates confusion between contracts (in which there is a specific product or service “due” to the federal government) and grants (which are assistance to various entities institutions or governments.) The prevalence of unexpended balances in contracts is a far different issue than in grants and the combining of the two creates misunderstandings and is seen, by many, as simply a misunderstanding of how government works, again undermining the credibility of financial management documents as analytical or management tools.

D. Appropriation

There are many forms of appropriations – each with its own set of rules, issues in budget execution and oversight. For example there are at least three different forms of mandatory appropriation:

- Appropriated entitlements (Medicaid, Veteran’s Compensation) in which in spite of an entitlement to the benefit, the amounts available are constrained by a fixed appropriation;
- Fixed annual appropriations in an authorization (TANF, CHIP) in which the authorization appropriates fixed amounts for many successive fiscal years. These accounts not only are constrained by the amount appropriated, but funds must be obligated during the one-year period of availability and unexpended balances liquidated during the subsequent 5 year “expired” period – just as with appropriated accounts;
- Permanent, indefinite appropriations (Social Security, Title II, Medicare Part A) in which, except for trust fund balances, there are no time or amount limitations on outlays.

Confusion with respect to appropriation in the SBR/SOS takes two forms. First the use of one, or at most, two categories again evidences an oversimplification that undermines credibility. Secondly, when the term is applied to the budget, it

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2 “The portion of an appropriation that has not actually been spent at the end of the fiscal year...is called the ‘unexpended balance.’ It consists of two components—the obligated balance and the unobligated balance” GAO Redbook pp. 5-67-8.

3 An example of this funding mechanism is in Section 2104 of the Social Security Act relating the Children’s Health Insurance Program (a) Appropriation; Total Allotment.—For the purpose of providing allotments to States under this section, subject to subsection (d), there is appropriated, out of any money in the Treasury not otherwise appropriated—

(1) for fiscal year 1998, $4,295,000,000;
(2) for fiscal year 1999, $4,275,000,000;
(3) for fiscal year 2000, $4,275,000,000;
(4) for fiscal year 2001, $4,275,000,000;
(5) for fiscal year 2002, $3,150,000,000;
(6) for fiscal year 2003, $3,150,000,000;
(7) for fiscal year 2004, $3,150,000,000;
(8) for fiscal year 2005, $4,050,000,000;
(9) for fiscal year 2006, $4,050,000,000;...
increase errors in some accounts. As noted above, the amounts for Social Security Title II benefits and Medicare part A, as for many mandatory accounts, are estimates and the actual amount may vary substantially. This difference is not a violation of appropriations limitations (as the term would suggest) but simply the result of the inability to predict the future.

E. Amounts Not Agreed to be Spent/Amounts Not Available to be Spent

These terms in the HHS Statement of Spending are mysterious ones. The explanatory note states:

*Amounts Not Agreed to be Spent represents amounts that HHS was allowed to spend but did not take action to spend by the end of the fiscal year. Amounts Not Available to Spend represents amounts that HHS was not approved to spend during the current fiscal year.*

To my knowledge, the terms appear in the executive budgeting process nor in the Congressional appropriations process and the definitions are tautological. The process, therefore could use some additional standardization of terms.

F. How the Money was Spent

The Statement of Spending is to include “How the Money was Spent.” In the example of Commerce, the SOS uses “Contracts,” “Grants,” and other mechanisms. In the case of the Department of Veterans Affairs, they seem to use object classes. However, once again, the issue of grants creates major definitional problems. For a vast array of federal domestic programs, a federal agency makes grants to both a state agency and often major metropolitan areas. The state often subgrants its funds to local governments, sometimes adding state funds and, often, a significant portion of its funds also go to metropolitan areas. The metropolitan city or county then (with or without additional local money) contract with not-for-profit or for-profit entities to provide the service. For someone interested how much money goes to for-profit entities, for example, the data showing who the federal government granted the money to is misleading; the full story is far more complex.

The point of this section is not to specifically highlight these specific issues. Rather it is to make the broader point that far more care needs to be taken in abandoning existing terms and concepts and in the use of those terms and concepts in the SBR/SOS.

IV. RESPONSES TO QUESTIONS

A. What decisions or conclusions can be drawn from the current line items on the Statement of Budgetary Resources?

*My experience at HHS, the Appropriations Committee and at HRSA is that rarely, if ever, did anyone asked for the breakdown of funding levels at the departmental level. At the agency level, the totals were sometimes requested, but the request occurred when the agency was the program, the agency amounts had symbolic meaning (Department of Veterans’ Medical Care) or when the agency totals and percent increase/decrease translated directly to program or office increases or decreases (NIH).*

*Most federal departments and many federal agencies are simply institutions to house and minimally mange agencies and programs. They are far less than the*
sum of their parts and have little identity or presence apart from their constituent programs.

B. What ideas do you have for improving agency presentation of budgetary information for general purpose external reports?

As noted earlier in this memorandum, if the purpose is to provide assurance of the integrity of the numbers used from “other reports,” than the user must be able to determine which numbers are covered by the SBR/SOS. Similarly, if the goal is to have the SBR/SOS used as working document, than, consistent with my comments in Section II, there must be a way to disaggregate the data probably to the level of detail in the Budget Appendix, Justifications, PPA’s and other levels appropriate for mandatory accounts.

C. Some have suggested creating a “budget to actual” comparison. How would you define “budget” for an agency and what would the corresponding “actual” be?

Clearly, “budget” is the enacted funding levels. For discretionary accounts “budget” is the appropriation. For some mandatory accounts, the underlying authorizing legislation sets funding limits that act the same as a fixed annual appropriation (TANF, CHIP) and that amount would be the “budget.” For others that include permanent, indefinite appropriations and Deeming (TARP) the “budget” is an estimated outlay amount.

For discretionary accounts and fixed annual appropriations in authorizations (TANF, CHIP) outlays are estimates and do not represent any legal or administrative constraint on expenditures. Yet, for certain accounts when properly arrayed, they can provide some information on the level of effort or services actually provided.

For discretionary accounts, particularly salary and expense accounts, agencies leave a small amount unobligated to provide a cushion for unexpected expenses chargeable to that fiscal year’s appropriation. That discrepancy will show up, but I am not sure of its implications. In the case of permanent, indefinite and similar appropriation forms, and for outlays, the “budget to actual” simply indicates the accuracy of the estimate.

Conclusions

1. If the Statement of Budgetary Resources is to be useful for budget formulation and execution and for informing various audiences it will have to relate to the more detailed data which is of primary interest to them. For appropriated accounts this level of detail extends to the levels in the Budget Appendix, the budget justifications and, probably, PPA’s. Similar levels of detail will be necessary for mandatory accounts, depending on the form and program.

2. To increase credibility, terms and concepts must be far more carefully chosen and defined. The introduction of new, and presumably more simplified terms must be minimized and the use of more traditional terms expanded. Use of existing budgetary terms must be consistent with current technical usage.

3. Individuals and groups defined as potential users of the information in the SBR/SOS (in fact, in the complete financial report) must play a far more substantial role in defining terms, standards and issues to be addressed.
Operating Structure

Risk Management Agency (RMA) operates and manages the Federal Crop Insurance Corporation (FCIC)

FCIC has no employees

FCIC has a Board of Directors
  • USDA Chief Economist
  • Two Under Secretaries
  • Four Producers
  • Two Insurance Regulators
Program Overview

CIC (RMA)
Establishes policies, standards, and premium rates
Subsidizes premium for growers
Pay AIPs to market and service policies (A&O subsidy/Delivery Expense)
Reinsurance to AIPs - AIPs and FCIC share in underwriting gains/losses

Approved Insurance Providers (AIPs)
• Market and service policies
• Collect and guarantee producer premium payment to FCIC
## Crop Statistics

<table>
<thead>
<tr>
<th>Program Information Comparison</th>
<th>Crop Year 2014 (Estimated)</th>
<th>Crop Year 2013 (Actual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policies</td>
<td>1.20 million</td>
<td>1.22 million</td>
</tr>
<tr>
<td>Farmer Paid Premium</td>
<td>$3.88 billion</td>
<td>$4.51 billion</td>
</tr>
<tr>
<td>Premium Subsidies</td>
<td>$6.24 billion</td>
<td>$7.30 billion</td>
</tr>
<tr>
<td>Total Premium</td>
<td>$10.12 billion</td>
<td>$11.81 billion</td>
</tr>
<tr>
<td>Indemnities</td>
<td>$7.49 billion</td>
<td>$12.06 billion</td>
</tr>
<tr>
<td>Loss Ratio</td>
<td>74%</td>
<td>102%</td>
</tr>
<tr>
<td>Insurance Protection</td>
<td>$109.46 billion</td>
<td>$123.77 billion</td>
</tr>
</tbody>
</table>
Percentage of Insurance in Force by Type of Insurance Plan

- **Actual Production History**: 19%
- **Revenue**: 75%
- **Other**: 6%
Types of Insurance Plans

Revenue Policies:
• Policies to protect the producers against loss of revenue due to price fluctuations and yield loss due to natural causes.

Actual Production History & Yield Protection Policies:
• Policies insure producers against yield losses due to natural causes.

Other Policies:
• Policies based on county results rather than individual farms
• Adjusted Gross Revenue
• Fixed Dollar Amount of Insurance
Premium Rates

Determined by RMA on behalf of FCIC

Federal Crop Insurance Act:

• “the amount of the premium shall be sufficient to cover anticipated losses and a reasonable reserve.”
• “the Corporation shall periodically review the methodologies employed for rating plans of insurance”
• “The Corporation shall take such actions. . . to achieve an overall projected loss ratio of not greater than 1.0.”
2011 Losses

2011 RMA Crops’ Indemnities
(As of 07/23/2012)

2011 Indemnity by County
- No Indemnity ($0)
- $1 to $500,000
- $500,000 to $1,000,000
- $1,000,000 to $5,000,000
- $5,000,000 to $10,000,000
- Over $10,000,000

USDA Risk Management Agency

Drought Severity Index by Division
Weekly Value for Period Ending AUG 13, 2011
Long Term Palmer

-4.0 or less (Extreme Drought)
-3.0 to -3.9 (Severe Drought)
-2.0 to -2.9 (Moderate Drought)
-1.9 to +1.9 (Near Normal)
+2.0 to +2.9 (Usual Moist Spell)
+3.0 to +3.9 (Very Moist Spell)
+4.0 and above (Extremely Moist)

Climate Prediction Center, NOAA
2013 Losses

2013 RMA Crops' Indemnities
(As of 12/16/2013)

Drought Severity Index by Division
Weekly Value for Period Ending AUG 3, 2013
Long Term Palmer

USDA Risk Management Agency
Premium Rating

Pure premium rate
- No expense load
- Expected indemnities

Loss cost method – Average rate of loss
- Loss/Liability
- Rolling 20 years

Other Adjustments:
- Credibility smoothing with adjacent counties
- Catastrophic loading
- Weather weighting
Individual Rates

Individualization of Rate

- Coverage Level
- Unit Choice
- Yield Ratio
- Revenue Coverage

Relative Yield Adjustment
County Average Yield = 100, Exponent = -1.8
Loss Ratio History

Loss Ratios for the Crop Insurance Program, 1975-2013

- 1988 Drought, Loss Ratio = 2.39
- 1993 Flood, Loss Ratio = 2.19
- 2012 Drought, Loss Ratio = 1.57

1975-1994 Average = 1.39
1995-2013 Average = 0.89
Premium Pricing

How are the pricing policies determined for premiums?
Who sets the pricing policy for the premiums?

- Actuarial Branch identifies specific issues
  - Address internally/contract with external party

- Periodic Rate review
  - Contract with external party

- Annual premium rating strategy memo
  - Studies and implementation
  - Generated and approved within RMA
Timing of Revenue Recognition

When does your program bill for premiums and recognize revenue/unearned revenue?

- Premium Revenue is recognized each month as acreage reports are submitted. The acreage report is the basis for determining the amount of insurance provided and the premium charged.

- The acreage report shows:
  - crops planted
  - acreage prevented from planting
  - where crops are located
  - number of acres planted
  - dates planted
Components of Revenue

- Premium Revenue is comprised of two pieces
  - Producer Paid Premium
  - Premium Subsidy
- Recognized at the time acreage report is accepted
- FCIC receives an appropriation for premium subsidy.
- An Appropriations Used entry is recorded to recognize the benefit of the premium subsidy

Unexpended Appropriations – Used (SGL 3107)
Expended Appropriations (SGL 5700)
Unearned Revenue/Premium Deficiency Reserve

At fiscal year end, liabilities are established for a portion of revenue deferred into the next fiscal year to pay the losses incurred in the next year. The amount is based on the average number of days between planting date to billing and planting date to end of insurance period compared to the days after the end of fiscal year.

---

**Growing Season Insurance Period**

<table>
<thead>
<tr>
<th></th>
<th>FY 2014 - 75%</th>
<th>FY 2015 - 25%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Final Planting Date</strong></td>
<td>6/30/14</td>
<td></td>
</tr>
<tr>
<td><strong>Billing Date</strong></td>
<td>8/30/14</td>
<td>9/30/14</td>
</tr>
<tr>
<td><strong>Fiscal Year End</strong></td>
<td></td>
<td>10/30/14</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>12/30/14</td>
</tr>
<tr>
<td><strong>End of Insurance Period</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Estimating Claims

Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?

- Limited data – major crops
- NASS yield projections
- Commodity Market Prices

Loss Ratio v. Yield
(Mississippi Cotton, APH Buy-Up Policies)
Challenges in Estimating Claims

- Growing season for 93% of premium extends past September 30
  - Final yield is not known as of September 30
- Damage is not a one-time event
  - Decline in yield occurs over time
  - Pinpointing loss date is difficult
  - Currently, RMA uses the same percentage of time as the earned revenue to determine incurred losses
- Fluctuation in market prices
- Over 75% of insurance policies are based on revenue
- Revenue products based on market prices as of October/November are not known at September 30
Incurred But Not Reported Claims

FCIC uses model to estimate Total Losses for all policies in force.

Incurred Losses in current fiscal year = Total Losses - Unearned Premium and PDR

IBNR = Incurred Losses less Recorded Losses
Example of Accounting Impact

Assumptions:

• 1 policy with total premium of $100
• Producer Premium = $40
• Premium Subsidy = $60
• 75% of growing season from crop is in FY 14 and 25% in FY 15
• Expected Loss ratio at September 30 is 1.0
• Indemnity payment is $100
## Scenario Example: FY 2014

<table>
<thead>
<tr>
<th>Event</th>
<th>Accounting Transaction</th>
<th>Amount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apportionment</td>
<td>Receive Appropriation for Premium Subsidy</td>
<td>$60</td>
<td>Cash (1010)</td>
<td>Unexpended Appropriation Received (3101)</td>
</tr>
<tr>
<td></td>
<td>Producer Premium</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acreage Report</td>
<td>recognized</td>
<td>$40</td>
<td>Accounts Receivable (1310)</td>
<td>Premium Revenue (5500)</td>
</tr>
<tr>
<td>Acreage Report</td>
<td>Premium Subsidy recognized</td>
<td>$60</td>
<td>Unexpended Appropriations Used (3107)</td>
<td>Expended Appropriations (5700)</td>
</tr>
<tr>
<td>Billing</td>
<td>Producer Premium Collected</td>
<td>$40</td>
<td>Cash (1010)</td>
<td>Accounts Receivable (1310)</td>
</tr>
<tr>
<td>Year-End</td>
<td>Record Unearned</td>
<td>$10</td>
<td>Premium Revenue (5500)</td>
<td>Deferred Revenue (2320)</td>
</tr>
<tr>
<td></td>
<td>Producer Premium</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year-End</td>
<td>Record Premium</td>
<td></td>
<td>Future Funded Expense (6800)</td>
<td>Estimated Losses for Insurance (2660)</td>
</tr>
<tr>
<td></td>
<td>Deficiency Reserve (PDR)</td>
<td>$15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year-End</td>
<td>Record Incurred But Not Reported (IBNR)</td>
<td>$75</td>
<td>Future Funded Expense (6800)</td>
<td>Estimated Losses for Insurance (2660)</td>
</tr>
</tbody>
</table>
### Scenario Example: FY 2015

<table>
<thead>
<tr>
<th>Event</th>
<th>Accounting Transaction</th>
<th>Amount</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reverse Year-end accruals</td>
<td></td>
<td>$10</td>
<td>Deferred Revenue (2320)</td>
<td>Premium Revenue (5500)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$15</td>
<td>Estimated Losses for Insurance (2660)</td>
<td>Future Funded Expense (6800)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$75</td>
<td>Estimated Losses for Insurance (2660)</td>
<td>Future Funded Expense (6800)</td>
</tr>
<tr>
<td>Loss Adjustment</td>
<td>Pay Claims</td>
<td>$100</td>
<td>Operating Expense (6100)</td>
<td>Cash (1010)</td>
</tr>
</tbody>
</table>
### Scenario Example: Financial Statement Impact

#### Balance Sheet Liabilities

<table>
<thead>
<tr>
<th>Estimated Losses on Insurance Claims:</th>
<th>FY 2014</th>
<th>FY 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBNR</td>
<td>$75</td>
<td>-</td>
</tr>
<tr>
<td>PDR</td>
<td>$15</td>
<td>-</td>
</tr>
<tr>
<td>Total Estimates Losses</td>
<td>$90</td>
<td>-</td>
</tr>
<tr>
<td>Unearned Revenue</td>
<td>$10</td>
<td>-</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>$100</td>
<td>-</td>
</tr>
</tbody>
</table>

#### Statement of Net Cost

<table>
<thead>
<tr>
<th></th>
<th>FY 2014</th>
<th>FY 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims Incurred</td>
<td>$75</td>
<td>$25</td>
</tr>
<tr>
<td>PDR</td>
<td>$15</td>
<td>($15)</td>
</tr>
<tr>
<td>Total Cost</td>
<td>$90</td>
<td>$10</td>
</tr>
<tr>
<td>Less Revenue</td>
<td>$90</td>
<td>$10</td>
</tr>
<tr>
<td>Net Cost</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>
What reports (other than your financial statements) are available that provide information about premium pricing, unearned revenue, future estimated losses, and projections of future fiscal year results?

• The premium prices and actuarial methodology are available on RMA’s public website at: [http://www.rma.usda.gov/](http://www.rma.usda.gov/)

• Whitepaper on Loss Projection Methodology is available upon request.
Points of Contact

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(816) 926-1684

Shanda Sander, Special Assistant to CFO  
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(816) 926-2654

Michael Drewel, Accounting Officer  
michael.Drewel@rma.usda.gov  
(816) 926-1872
National Flood Insurance Program

A Discussion in Three Parts:
— The Nature of Flood Risk
— An Overview of the NFIP
— FASAB - Q&A

Presented to:
FASAB Insurance Program Education Session
December 17, 2014
“FLOODS ARE AN ACT OF GOD; FLOOD DAMAGES RESULT FROM ACTS OF MEN.”

H.D. 465
Nature of Flood Risk

1920-1959

1960-1999
Nature of Flood Risk

US Mainland Hurricane Strikes
Average per Year by Category

- Category 1,2
- Category 3,4,5
- All Categories

1900-1969
1970-1996
Nature of Flood Risk

Average Loss Cost* Per Policy (Trended to 2015)

Hurricane Katrina:

Estimated →

Untrended  Earned Exposure (Millions)

FEMA
Nature of Flood Risk

Average Loss Cost* Per Policy (Trended to 2015)

Hurricane Katrina:
Avg Loss Cost of $4,700
Nature of Flood Risk

Average Loss Cost* Per Policy (Trended to 2015)
NFIP Overview – Rate Model

A Probabilistic Hydrologic Model

\[
\text{RATE} = \left[ \max_{i=\text{Min}} \left( PELV_i \times DELV_i \right) \right] \times \frac{LADJ \times DED \times UINS}{\text{EXLOSS}}
\]

- PELV is the probability that flood waters reach a certain depth (frequency)
- DELV is the ratio of the flood damage to the value of the insurable properties (severity)
- LADJ, DED, UINS Loss adjustment expenses, underinsurance, and deductible
- EXLOSS is the loading for expenses and contingency
### NFIP Overview - Severity

Expected Damages for $250,000 of Building Coverage on a $295,000 Structure that is 8 Feet below BFE

<table>
<thead>
<tr>
<th>Depth in Structure (ft)</th>
<th>Percent Damage</th>
<th>Damage Amount</th>
<th>Less Deductible</th>
<th>ALAE</th>
<th>ULAE and SALAE</th>
<th>Paid Loss and LAE</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.5 and up</td>
<td>78.4%</td>
<td>$230,701.57</td>
<td>$229,701.57</td>
<td>$5,972.24</td>
<td>$3,904.93</td>
<td>$239,578.74</td>
</tr>
<tr>
<td>12.0 to 12.5</td>
<td>73.8%</td>
<td>$217,073.69</td>
<td>$216,073.69</td>
<td>$5,617.92</td>
<td>$3,673.25</td>
<td>$225,364.86</td>
</tr>
<tr>
<td>11.0 to 12.0</td>
<td>73.1%</td>
<td>$215,103.73</td>
<td>$214,103.73</td>
<td>$5,566.70</td>
<td>$3,639.76</td>
<td>$223,310.19</td>
</tr>
<tr>
<td>10.0 to 11.0</td>
<td>70.5%</td>
<td>$207,347.61</td>
<td>$206,347.61</td>
<td>$5,365.04</td>
<td>$3,507.91</td>
<td>$215,220.56</td>
</tr>
<tr>
<td>9.0 to 10.0</td>
<td>68.0%</td>
<td>$199,856.35</td>
<td>$198,856.35</td>
<td>$5,170.27</td>
<td>$3,380.56</td>
<td>$207,407.18</td>
</tr>
<tr>
<td>8.0 to 9.0</td>
<td>63.5%</td>
<td>$186,841.53</td>
<td>$185,841.53</td>
<td>$4,831.88</td>
<td>$3,159.31</td>
<td>$193,832.71</td>
</tr>
<tr>
<td>7.0 to 8.0</td>
<td>59.6%</td>
<td>$175,328.49</td>
<td>$174,328.49</td>
<td>$4,532.54</td>
<td>$2,963.58</td>
<td>$181,824.61</td>
</tr>
<tr>
<td>6.0 to 7.0</td>
<td>54.2%</td>
<td>$159,315.80</td>
<td>$158,315.80</td>
<td>$4,116.21</td>
<td>$2,691.37</td>
<td>$165,123.38</td>
</tr>
<tr>
<td>5.0 to 6.0</td>
<td>48.9%</td>
<td>$143,936.04</td>
<td>$142,936.04</td>
<td>$3,716.34</td>
<td>$2,429.91</td>
<td>$149,082.29</td>
</tr>
<tr>
<td>4.0 to 5.0</td>
<td>41.9%</td>
<td>$123,200.58</td>
<td>$122,200.58</td>
<td>$3,400.00</td>
<td>$2,077.41</td>
<td>$127,677.99</td>
</tr>
<tr>
<td>3.0 to 4.0</td>
<td>33.2%</td>
<td>$97,648.74</td>
<td>$96,648.74</td>
<td>$3,286.06</td>
<td>$1,643.03</td>
<td>$101,577.83</td>
</tr>
<tr>
<td>2.0 to 3.0</td>
<td>28.6%</td>
<td>$83,979.90</td>
<td>$82,979.90</td>
<td>$2,821.32</td>
<td>$1,410.66</td>
<td>$87,211.87</td>
</tr>
<tr>
<td>1.0 to 2.0</td>
<td>23.3%</td>
<td>$68,505.15</td>
<td>$67,505.15</td>
<td>$2,295.18</td>
<td>$1,147.59</td>
<td>$70,947.91</td>
</tr>
<tr>
<td>0.0 to 1.0</td>
<td>16.6%</td>
<td>$48,966.01</td>
<td>$47,966.01</td>
<td>$1,640.00</td>
<td>$815.42</td>
<td>$50,421.43</td>
</tr>
<tr>
<td>-0.5 to 0.0</td>
<td>3.5%</td>
<td>$10,294.12</td>
<td>$9,294.12</td>
<td>$970.00</td>
<td>$158.00</td>
<td>$10,422.12</td>
</tr>
<tr>
<td>-0.5 and below</td>
<td>0.0%</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
</tbody>
</table>
### NFIP Overview – Frequency x Severity

**Expected Paid Loss & LAE for $250,000 of Building Coverage on a $295,000 Structure that is 8 Feet below BFE**

<table>
<thead>
<tr>
<th>Depth in Structure</th>
<th>Probability in range</th>
<th>Paid Loss and LAE</th>
<th>Expected NFIF Loss</th>
<th>with Contingency Load</th>
</tr>
</thead>
<tbody>
<tr>
<td>12.5 and up</td>
<td>0.2%</td>
<td>$239,578.74</td>
<td>$477.92</td>
<td>$573.50</td>
</tr>
<tr>
<td>12.0 to 12.5</td>
<td>0.1%</td>
<td>$225,364.86</td>
<td>$113.98</td>
<td>$136.78</td>
</tr>
<tr>
<td>11.0 to 12.0</td>
<td>0.1%</td>
<td>$223,310.19</td>
<td>$278.57</td>
<td>$334.29</td>
</tr>
<tr>
<td>10.0 to 11.0</td>
<td>0.2%</td>
<td>$215,220.56</td>
<td>$340.65</td>
<td>$408.78</td>
</tr>
<tr>
<td>9.0 to 10.0</td>
<td>0.2%</td>
<td>$207,407.18</td>
<td>$403.90</td>
<td>$484.68</td>
</tr>
<tr>
<td>8.0 to 9.0</td>
<td>0.3%</td>
<td>$193,832.71</td>
<td>$542.10</td>
<td>$650.52</td>
</tr>
<tr>
<td>7.0 to 8.0</td>
<td>0.3%</td>
<td>$181,824.61</td>
<td>$534.85</td>
<td>$641.81</td>
</tr>
<tr>
<td>6.0 to 7.0</td>
<td>0.4%</td>
<td>$165,123.38</td>
<td>$591.91</td>
<td>$710.29</td>
</tr>
<tr>
<td>5.0 to 6.0</td>
<td>0.4%</td>
<td>$149,082.29</td>
<td>$660.29</td>
<td>$792.35</td>
</tr>
<tr>
<td>4.0 to 5.0</td>
<td>0.7%</td>
<td>$127,677.99</td>
<td>$845.47</td>
<td>$1,014.57</td>
</tr>
<tr>
<td>3.0 to 4.0</td>
<td>0.7%</td>
<td>$101,577.83</td>
<td>$750.23</td>
<td>$900.27</td>
</tr>
<tr>
<td>2.0 to 3.0</td>
<td>1.0%</td>
<td>$87,211.87</td>
<td>$832.23</td>
<td>$998.68</td>
</tr>
<tr>
<td>1.0 to 2.0</td>
<td>1.2%</td>
<td>$70,947.91</td>
<td>$881.15</td>
<td>$1,057.38</td>
</tr>
<tr>
<td>0.0 to 1.0</td>
<td>1.9%</td>
<td>$50,421.43</td>
<td>$974.96</td>
<td>$1,169.96</td>
</tr>
<tr>
<td>-0.5 to 0.0</td>
<td>1.0%</td>
<td>$10,422.12</td>
<td>$107.10</td>
<td>$128.52</td>
</tr>
<tr>
<td>-0.5 and below</td>
<td>91.3%</td>
<td>$ -</td>
<td>$ -</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0%</td>
<td><strong>$8,335.32</strong></td>
<td><strong>$10,002.38</strong></td>
<td></td>
</tr>
</tbody>
</table>
Actual Premium can significantly vary by the elevation of the structure relative to the flood risk.

**Premium at 4 Feet Below Base Flood Elevation**
- $9,500/year
- $95,000/10 years

**Premium at Base Flood Elevation**
- $1,410/year
- $14,100/10 years

**Premium at 3 Feet Above Base Flood Elevation**
- $427/year
- $4,270/10 years

*250,000 building coverage only (does not include contents), AE (high to moderate risk) zone, single-family, one-story structure without a basement at: 4 feet below Base Flood Elevation (BFE); at BFE; and at 3 feet above BFE. (Rating per FEMA flood insurance manual, October 1, 2012). The illustration above is based on a standard National Flood Insurance Program (NFIP) deductible.*
The NFIP – more than insurance

The NFIP is a voluntary Federal program enabling property owners in participating communities to purchase insurance against flood losses in exchange for adopting and enforcing regulations that reduce future flood damages. A participating community’s floodplain management regulations, must meet or exceed the NFIP minimum requirements.
NFIP Overview

Subsidized Policies

- Emergency Program – Communities newly entering the NFIP
- Pre-FIRM Subsidized – older structures built before their community’s initial Flood Insurance Rate Map (FIRM) was developed.
- Levees in the course of construction (A99 Zone) or reconstruction (AR Zone)
- Pre-1981 VE Zone structures
- Group Flood Insurance Policies (GFIP) for recipients of Individual Assistance
NFIP Overview: Policyholder Subsidies
FASAB’s Questions about an Insurance Program’s Premium & Claims

- How are the pricing policies determined for premiums?
- Who sets the pricing policy for the premiums?
- When does your program bill for premiums and recognize revenue/uneearned revenue?
- Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?
- What reports (other than your financial statements) are available that provide information about premium pricing, unearned revenue, future estimated losses, and projections of future fiscal year results?
**FASAB’s Questions about an Insurance Program’s Premium & Claims**

**Q1: How are the pricing policies determined for premiums?**

**A:** FEMA’s actuaries and underwriters annually review the pricing and classification structure of the NFIP. They recommend changes for management approval. The annual review process incorporates any recent legislative changes such as the Biggert-Waters Flood Insurance Reform Act of 2012 (BW-12) and the recent Homeowner Flood Insurance Affordability Act (HFIAA) of 2014.

**How are the pricing policies determined for premiums?**

<table>
<thead>
<tr>
<th>Who sets the pricing policy for the premiums?</th>
</tr>
</thead>
<tbody>
<tr>
<td>When does your program bill for premiums and recognize revenue/uneearned revenue?</td>
</tr>
<tr>
<td>Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?</td>
</tr>
<tr>
<td>What reports (other than your financial statements) are available that provide information about premium pricing, unearned revenue, future estimated losses, and projections of future fiscal year results?</td>
</tr>
</tbody>
</table>
Q2: Who sets the pricing policy for the premiums?

A: There are two types of premiums for NFIP policyholders – actuarial (i.e., full-risk) premiums and subsidized (i.e. less than full-risk, or “discounted”) premiums.

FEMA’s actuaries, in accordance with Actuarial Standards of Practice (ASOPs) and in compliance with the National Flood Insurance Act of 1968, as amended, make recommended revisions to FEMA management.

Premium rates for actuarial premiums are made using an accepted actuarial “frequency and severity” approach as described earlier in this presentation.
Q3: When does your program bill for premiums and recognize revenue/uneearned revenue?

A: The NFIP sells policies on individual structures (i.e., buildings). The policyholder pays the entire annual premium on or, more commonly, before the effective date of the policy.

Premiums are recognized as the Program receives the premium. An unearned premium reserve is established for each individual policy and earned in a uniform basis over the life of the policy.
Q4: Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?

A: Preface: In answering this question, we assume that the question is focused on
(i) losses from future flood events that happen after the end of the reporting period
(ii) on policies that
   a. were in-force on the statement date and
   b. were still in-force when the future flooding event occurs.

Losses that occurred on or prior to the end of the reporting period but are still in the process of being reported, investigated and paid are part of the “Loss and Loss Adjustment Expense Reserve” on the Financial Statement.
Q4: *Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?*

A: The Balance Sheet of the NFIP does not contain a line item for estimated claims that might occur during the remaining open policy period following the end of the reporting period. Since an unearned premium liability is carried, the Balance Sheet would need only carry the amount, if any, by which such a claims estimate exceeds the unearned premium reserve liability. Due to the extreme variability of flooding, most years the unearned premium will be sufficient to pay such future losses. Therefore, the NFIP Financial Statement documents this future risk in a “Risk Assumed” Note.
Q5: What reports (other than your financial statements) are available that provide information about premium pricing, unearned revenue, future estimated losses, and projections of future fiscal year results?

A: Annual Actuarial Rate Review found at:

Flood Insurance Rate Manual found at:
https://www.fema.gov/media-library/assets/documents/97901

Statement of Actuarial Opinion (Reserve Valuation as of September 30, 2014) – copies will be provided at meeting

Risk Assumed Note – copies will be provided at meeting

How are the pricing policies determined for premiums?

Who sets the pricing policy for the premiums?

When does your program bill for premiums and recognize revenue/uneearned revenue?

Does your program estimate claims for the remaining open policy period following the end of the reporting period? If yes, how?

What reports (other than your financial statements) are available that provide information about premium pricing, unearned revenue, future estimated losses, and projections of future fiscal year results?