
Statement of Federal Financial Accounting Standards 51: Insurance Programs

Status

Issued	January 18, 2017
Effective Date	For periods beginning after September 30, 2018.
Interpretations and Technical Releases	None.
Affects	SFFAS 5, rescinds par. 97-121.
Affected by	None.

Summary

This Statement establishes accounting and financial reporting standards for insurance programs. It provides standards to ensure that insurance programs are adequately defined and report consistent information about the liabilities for losses incurred and claimed as well as expected losses during remaining coverage. These standards replace the insurance and guarantee program standards provided in paragraphs 97-121 of Statement of Federal Financial Accounting Standards 5, *Accounting for Liabilities of The Federal Government*.

To support consistency, this Statement identifies three categories: 1) exchange transaction insurance programs other than life insurance, 2) nonexchange transaction insurance programs, and 3) life insurance programs. Insurance programs are categorized based upon the type of revenue received as defined by Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

This Statement provides guidance as to how and when insurance programs should recognize revenue, expenses, and liabilities according to the aforementioned categories. The recognition, measurement, and disclosure guidance provides for concise, meaningful, and transparent information regarding the operating performance of insurance programs.

Insurance Programs is the first phase in a multiple phase project entitled *Risk Assumed*. Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.

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.

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Standards

Scope

1. This Statement applies when a reporting entity is presenting general purpose federal financial reports (GPFFRs), including the consolidated financial report of the 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*.
2. This Statement provides general principles that should guide preparers of GPFFRs in accounting for and reporting on exchange and nonexchange insurance transactions, related claims and liabilities, losses, and costs of insurance programs. Other items related to insurance program activities such as revenue classification that are not addressed in this Statement should be reported in accordance with other standards.
3. This Statement rescinds the Insurance and Guarantees section in SFFAS 5, *Accounting for Liabilities of The Federal Government, paragraphs 97-121*.
4. 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 5 through 21 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards

5. **Insurance Program-** "insurance program" is a general term used to refer to a 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.
6. The following are excluded from insurance programs:
 - a. Programs that administer direct loans and loan guarantees¹
 - b. Programs that qualify as social insurance²
 - c. Programs authorized to engage in disaster relief activities³
 - d. Programs that provide grants
 - e. Programs that provide benefits or assistance based on an individual's or a household's income and/or assets
 - f. Programs that assume the risk of loss arising from federal government operations⁴
 - g. Programs that pay claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency⁵

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

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

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 For example, see Government Accountability Office (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.

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- h. Programs that indemnify contractors, agreement partners, and other third parties for loss or damage incurred while or caused by work performed for a federal agency⁶
 - i. Workers' or occupational illness compensation 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
 7. **Adverse Event**—an "adverse event" may be a single-occurring event or a series of events that cause losses to the beneficiary or beneficiaries as identified in the insurance arrangement.
 8. **Cash Surrender Value**—the "cash surrender value" is the sum of money that will be returned to the policyholder on a life insurance policy if the policy is canceled before its maturity or the insured event (death) occurs.
 9. **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.
 10. **Arrangement Period**—"arrangement period" is the period over which adverse events that occur are covered.
 11. **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
 12. **In-Force**—"in-force" refers to arrangements that are unexpired as of a given date.
 13. **Incurred But Not Reported (IBNR)**—claims "incurred but not reported" (IBNR) are estimated claims from events that have occurred as of the end of the reporting period but have not yet been reported for settlement.

⁶ These are administrative settlements for transactions with contractors under the Federal Acquisition Regulation's authorized indemnification clauses, as well as authorized indemnification clauses within other legally binding arrangements. First responders within programs that do not have a statutory insurance or guarantee mission are also within this scope.

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

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14. **Insurance Claim**—an "insurance claim" is a formal request for payment for losses as authorized under the insurance arrangement.
15. **Insurance Arrangement (Arrangement)**—an "insurance arrangement" (arrangement) is a general term used for a contract or other agreement between an insurance program and specific parties, such as but not limited to individuals, state, local, or foreign governments, other federal agencies, or businesses. An arrangement may include and/or identify:
- a. the term the insurance arrangement 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 or parties and their premium requirements,
 - f. the beneficiary or beneficiaries and their responsibilities for filing claims, and/or
 - g. the financial compensation.
16. **Insurance Portfolio**—an "insurance portfolio" is a grouping of insurance programs or arrangements that have some meaningful relationship based on arrangement period/duration, shared risks, management, customers, geographic regions, or other factors.
17. **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 arrangement period.

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18. **Life Insurance Programs**—“life insurance programs” cover the risk of loss from death of individuals.
 19. **Nonexchange Transaction Insurance Programs**—“nonexchange transaction insurance programs” cover the risk of loss from adverse events through nonexchange transactions, as defined in SFFAS 7.
 20. **Premiums**— “premiums” is a general term used to refer to exchange revenue⁸ billed by insurance programs. Programs may refer to their exchange revenue by various terms, including but not limited to premiums, assessments, and/or fees.
 21. **Recoveries**—“recoveries” include monies:
 - 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. received from adjustments made to previously paid insurance claims.

Exchange Transaction Insurance Programs Other Than Life Insurance

22. Exchange transaction insurance programs other than life insurance collect premiums through arrangements to cover the risk of loss from adverse events other than death of individuals.
23. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

⁸See 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.

Recognition and Measurement

Revenue and Liability for Unearned Premiums

24. Premiums should be recognized as revenue when earned over the period of the arrangement in proportion to insurance protection provided.
25. 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 arrangement period.

Liability for Unpaid Insurance Claims

26. 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.
27. 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 single-occurring event or 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 causes claims IBNR prior to the reporting date.
 - b. related estimated CAE, and
 - c. estimated inflows from recoveries not realized at the end of the reporting period.

⁹If 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 claims IBNR.

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- i. If estimated recoveries exceed the related claims for an insurance portfolio 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.
 28. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.
 29. Guidance from SFFAS 39, *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statement on Auditing Standards*, applies to subsequent events relating to unpaid insurance claims.

Liability for Losses on Remaining Coverage

30. The liability for losses on remaining coverage as of the end of the reporting period represents the estimated amounts to be paid to settle claims (including CAE) for the remaining open arrangement period in excess of the sum of both:
 - a. related unearned premiums as of the end of the reporting period and
 - b. premiums due after the end of the reporting period that relate to the remaining open arrangement period.
31. Estimates should be determined by considering insurance portfolios rather than individual arrangements.
32. The liability should be estimated using methods designed to address uncertainties concerning future events.
33. The objective of such methods is a reasonable estimate of expected cash flow. While there are various ways to determine expected cash flow, methods using Actuarial Standards of Practice¹¹ are generally appropriate.
34. No specific method is required. An entity must use judgment based on the risk inherent in the insurance portfolio, sensitivity to external factors, and the availability of relevant

¹⁰Any 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.

¹¹See <http://www.actuarialstandardsboard.org/standards-of-practice/> (last accessed October 18, 2016).

information to select a method. A reporting entity should consider all relevant information at the balance sheet date. This information may include:

- a. historical experience;
 - b. adjustments to historical experience for differences in current conditions;
 - c. current conditions;
 - d. trends;
 - e. assumptions about future events;
 - f. risk factors;
 - g. uncertainties about possible variations in the amount or timing of the potential settlement of claims; and
 - h. as appropriate, data, projections, and supporting analysis supplied by independent expert(s).
35. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to losses on remaining coverage should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.
36. 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.)
37. Adjustments to the liability for losses on remaining coverage should be recognized as a component of claims expense.

Disclosure Requirements

Factors in Determining Disclosures

38. Materiality is an overarching consideration in financial reporting for information that should be presented regarding exchange transaction insurance programs other than life insurance. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating

large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.

39. 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

40. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:
- 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. Full costs,¹² premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing
 - c. Investing activities, such as buying treasury securities
 - d. Arrangement 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 of estimated amounts to be paid to settle future claims, including:
 - i. the basis and estimation method
 - ii. significant risk assumptions and factors, including relevant trend information
 - iii. how much risk, if any, is shared by third parties

¹² See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

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- g. The total amount of coverage provided through insurance in-force as of the end of the reporting period¹³
 - 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
41. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:
- a. Beginning balance
 - b. Claims expense
 - c. CAE¹⁴
 - d. Payments to settle claims
 - e. Recoveries and other adjustments
 - f. Ending balance

Nonexchange Transaction Insurance Programs

42. Nonexchange insurance programs collect funds on demand and/or receive appropriations to cover the risk of loss from certain adverse events.
43. An insurance program other than a life insurance program receiving any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.

¹³ 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.

¹⁴ Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

Recognition and Measurement

Revenue

44. Nonexchange transaction insurance programs should apply general revenue recognition standards as found in SFFAS 7 (as amended).

Liability for Unpaid Insurance Claims

45. 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.
46. The estimated settlement amount includes:
- a. outflows to liquidate:
 - i. claims that have been reported but not paid
 - ii. claims 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.¹⁵
 - (2.) Management should use judgment to determine if an adverse event causes claims IBNR prior to the reporting date.
 - b. related estimated CAE, 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.¹⁶

¹⁵If 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 claims IBNR.

¹⁶Any 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; a contingent gain cannot be recognized until realized.

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- ii. Recoveries should be recognized as reductions of claims, rather than as revenue.
47. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.
48. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

Disclosure Requirements

Factors in Determining Disclosures

49. Materiality is an overarching consideration in financial reporting for information that should be presented regarding nonexchange transaction insurance programs. Materiality judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements is of immediate concern to constituents, politically sensitive, and/or controversial.
50. 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 GPFER but which relate to the insurance program.

Disclosures Applicable to Component Reporting Entities

51. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:
- 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. Full costs,¹⁷ premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing
 - c. Investing activities, such as buying treasury securities

¹⁷See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, paragraphs 80 -104.

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- 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
52. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:
- a. Beginning balance
 - b. Claims expenses
 - c. CAE¹⁸
 - d. Payments to settle claims
 - e. Recoveries and other adjustments
 - f. Ending balance

Life Insurance Programs

53. Life insurance programs collect premiums for life insurance arrangements to cover the risk of loss from death of individuals.

Recognition and Measurement

Revenue

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

Liability for Unpaid Insurance Claims

55. 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.
56. The estimated settlement amount includes:

¹⁸Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

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- a. outflows to liquidate:
 - i. claims that have been reported but not paid
 - ii. claims IBNR
 - b. related estimated CAE, 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 arrangements then recognition is limited to the amount of the related claims.¹⁹
 - ii. Recoveries should be recognized as reductions of claims, rather than as revenue.
57. Adjustments to the liability for unpaid insurance claims, other than those resulting from payments made to liquidate existing liability balances, should be recognized as a component of claims expense.
58. Guidance from SFFAS 39 applies to subsequent events relating to unpaid insurance claims.

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. SFFAS 39 addresses subsequent events and provides guidance regarding recognized and nonrecognized events. All subsequent events relating to the liability for future policy benefits should be classified as nonrecognized events. Nonrecognized events are to be disclosed in accordance with SFFAS 39, paragraph 15.
61. Estimates should be determined by considering insurance portfolios rather than individual arrangements.

¹⁹Any 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; a contingent gain cannot be recognized until realized.

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62. 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. (For more information, see SFFAS 33.)
 63. Changes in the liability for future policy benefits that result from periodic re-estimations should be recognized as an expense during the period in which the changes occur.
 64. The effects of changes in relevant law or policy should be recognized when those changes occur.

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 judgments consider both quantitative and qualitative factors. Acceptable quantitative factors may include whether certain groups of arrangements are accumulating large claim expenses or unpaid claim liability balances. Acceptable qualitative factors may include whether a group of arrangements 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. The following information should be provided for each material insurance portfolio, and/or in aggregate for all remaining insurance portfolios, and/or individual insurance arrangements:
 - a. The type of life insurance and specific characteristics of those products, such as when and how benefits are paid and what other government agencies 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. Full costs,²⁰ premiums collected, appropriations used, and borrowing needed during the reporting period, as well as the ability to repay borrowing

²⁰See SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, par. 80-104.

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- d. Investing activities, such as buying treasury securities
 - e. The nature and magnitude of uncertainty to estimate the amounts to be paid to settle future claims, including the basis and estimation method
 - i. Significant risk assumptions and factors, including relevant trend information
 - ii. How much risk, if any, is shared by third parties
 - f. The total value of life insurance policies issued—insurance in-force—at the end of the reporting period, which represents the maximum risk exposure²¹
 - g. 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
 - 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
68. Information for changes in the liability balance for unpaid insurance claims should be provided as follows:
- a. Beginning balance
 - b. Claims expenses
 - c. CAE²²
 - d. Payments to settle claims
 - e. Recoveries and other adjustments
 - f. Ending balance

²¹ 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.

²² Claims Adjustment Expenses should be recognized for claims occurring prior to the end of the current reporting period.

Disclosures Applicable to the Consolidated Financial Report of the U.S. Government

69 The CFR should disclose the following information:²³

- a. A broad description of insurance programs
- b. A general reference to relevant component reporting entity reports²⁴
- c. The balance for insurance program liabilities
- d. A narrative discussion of programs' ability or inability to repay any borrowing
- e. The total amount of coverage provided through insurance in-force as of the end of the reporting period²⁵

Effective

70. The requirements of this Statement are effective for reporting periods beginning after September 30, 2018.

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

²³ Disclosure is "reporting information in notes or narrative regarded as an integral part of the basic financial statements."

²⁴ 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, for example, smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations.

²⁵ Include an explanation about the insurance in-force amount that avoids the misleading inference that there is more than a remote likelihood that claims equal to this maximum risk exposure will be paid at the same time.

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.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

Project History

- A1. The Federal Accounting Standards Advisory Board (FASAB or “the Board”) undertook a project to improve the accounting and reporting of all significant risks assumed by the Federal Government. Due to the breadth of the *Risk Assumed* project, the Board decided to break it into multiple phases. These standards address the first phase – *Insurance Programs*. Other programs designed to manage risk for the federal government will be addressed by future research conducted under the *Risk Assumed* project.
- A2. FASAB undertook insurance programs as phase I of the *Risk Assumed* project because while paragraphs 97-121 in SFFAS 5 include a requirement to report risk assumed for insurance programs, the resulting information as reported by various agencies is not comparable. Further review found that it is challenging to determine the operational results and financial position of insurance programs.
- A3. In addition, the Board’s conceptual framework now provides a definition of liability and describes measurement attributes that were not available when FASAB developed SFFAS 5. Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for 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 Statement adopts the most current concepts so that the accounting principles for insurance liabilities provide comprehensive guidance for consistent reporting.

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- A4. 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 measuring uncertainty regarding estimating losses on open arrangements 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.
- A5. The Board formed a task force to assist in developing the proposed standards for insurance programs. Task force members included accounting, budget, and insurance subject matter experts from federal agencies and independent public accounting firms.
- A6. The task force met several times over the course of the project, delivered an education session to the Board, and also exchanged numerous ideas and recommendations electronically. Staff sought the task force's views and recommendations 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 the proposed standards and this Statement.

Summary of Outreach Efforts and Responses

- A7. FASAB issued the ED, titled *Insurance Programs*, on December 30, 2015, with comments requested by March 30, 2016.
- A8. Upon release of the ED, FASAB provided notices and press releases to the FASAB email listserv, the Federal Register, *FASAB News*, the *Journal of Accountancy*, Association of Government Accountants *Topics*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, the Chief Financial Officers Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

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- A9. FASAB followed up this broad announcement with direct mailings of the ED to the following relevant congressional committees:
- a. House Agriculture Committee
 - b. House Appropriations Committee
 - i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
 - ii. Subcommittee on Oversight and Government Reform
 - iii. Subcommittee on Homeland Security
 - c. House Budget Committee
 - d. House Committee on Veterans' Affairs
 - e. House Committee on Homeland Security —Subcommittee on Emergency Preparedness, Response, and Communications, Majority
 - f. House Committee on Financial Services
 - g. Senate Agriculture Committee
 - h. Senate Appropriations Committee
 - i. Subcommittee on Agriculture, Rural Development, Food and Drug Administration and Related Agencies
 - ii. Subcommittee on Homeland Security
 - i. Senate Committee on Banking, Housing, and Urban Affairs—Subcommittee on Securities, Insurance, and Investment
 - j. Senate Budget Committee
 - k. Senate Committee on Finance
 - l. Senate Committee on Health, Education, Labor & Pensions
 - m. Senate Committee on Homeland Security and Governmental Affairs
 - n. Senate Committee on Veterans' Affairs
- A10. FASAB received 18 responses from preparers, auditors, professional associations, and citizens. The majority of respondents agreed with proposals for new definitions and exclusions; they also agreed with the three categories: exchange transaction insurance programs other than life insurance, nonexchange transaction insurance programs, and life insurance programs for reporting insurance programs.
- A11. However, the auditors and accounting associations disagreed with the proposals for how to estimate the settlement of future claims for the liability for losses on remaining coverage.
- A12. Some respondents also identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.
- A13. The Board did not rely on the number in favor of or opposed to a given position. Staff provides the Board information about the respondents' majority view only as a means of

summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized in the following section.

Key Areas of Improvement

- A14. SFFAS 5 resulted in inconsistent reporting among insurance programs due to the absence of definitions and use of terms like 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. clarity for what programs are excluded,
 - c. guidance for revenue recognition and unearned premiums,
 - d. consistent recognition of liabilities including future loss estimates, and
 - e. structured disclosure requirements.

Definitions of Relevant Terms and Excluded Activities

- A15. During the initial phase of the project, the Board determined that definitions of relevant terms would be necessary for consistent reporting. Staff worked extensively with the task force to develop these definitions. The Board decided to use general terms to include all current insurance and future insurance programs in this Statement. The Board determined that the following provided the foundation for the definitions developed for this project.
- a. Insurance Program—while most respondents did agree with the definition, programs that were not structured like commercial insurance programs with actual contracts requested clarification. In addition, respondents found inclusion of the term “non-loan guarantee” in the definition confusing; this was subsequently removed. Therefore, the Board defined a federal insurance program by its fundamental nature. The substance—and not the name—of a program determines if it is an insurance program and therefore subject to these standards.
 - i. Exclusions—a number of respondents requested clarification on what activities were excluded from this Statement. One respondent requested that the Board expand upon the exclusion of entitlement programs to avoid excluding insurance

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- programs that perform entitlement-like activities but are actually insurance programs.
- ii. One respondent recommended including fiduciary funds, workers' compensation programs, and programs established to pay claims on adverse events that occurred in the past.
 - iii. A number of respondents requested that the Board provide context to explain the exclusions in this proposed standard.
- b. Therefore, the Board amended the wording of certain exclusions to aid in assessing the programs and activities that should be excluded.
- c. Each of the activities and programs excluded involve risk and, therefore, share a characteristic of insurance programs. The Board concluded that judgment is required in applying the exclusions and that providing context may aid in making such judgments. The rationale for each exclusion is presented below:
- i. Programs that administer direct loans and loan guarantees are excluded because standards for these programs are provided in SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*.
 - ii. Programs that qualify as social insurance are excluded because standards for these programs are provided in SFFAS 17, *Accounting for Social Insurance* (including unemployment insurance).
 - iii. Programs authorized to engage in disaster relief activities are excluded because while benefits are based on losses from adverse events, coverage is available broadly to the population and benefits may not be as clearly defined as in insurance programs. These aspects make it more challenging to apply the recognition and measurement provisions of this Statement. Disaster relief activities will be addressed in a later phase of risk assumed.
 - iv. Programs that provide grants are excluded because while grants may be based on losses from adverse events, other criteria make it more challenging to apply the recognition and measurement provisions of this Statement.
 - v. Programs that provide benefits or financial assistance based on an individual's or a household's income and/or assets are excluded because while an adverse event may be a cause of the income/asset criteria, it is the criteria that determine the benefits or assistance and not the event behind it.
 - vi. Programs that assume the risk of loss arising from federal government operations; workers' or occupational illness compensation programs; programs that pay

claims through an administrative or judicial role for individuals or organizations who claim they have been harmed by a federal agency; and programs that indemnify contractors, arrangement partners, and other third parties for loss or damages incurred while or caused by work performed for a federal agency are excluded. The Board updated these exclusions by removing a reference to self-insurance and missions because these terms were unclear to respondents. The Board determined that the cost incurred for such activities and programs are part of the full cost of doing business. For example, a program with fleet vehicles that pays for damage from accidents out of funds designated as operation and maintenance would include such costs in the overall program cost.

- d. Adverse Event—each insurance program is responsible for settling losses that result from specific adverse events. The Board learned through an education session with the Federal Crop Insurance Corp 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.
- e. Insurance Arrangement—while most respondents agreed with the term “contract” some respondents noted that they do not have formal contracts and may then be excluded from this Statement. The task force provided information that exchange transaction insurance programs and life insurance programs engage in an explicit agreement or arrangement. The Board decided to change the term from “insurance contract” to “insurance arrangement” to capture the nature of the arrangement as defined by law or regulation. Therefore, the definition of an insurance arrangement includes the elements that insurance programs agree upon to provide settlement of losses to beneficiaries.
- f. Insurance Portfolios—one respondent requested that the Board define insurance portfolios and refer to that term consistently throughout the Statement. The Board agreed and added a definition for insurance portfolios.
- g. 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.

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- iii. Life insurance programs cover the risk of loss from death of individuals.
- h. A number of respondents requested additional information for better understanding of the exchange and nonexchange transaction categories other than life insurance. In particular, respondents wanted to know (1) how to determine if a program should be classified as a nonexchange transaction insurance program and (2) how to classify a program if it receives both exchange and nonexchange revenue.
- i. The Board's intention for the exchange transaction insurance programs other than life insurance and nonexchange transaction insurance programs is to define these categories in relation to the revenue standards in SFFAS 7.
- ii. Some respondents were confused by the Board's reference to only SFFAS 7 and not SFFAS 5 in defining these categories. SFFAS 7 and SFFAS 5 each define exchange transactions as occurring when "each party to the transaction sacrifices value and receives value in return."²⁶ The Board determined that classifying the programs based on the type of revenue received would be straightforward and that no other substantive difference would result.
- iii. 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.
- iv. The Board notes that some insurance programs may be funded with both exchange and nonexchange revenue. The Board concluded that a program other than life insurance that receives any exchange revenue should be designated as an exchange transaction insurance program other than life insurance.
- v. Nonexchange transaction insurance programs cover the risk of loss from adverse events through nonexchange transactions, such as collection of nonexchange revenue or use of appropriations. For example, some levy:
- (1) excise taxes which, like other taxes, are determined by the government's power to compel payment and are classified by SFFAS 7, paragraph 243 as nonexchange revenue;
 - (2) surcharges which, like excise taxes, are determined by the government's power to compel mandatory recoupment of the federal share of pay for losses.

²⁶ See SFFAS 5, par. 22, and SFFAS 7, par. 33.

Revenue Recognition and Liability for Unearned Premiums

- A16. 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 arrangement period because insurance protection is provided evenly during the arrangement period. The premium of \$1,200 is collected on July 1. By September 30, three months have been covered earning the exchange program \$300. The remaining \$900 is unearned because the remaining arrangement period is still open into the next fiscal year: from October 1 through June 30. 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 held during a 12-month arrangement period. The premium of \$1,500 is collected on July 1. By September 30, 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 20, which is during the remaining arrangement period from October 1 through June 30. The \$500 is recognized separately on the balance sheet as unearned premium.
- A17. 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.
- A18. Life insurance programs do not recognize unearned premiums. The Board concluded that revenue from life insurance arrangements 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 arrangement. 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

- A19. 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.

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- 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 IBNR. 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 concluded that these are not claims IBNR and should not be included in the liability for unpaid claims. Nonetheless, for exchange transaction insurance programs other than life insurance, such series should 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 concluded that CAE should be included in the liability for unpaid claims for submitted and IBNR claims to recognize the full cost to settle claims.
- A20. Recognition of a liability for losses on remaining coverage is required for exchange transaction insurance programs other than life insurance.
- a. 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 arrangement period. The Board agrees and therefore decided to separate the liability for losses on remaining coverage from the liability from the unpaid claims portion.
 - b. The Board concluded that recognizing a reasonable estimate of future losses for the open arrangement period that extends beyond the end of the reporting period will remove ambiguity created by SFFAS 5 standards to recognize contingency liabilities.
 - c. According to SFFAS 5, paragraph 38, contingent liabilities must be recognized if a past transaction has occurred and a future outflow or other sacrifice of resources is probable and measureable. Under the new standards, the liability for losses on remaining coverage is the estimated future cash flows arising from adverse events that are expected to happen during the period that coverage will be provided. Therefore, the Board's next challenge was how to consistently address uncertainty regarding measurement.
 - d. Task force research showed that federal insurance programs were using a variety of statistical modeling methods to estimate future losses depending on their unique uncertainties and risk factors. For example, the Department of Agriculture's Risk Management Agency oversees crop insurance and relies upon a regression analysis;²⁷ the Department of Homeland Security's Federal Emergency Management

²⁷ 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.

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- Agency oversees flood insurance and relies on a lognormal distribution;²⁸ and the National Credit Union Administration uses an internal econometric model that applies estimated failure and loss rates, taking into account the historical loss history, insuree, risk ratings, insuree financial ratios, and other conditions.
- e. To address such measurement challenges, the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 7, paragraphs 44-54, describes a variety of pricing tools and methods for developing an expected cash flow estimate.
 - f. To allow for a variety of estimating methods for federal insurance programs, the ED required that programs should first use expected cash flow to estimate the cost to settle claims on remaining coverage. The ED acknowledged that there would be various methods available to estimate cash flows and probabilities. Further, the proposal provided that if expected cash flow estimates were not practical and appropriate, then an entity could estimate a single most-likely amount to be paid to settle future claims during the remaining open arrangement period.
 - g. A number of respondents were concerned with implementation of and auditing to the terms “practical and appropriate.”
 - h. In addition, one member believed 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. However, the majority of members still preferred expected cash flow to estimated cash flow. After discussion, all members agreed to allow any method for which the objective is a reasonable estimate of expected cash flows. This allows management the flexibility to choose a method that produces a reasonable estimate of expected cash flows specific to the program’s future adverse event uncertainties and risk factors.
- A21. 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 arrangement duration. These amounts are discounted to the present value to recognize the liability for future benefits.

²⁸ 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.

A22. Estimates for the liability for losses on remaining coverage and future policy benefits are recognized by insurance portfolios with similar characteristics, including arrangement duration. The Board decided not to define “arrangement duration” due to the subjective nature of duration. For example, one insurance program might determine that a 36-month arrangement is short-duration, while another assigns the arrangement to a long-duration group. Recognizing these liabilities by groups of arrangements allows judgment by each insurance program in defining the duration of their arrangements.

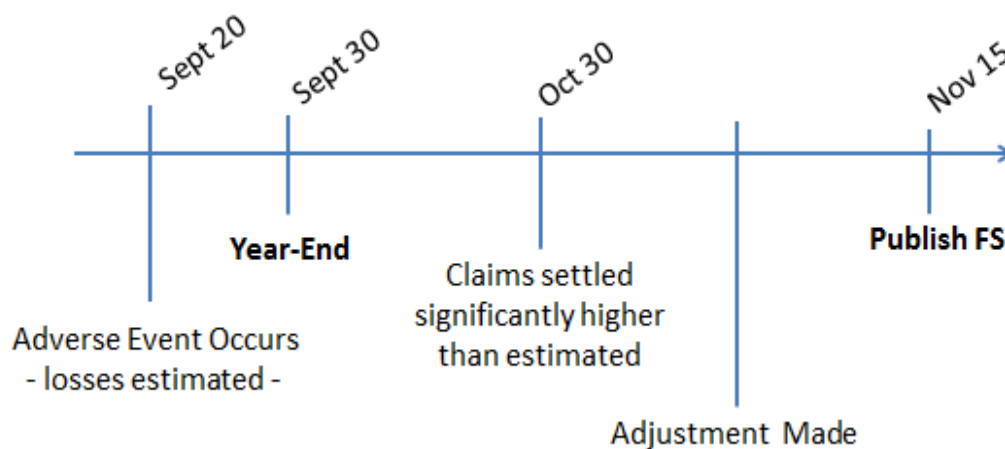
Subsequent Events

A23. Certain respondents requested clarification regarding subsequent events and the application of SFFAS 39 in relation to whether these standards are to add to or supplement SFFAS 39. The Board determined that the treatment of subsequent events should differ for the liability for unpaid insurance claims versus the liability for losses on remaining coverage as follows.

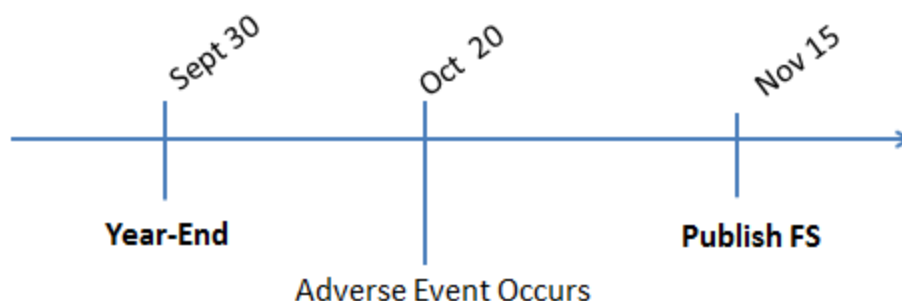
Liability for Unpaid Insurance Claims

A24. For the liability for unpaid insurance claims, 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 result in the adjustment of the financial statements, depending on whether it is a recognized or nonrecognized event. See SFFAS 39 for detailed guidance. Examples of subsequent events for insurance programs with a September 30 year-end and a November 15 financial statement (FS) publication date may include the following.

- a. Recognized event: claims settled on October 30 for an amount significantly different from the liability recorded for a major disaster that occurred on September 20 would require adjustment to the liability for unpaid claims in the financial statements.



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



Liability for Losses on Remaining Coverage

A25. The liability for losses on remaining coverage estimates future events. Due to the uncertainty of the occurrence, magnitude, and timing of these future events, the Board decided that all subsequent events relating to the liability for losses on remaining coverage should be classified as nonrecognized events in accordance with SFFAS 39, paragraph 15.

Disclosures

A26. 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.

Avoiding Duplicity of Information

- 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 concluded that the updated disclosures will avoid duplication by allowing insurance programs to reference relevant notes.

Changes in the Liability for Unpaid Insurance Claims

- c. For consistent reporting, the Board requires a reconciliation of the liability for unpaid claims that a number of insurance programs already produce. The Board reviewed the current reconciliations and consolidated relevant information for consistent reporting. All categories should report this information so readers receive consistent information.
- d. The Board concluded that requiring disclosure of full costs, premiums collected, appropriations used, borrowing needed during the reporting period, as well as the ability to repay the borrowing should provide a holistic picture of an insurance program's performance.

Insurance In-Force

- e. The Board concluded that disclosing the balance of insurance in-force as of the end of the reporting period will provide useful information as to the maximum risk exposure to the program. However, one respondent requested, and the Board subsequently agreed, to update the standard to provide more clarity on how the program should explain that paying the full amount of insurance in-force is very unlikely.

Low Probability, High Impact Adverse Events-Uncertainty

- f. Some respondents were concerned about how to disclose the uncertainty of adverse events, including those that are low probability, high impact (very rare, but upon occurrence causes extreme loss). The Board understands that uncertainty is subjective to each insurance program in relation to the risks it insures—which may cause extreme loss that is hard to estimate. Some programs may also encounter uncertainty in relation to a multitude of events that must occur over time and often do not occur within one reporting period.
 - i. The following are examples of hard to predict adverse events that may cause substantial losses: a “Katrina” type²⁹ of hurricane, a political uprising in a country that completely disrupts American businesses, or an unusual detrimental weather pattern combined with volatile commodity pricing.
 - ii. Due to this uncertainty in magnitude and timing, the Board concluded that the disclosure about estimating uncertainty allows management to discuss its particular constraints in determining the liability for losses on remaining coverage.

Disclosures – Financial Report of U.S. Government

A27. Disclosures for the financial report of the U.S. Government should be reported at a high level of detail. The Board concluded that detailed disclosures should be found at the component reporting entity level.

ADDENDUM

Board Approval

This Statement was approved unanimously. Written ballots are available for public inspection at FASAB’s office.

²⁹ Per FEMA - Hurricane Katrina was a long-lived hurricane that made landfall three times along the United States coast and reached Category 5 at its peak intensity... CNN reported that ...Hurricane Katrina is the costliest disaster in the history of the global insurance industry. The National Flood Insurance Program paid out \$16.3 billion in claims...Private Insurance companies have paid an estimated \$41.1 billion in claims.

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