Tab E – Appendices

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Excerpt from SFFAS 5, *Accounting for Liabilities of the Federal Government*

Contingencies

35. A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity. The uncertainty will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm a gain (i.e., acquisition of an asset or reduction of a liability) or a loss (i.e., loss or impairment of an asset or the incurrence of a liability).[17]

36. This Statement does not deal with gain contingencies or measurement of contingencies that involve impairment of nonfinancial assets. When a loss contingency (i.e., contingent liability) exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can range from probable to remote. The probability classifications are as follows:

- Probable: The future confirming event or events are more likely than not to occur, with the exception of pending or threatened litigation and unasserted claims. For pending or threatened litigation and unasserted claims, the future confirming event or events are likely to occur.
- Reasonably possible: The chance of the future confirming event or events occurring is more than remote but less than probable.
- Remote: The chance of the future event or events occurring is slight.

[17]Contingencies are different from "subsequent events." Subsequent events are events or transactions that affect the basic information or required supplementary information (RSI) and occur subsequent to the end of the reporting period but before the financial report is issued. Some of those transactions and events (referred to as recognized events) require adjustments to the basic information or RSI while others (referred to as nonrecognized events) may require disclosure in the basic information or RSI. A subsequent event may affect a contingency by providing information that resolves an uncertainty related to a contingent liability and confirm the impairment of an asset or incurrence of a liability as of the end of the reporting period.

Excerpt from SFFAS 5 (contd.)

37. The following are some examples of loss contingencies:

- collectability of receivables,
- pending or threatened litigation, and
- possible claims and assessments.

Criteria For Recognition Of A Contingent Liability

38. A contingent liability should be recognized when all of these three conditions are met:[18]

- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).[19]
- A future outflow or other sacrifice of resources is probable (e.g., the nonfederal entity has filed a legal claim against a federal entity for breach of contract and the federal entity's management believes the claim is likely to be settled in favor of the claimant).
- The future outflow or sacrifice of resources is measurable (e.g., the federal entity's management determines an estimated settlement amount). [See SFFAS 12.]

39. The estimated liability may be a specific amount or a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized and the range and a description of the nature of the contingency should be disclosed.

[18]The unit of analysis for estimating liabilities can vary according to the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, SFFAS Number 2, "applies to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category." Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*. par. 21. See the standard on Insurance and Guarantees in this document for a description of incurred but not reported (IBNR) claims.

[19]In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.

Excerpt from SFFAS 5 (contd.)

Criteria For Disclosure Of A Contingent Liability	40. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss may have been incurred. "Disclosure" in this context refers to reporting information in notes regarded as an integral part of the basic financial statements.
	41. Disclosure should include the nature of the contingency and an estimate of the possible liability, an estimate of the range of the possible liability, or a statement that such an estimate cannot be made.
	42. In some cases, contingencies may be identified but the degree of uncertainty is so great that no reporting (i.e., recognition or disclosure) is necessary in the general purpose federal financial reports. Specifically, contingencies classified as remote need not be reported in general purpose federal financial reports, though law may require such disclosures in special purpose reports. If information about remote contingencies or related to remote contingencies is included in general purpose federal financial reports (e.g., the total face amount of insurance and guarantees in force), it should be labeled in such a way to avoid the misleading inference that there is more than a remote chance of a loss of that amount.
	See SFFAS 7, par. 36b, for guidance on losses on contracts for goods made to order or services produced to order

Excerpt from SFFAS 5, Basis for Conclusions (BfC)

Conclusion On Contingencies

144. In the Exposure Draft the Board asked the following question. "When an estimated [contingent] liability is a range of amounts and no amount within the range is a better estimate than any other amount, should either the midpoint or, alternatively, the 'expected value' (as the term is used in statistics) be recognized as a liability instead of the minimum amount?" The majority of respondents preferred the expected value and the second preference was the minimum amount.

145. The Board further considered all of the options. Based on the Board discussions it was noted that it would be difficult to use "expected value" to pinpoint an estimate within a range. The expected value method would assign a probability percentage to each of the numbers within the range, but these probabilities would usually be difficult to estimate.

146. After much discussion the majority of the Board preferred the minimum amount because of its established use in other accounting standards. The Board decided that liabilities arising from nonexchange transactions would be recognized for any unpaid amounts due as of the reporting date. This includes amounts payable from the federal entity to pay for benefits, goods, or services[58] provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity (for example, estimated Medicaid payments due to health providers that will be financed by the federal entity but have not yet been reported to the federal entity).

147. In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions a liability would then be recognized at the point the amount is due. Therefore, government-acknowledged events do not meet the recognition criteria necessary to be recognized as a contingent liability. The government is acting in its sovereign capacity when it assumes financial responsibility and makes income transfer payments or provides other nonexchange benefits. The Board does not believe that accounting recognition should anticipate sovereign actions in advance of occurrence.

Excerpt from SFFAS 5, *Accounting for Liabilities of the Federal Government*

Insurance And Guarantees

Nature Of Federal Insurance And Guarantee Programs[47]

97. Insurance and guarantee programs are federal programs that provide protection to individuals or entities against specified risks. Many of these programs were established to assume risks that private sector entities are unable or unwilling to assume [at least at prices that beneficiaries of the program can afford (in some cases) or want to pay (in other cases)] or to subsidize the provision of insurance to achieve social objectives. Program participants pay fees or premiums for specific services. These funds are commonly held in revolving funds within the federal government; losses sustained by participants are paid from these funds. Many of these programs receive appropriations to pay excess claims and/or have authority to borrow from the Treasury.

98. For accounting purposes, private sector insurance and guarantee contracts are customarily divided into two types. The first type provides insurance protection for a fixed period. The insurer may cancel the coverage or adjust the provisions of coverage at the end of any coverage period, for example, by adjusting the amount of premiums charged or changing the conditions under which coverage is provided. Most property insurance and health insurance offered by private insurers is of this type.

99. The second type of insurance or guarantee contract is one in which the insurer cannot cancel the insurance or the insured is guaranteed the ability to renew it. The insurer must provide coverage for an extended period until the insured event occurs or can no longer occur, or when the insured party allows the policy to lapse. Examples of this type of insurance offered by private insurers include whole and guaranteed renewable term life insurance, annuities, and title insurance.

100. Federal programs provide protection against many types of risk for individuals and entities. These include life insurance; medical insurance; and insurance against damage to property (homes, crops, and airplanes) or other assets (deposits and pension benefits) caused by perils such as flooding and other natural disasters, war-risk, and insolvency.

[47]In the federal government, the aspects of insurance and guarantees are frequently commingled within the same program. Therefore, this Statement treats the terms as a single type of activity.

Excerpt from SFFAS 5 (contd.)

101. For federal insurance and guarantee programs, there often is no explicit contract. For example, the federal government, acting through the Pension Benefit Guaranty Corporation (PBGC), functions as an insurer of pension benefits, but the "contract" with employers and pension plans is implicit in federal law, not explicit in contracts between PBGC and employers. Moreover, the PBGC itself has no power to set premiums or to change the terms of coverage, though it may recommend changes to the Congress. The Congress has occasionally raised premiums and changed other factors, such as pension plan funding requirements, in an effort to achieve the statutory intent that the program be self-financing without appropriations from general revenue.[48] Companies with defined benefit pension plans must participate, but may (and sometimes do) elect to terminate their defined benefit pension plans.

102. Federal insurance programs also differ from private insurance in that they are not subject to the same market forces (e.g., competition for business and for capital) and regulatory requirements (e.g., for capitalization) that apply to privately owned insurers. In particular, federal insurance, unlike private insurance, is not extended with the intent of earning a profit. Some programs operate deliberately at a loss, as when disabled veterans are offered life insurance at premiums set for healthy participants. Other programs offer insurance covering catastrophic or systemic risks, where large losses can occur all at once, as in war-risk or deposit insurance. At most, federal insurance programs are expected just to meet anticipated costs, leaving them vulnerable to unfavorable surprises.

103. For this reason, the issue in accounting for federal insurance and guarantee programs is when to recognize net expected losses. In this respect, federal insurance programs are similar to federal credit programs. The federal government extends credit on terms and conditions designed to subsidize particular borrowers or encourage particular activities for social policy reasons. As soon as a federal direct loan or loan guarantee is obligated, the federal government is committed to bear whatever loss, through defaults or interest subsidies, is inherent in the terms and the conditions under which the credit is extended. The government is likewise committed when

[48] Further details on PBGC may be found in Controlling Losses of the Pension Benefit Guaranty Corporation, Congressional Budget Office, January 1993.

Excerpt from SFFAS 5 (contd.)

federal insurance is extended to additional policyholders, either for an additional fixed period, or to cover additional amounts of assets.

Accounting For Liabilities Of Federal Insurance And Guarantee Programs

104. All federal insurance and guarantee programs (except social insurance and loan guarantee programs[49]) should recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. The standard requires recognition of the liability that is known with certainty plus an accrual for a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. Insurance and guarantee programs should recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported and contingencies that meet the criteria for recognition. Life insurance programs should recognize a liability for future policy benefits (a liability to current policyholders that relates to insured events, such as death or disability) in addition to the liability for unpaid claims incurred. (See Contingencies section for the criteria for disclosure of a contingent liability.)

105. Risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs) and will be considered in the context of the Stewardship reporting. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. [See SFFAS 25, par. 4.]

Additional Disclosures For Insurance And Guarantee Programs Administered By Government Corporations

106. When financial information pursuant to FASB's standards on federal insurance and guarantee programs conducted by government corporations is incorporated in general purpose financial reports of a larger federal reporting entity, the entity should report as RSI what

[49]Social insurance is considered to be a different type of program not included within insurance and guarantee programs. See social insurance discussion in the FASAB ED, *Supplementary Stewardship Reporting*. Accounting for all federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees* (August 23, 1993).

Excerpt from SFFAS 5 (contd.)

amounts and periodic change in those amounts would be reported under the "risk assumed" approach referred to in this section (see par. 105). In other words, in addition to the liability for unpaid claims from insured events that have already occurred (including any contingent liability that meets criteria for recognition), such reporting entities should also report as RSI risk assumed information.

Illustrations Of The Application Of The Standard

107. Table 9 illustrates the application of the liability recognition, disclosure, and supplementary reporting standards for six federal insurance and guarantee programs. Two of these, flood and crop insurance, offer fixed period annual insurance. A third, deposit insurance, also can be said to offer fixed period annual insurance, though in practice it is continually renewed at the option of the insurer.[50] A fourth program listed, overseas private investment insurance, offers a fixed period multi-year written contract. The fifth program, life insurance, offers coverage that in practice is noncancelable by the insurer and guaranteed renewable by the insured, continuing until the insured event has occurred or the policy is cancelled by the insured. Finally, the pension benefit guarantee program is included as an example of noncancelable insurance. Pension insurance is characterized here as noncancelable with respect to vested guaranteed benefits earned by covered employees to date, on the assumption that this coverage would remain in effect even if the Congress ended the program.

108. The column numbered (3) in the table shows the point at which the standard requires a liability to be recognized for insurance and guarantee programs except life insurance. Column (3) recognizes all unpaid claims and expected claims resulting from insured events that have already occurred, whether floods, crop damage, overseas investment losses, bank closures and insolvencies, deaths, or pension plan terminations. The liability for unpaid claims is the estimated amount needed to settle claims relating to insured events that have occurred on or before the reporting date. This liability includes a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other

[50] In effect, FDIC's options are to renew the insurance coverage or to assume losses of the institution; only Congress can reduce or eliminate the deposit insurance program.

Excerpt from SFFAS 5 (contd.)

sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable.

109. The liability at the end of any period should be the expected unpaid net loss inherent in insured events that have occurred, including any claims –both claims reported and when appropriate, claims incurred but not reported (IBNR)– and any contingent liabilities that meet the criteria for recognition. When payments and losses extend beyond the current year, net losses should be calculated on a present value basis to reflect the time value of money. The expense for claims incurred in the reporting period should be recognized in that period. Changes in estimates of claim cost resulting from the present value calculations, the continuous review process, and differences between estimates and actual payments for claims should be recognized as charges against operations of the period in which the estimates are changed or payments are made.

110. Liability recognition for life insurance programs spans over columns (3) and (4). The column numbered (4) in the table shows the point at which the standard requires liability recognition for life insurance and supplementary reporting for other insurance and guarantee programs. The supplementary reported amounts represent the present value of unpaid expected losses based on the risk assumed as a result of insurance coverage net of associated premiums.

Excerpt from SFFAS 5 (contd.)

Table 9 [Note: The below underlined items are recognized liabilities.]

Liability Recognition, Supplementary Information And Disclosure			
(1) Type of insurance	**(2) Example of program**	**(3) Insured event has occurred**	**(4) Risk assumed**
Fixed period, annual	National Flood Insurance	CLAIMS + IBNR FOR FLOODS TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Fixed period, annual	Federal Crop Insurance	CLAIMS + IBNR FOR DAMAGE TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Fixed period, annual	Federal Deposit Insurance	CLAIMS + PV OF COST FOR DEPOSITORIES IN PROCESS OF CLOSURE BY THE END OF THE REPORTING PERIOD; AND THE ESTIMATED LOSS FOR THE PROBABLE COST FOR INSTITUTIONS THAT HAVE NOT YET FAILED BUT THE REGULATORY PROCESS HAS IDENTIFIED AS EITHER EQUITY INSOLVENT OR IN-SUBSTANCE EQUITY INSOLVENT OR LIKELY TO BECOME IN-SUBSTANCE EQUITY INSOLVENT WITHIN THE FORESEEABLE FUTURE.	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Fixed period, Multi-year	Overseas Investment Insurance	CLAIMS + IBNR FOR LOSSES TO END OF PERIOD	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Noncancelable or renewable	Pension Benefit Guarantee	CLAIMS + IBNR; PV OF UNFUNDED GUARANTEED BENEFITS FOR PLANS TERMINATED OR MORE LIKELY THAN NOT TO BE TERMINATED	The present value of unpaid expected losses net of associated premiums, based on the risk assumed as a result of insurance or guarantee coverage.
Noncancelable or renewable	VA Life Insurance	CLAIMS + IBNR (PLUS RESERVE FOR CURRENT CASH VALUE, IF NECESSARY)	*LIABILITY FOR FUTURE POLICY BENEFITS (NET APV OF POLICIES IN FORCE).* All components of the liability for future policy benefits should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or to reducing federal support in the form of appropriations related to administrative cost or subsidies).

Present Value (PV)

Actuarial Present Value (APV)

Note: Liability recognition includes any contingent liability that meets the criteria for recognition.

This example is intended to illustrate examples of various programs and how the various liabilities would be determined. This table is not to be considered authoritative.

Excerpt from SFFAS 5 (contd.)

111. Insurance programs are on-going and may be viewed as having long term characteristics. Thus, from a broader, longer term perspective, the liability to be recognized (column 3), and the amount to be reported as supplementary information (column 4) may be conceptually different and materially different from each other. From the broader perspective column (4) could be a longer term measure and a probabilistic estimate of future costs of these programs.

112. For noncancelable or guaranteed renewable insurance also, a difference arises between columns (3) and (4). Thus, for pension guarantees, column (3) shows the net present value of losses arising from plans that have already been terminated or that are more likely than not to be terminated. This is the amount to be recognized as a liability. Column (4) shows the net present value of the expected loss inherent in the risk assumed as a result of coverage on the guaranteed and vested benefit amounts. This number should be reported as supplementary information. It will generally be larger than the liability because it includes a provision for the additional losses that are expected to arise because some plan sponsors currently in good financial condition will in the future face bankruptcy with pension assets too small to cover the vested benefits that were guaranteed.

113. The liability for life insurance includes both the liability for unpaid claims, including IBNR (i.e., column 3), and a liability for net future policy benefit outflows (i.e., column 4). The liability for future policy benefits represents the expected present value of future outflows 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. The liability is estimated using appropriate financial or actuarial methods that include assumptions, such as estimates of expected investment yield, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made and in accordance with existing law and related policy (see specific whole life insurance standard below). Changes in the liability for future net policy benefit outflows that result from periodic re-estimations would be recognized as expense in the period in which the changes occur. The effects of changes in relevant law or policy would be recognized when those changes occur.

Excerpt from SFFAS 5 (contd.)

114. The assessments of losses expected based on the risk assumed may be made by appropriate actuarial or financial methods that include information and assumptions applicable to the economic, legal, and policy environment in force at the time the assessments are made. Since all future events are uncertain, indicators of the range of uncertainty around expected estimates, including indicators of the sensitivity of the estimates to changes in major assumptions, should also be reported.

Whole Life Policies

115. Some VA life insurance programs are whole life policies.[51] These programs operate in a manner similar to private sector mutual life insurance enterprises,[52] except that the regulations and market forces that control the private sector are different for these federal programs. VA life insurance policyholders are issued participating policies, and a portion of the earnings from those policies is returned to policyholders in the form of dividends. The following paragraphs specifically address the accounting required for federal whole life insurance programs.

116. The premiums collected by the insurer are used to pay benefits and other cost, and the balance is usually invested to yield additional income. These assets would be fund balances with Treasury or investments. Encompassed in the liability (also referred to as policy reserves) is cash surrender value and the liability for future policy benefits. The cash surrender value is the portion of premiums paid or other amount recoverable on an insurance policy if immediately canceled. The liability for future policy benefits is the present value of future outflows to be paid to (or in behalf of) policyholders, less the present value of future related premiums. In general, for whole life policies, the liability for future policy benefits should be no less than the cash surrender value that accrues to the benefit of policyholders.

[51] Whole life policies provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of the insured. A level premium is usually paid for policies of this type. The premium may be paid annually or more frequently.

[52] A mutual company is an incorporated entity without private ownership interests which operates for the benefit of its policyholders and their beneficiaries. With limited exceptions, mutual companies issue only participating policies. In a mutual company, participating policyholders have the right to vote for members of the company's board of directors or trustees. In some states, the insurance laws provide that upon liquidation of a mutual insurance company, the net assets are distributed among the existing policyholders of the company, and the prior policyholders have no claim against such assets.

Excerpt from SFFAS 5 (contd.)

Accounting for Liabilities of Federal Whole Life Insurance Programs

117. All federal reporting entities with whole life insurance programs should follow the standards as prescribed in the private sector standards (and as these private sector standards are amended) when reporting the liability for future policy benefits, in addition to the required disclosures described below.[53] The U.S. government-wide financial statements need not follow the required disclosures described below.

118. A liability for future policy benefits relating to participating life insurance contracts should be equal to the sum of:

    a. the net level premium reserve for death and endowment policy benefits,

    b. the liability for terminal dividends, and

[53]The applicable private sector standards are as follows, FASB SFAS 60 *Accounting and Reporting by Insurance Enterprises*, FASB SFAS 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and FASB SFAS 120 *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts* and AICPA Statement of Position (SOP) 95-1 *Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises*.

For those federal entities with "mutual enterprise-type" whole life insurance programs, FASB SFAS 120 should be followed. SFAS 120 states that mutual life insurance enterprises shall apply SFAS 60 or 97, as appropriate, to participating life insurance contracts unless those contracts meet both of the following conditions:

- The contracts are long-duration participating contracts that are expected to pay dividends to policyholders based on actual experience of the insurer.

- Annual policyholder dividends are paid in a manner that identifies divisible surplus and distributes that surplus in approximately the same proportion as the contracts are considered to have contributed to divisible surplus (commonly referred to in actuarial literature as the contribution principle).

If the participating life insurance contracts meet the above conditions SOP 95-1 should be followed.

Excerpt from SFFAS 5 (contd.)

c. any premium deficiency.[54]

119. An assessment should be made to compare the liability for future policy benefits using actuarial assumptions applicable at the time the contract is made (contract assumptions) with the liability for future policy benefits using assumptions that consider current economic conditions and experience (current conditions). Actual mortality, morbidity, and termination rates should be used when determining experience. For economic conditions, the nature and the mix of current and expected investments should be considered with expected long-term yields.

120. A premium deficiency occurs if the liability for future policy benefits using current conditions exceeds the liability for future policy benefits using contract conditions; the difference should be recognized as a charge to operations in the current period.

Additional Whole Life Insurance Disclosure

121. All components of the liability for future policy benefits (i.e., the net level premium reserve for death and endowment policy and the liability for terminal dividends) should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or reducing federal support in the form of appropriations related to administrative cost or subsidies). The U.S. government-wide financial statements need not separately report or disclose all components of the liability for future policy benefits with a description of each amount and an explanation of its projected use and any other potential uses.

[54]The liability for future policy benefits is consistent with the liability required by SOP 95-1. Net level premium reserve is the excess, if any, of the present value of future guaranteed death endowment benefits over the present value of future net premiums. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contracts. The dividend fund interest rate is the interest rate determined at policy issuance used to determine the amount of the dividend fund. It is the rate used to credit interest to the dividend fund, and against which experience is measured to determine the amount of the interest portion of dividends paid to individual policyholders. Terminal dividends are dividends to policyholders calculated and paid upon termination of a contract, such as on death, surrender, or maturity. If the payment of terminal dividends is probable and the amount can be reasonably estimated, the liability should be recognized. [AICPA SOP 95-1, Glossary, p. 33]

Excerpt from SFFAS 5, Basis for Conclusions (BfC)

Conclusion On Insurance And Guarantees

185. The Board considered two possible bases for recognizing the liability of federal insurance programs. One would recognize as a liability the unpaid expected present value (PV) cost of insured events that had occurred. The second would recognize as a liability the unpaid expected PV cost of risks that had been assumed (i.e., the unpaid expected PV cost inherent in insurance extended or in force). This second approach would be similar to that taken by the Congress in budgeting for direct loans and loan guarantees and by FASAB in accounting for these transactions. (See Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*).

186. Several Board members believe that this second approach has merit from a conceptual standpoint. However, the Board has concerns about the measurability of the risk assumed, particularly in the context of pension guarantees. There may also be some question as to the exact nature or categorization of some assumed risks in the absence of written contracts. The Board concluded that it would continue the traditional practice of recognizing the effect of events that had occurred on the face of the financial statements. However, it also decided to require reporting as RSSI the estimated PV cost of the risk assumed for all programs, except social insurance, life insurance, and loan guarantee programs.

187. Accrual accounting for insurance programs attempts to report the expenses of operations for each period and the unpaid liability at the end of the period. Projections of future claims, including renewed, expanded, and new business, also provide important information for policy decisions about what rates should be charged to cover all expected future losses, what additional insurance should be extended, and similar decisions. Management of reporting entities may wish to include such projections in financial reports as other accompanying information, and may do so on a voluntary basis, but the Board is not presently making any specific recommendations about this, beyond those required by this Statement and those to be further considered in *Supplementary Stewardship Reporting*.

188. During the Exposure Draft stage of the Liability Standard, the Board asked respondents whether the Standard provided sufficient guidance on how the risk assumed amount should be measured. Two of the fifty five respondents asked for additional guidance but did not mention measurement possibilities.

Excerpt from SFFAS 5, BfC (contd.)

189. At the discussion stages of the final Statement the Board contemplated two possible measurement perspectives for reporting the risk assumed. The Statement requires that all federal insurance programs (except social insurance, life insurance, and loan guarantee programs) report the risk assumed amount as supplementary information. The risk assumed calculation as presented in the Exposure Draft measured the cost of the coverage outstanding during the reporting year. For annual term insurance programs, under this approach the risk assumed amount might not be significantly different from the sum of recognized liabilities and contingent liabilities reported on the Balance Sheet. However, the Board believes that requiring disclosure or supplementary reporting of a risk assumed number that is similar in concept and amount to the liability recognized could be confusing and would not add informational value.

190. In the second perspective, the risk assumed amount would be a broader and longer term measure of the government's potential cost for on-going insurance programs. Under some measures, this second approach to risk assumed could be regarded as an indicator of the "fair" or "full cost" premium that should be charged if taxpayers are not to subsidize the program. This measure would be a probabilistic estimate of the expected cost under certain assumed economic factors. The Board found merits in this calculation, and believes it can provide important additional information beyond that contained in the accrual. Although they believe the measure to be important, proponents of this approach acknowledge that the measure may be difficult to measure precisely. Accordingly, they would treat it as RSSI. The Board currently has a project at the Exposure Draft stage, *Supplementary Stewardship Reporting*, that will provide further details on the measurement and reporting of "risk assumed" in its final statement.

191. The Board also considered the liability recognition of whole life insurance programs. The federal government has a small number of whole life insurance programs that are administered by federal entities. The most significant programs (mutual enterprise-type whole life insurance) are through the Department of Veteran Affairs (VA).

192. At the time the exposure draft on liabilities was issued, there were no established accounting standards for mutual enterprise-type whole life insurance within the federal government, state and local government, or the private sector. Therefore VA followed the statutory requirements for accounting purposes as well as statutory insurance reporting.

Excerpt from SFFAS 5, BfC (contd.)

193. In January 1995, the FASB and AICPA issued a standard and a statement of position, respectively, that specified accounting for mutual whole life insurance enterprises. Due to the similarities between the federal programs and the insurance enterprises covered in the FASB and AICPA documents, the Board decided that the private sector standards would be appropriate for the applicable federal programs. Therefore the Board concluded that federal entities with whole life insurance programs would follow the standards as prescribed in the private sector standards (and as these private sector standards are amended) when reporting the liability for future policy benefits, along with the additional disclosures prescribed by this Statement. The Board further concluded that disclosure of the components of the liability was necessary to adequately inform the financial statement users of the projected use and any other potential uses of the liability components and associated assets.

Excerpt from SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, BfC

Conclusions Regarding Each Type of Stewardship Responsibility Information

19. Figure 2 on page 20 presents a list of general factors that one or more Board members considered relevant for the classification choices. Specific decisions on each of the three types of stewardship responsibility information are discussed in the remainder of this Appendix.

Risk Assumed

20. The Board agreed that information about Risk Assumed should be RSI rather than an integral part of the basic financial statements, because the amounts are not sufficiently reliable and measurement methods are still experimental. This information is potentially valuable, but it is not yet a suitable basis for recognition or disclosure.[5] The Office of Management and Budget (OMB), the Government Accountability Office (GAO), and the Congressional Budget Office (CBO) have considered the use of Risk Assumed information as a basis for budgeting for insurance programs. These agencies have concluded that more experience is needed before the measurements can be regarded as sufficiently reliable for budgeting. Similar considerations lead the FASAB to conclude that information about Risk Assumed should be included in financial reports as RSI, at least until agencies and auditors have more experience with this information.

21. The Board believes that analogies with insurance offered by private insurers, (where, for example, an expected premium deficiency on long-duration contracts such as life insurance is recognized), may be misleading due to differences in the length of the policy coverage, nature of insured risk, or other relevant variables. The Board believes that additional guidance from FASAB on definition and measurement of "Risk Assumed" would be necessary before it would be feasible to require recognition or disclosure of this information as an integral part of the basic financial statements. Developing and promulgating such guidance would require a separate project. Before the Board undertakes such a project, it is desirable to encourage continued improvement in agencies' data systems and modeling capabilities to support reporting Risk Assumed. The RSI requirement has the effect of providing this encouragement in an appropriate, cost-beneficial manner. The Board notes that the "state of the art" for such projections is constantly evolving. Should the Board in the future decide that it would be desirable to develop more specific criteria for reporting Risk Assumed, the Board will be able to learn from this ongoing experience.

[5] FASAB uses the term "disclosure" to refer to information that is not recognized on the face of the basic financial statements but is regarded as an integral part of the basic financial statements, essential for fair presentation in conformity with generally accepted accounting principles (GAAP). Normally such disclosures are presented in footnotes, but federal accounting standards published by FASAB do not currently prescribe the format for presentation of such disclosures. GAAP does not prohibit formatting or combining pieces of information in appropriate ways to direct the reader's attention, provided that the results are not misleading.

Excerpt from SFFAS 25 BfC (contd.)

Figure 2

-Low (implies RSI) < < < < < < < < < < < < < < > > > > > > > > > > > > > > > > +**High (implies basic**)

<Relevance to fair presentation>

< Connection with elements of financial reporting >

< Use of historical financial data or financial transaction data >

<Preparers' discretion in preparing and presenting the information>

< Strength of signal Board wishes to be sent in the financial report >

< Significance, relevance or importance of the item in light of *Objectives* >

< Strength of the signal the Board wishes to be sent in the auditor's report >

< Relevance to measuring financial position or changes in financial position >

<Extent to which the information interests a wide audience (rather than specialists)>

<Extent to which there are not alternative sources of reliable information>

< Agreement on criteria that permit comparable and consistent reporting >

< Experience among users, preparers, and auditors with the information >

<Extent to which the information is aggregated (lacking in detail)>

< Benefit/cost ratio of using resources to ensure accuracy >

< Connection with basic financial statements >

< Reliability and/or precision possible >

< Reliability and/or precision needed >

-Low (implies RSI) < < < < < < < < < < < < > > > > > > > > > > > > > +**High (implies basic**)

Task Force on Commitments and Obligations of the U.S. Government

Minutes from Meeting Held on May 9, 2012

May 17, 2012

Federal Accounting Standards Advisory Board
Task Force on Risks Assumed by the U.S. Government –
COMMITMENTS AND OBLIGATIONS
441 G St NW – Room 7B16 (Warren Room)
Wednesday, May 9, 2012
9 AM – 12 NOON

Agenda

9:00 – 9:15	Introductions and Overview of Objectives
9:15 – 10:30	Group Discussion • Draft definition of risk assumed • Risks assumed through grants • Current accounting and reporting of awarded grants
10:30 – 10:45	Break
10:45 – 11:45	Group Discussion • Risks assumed through contracts • Current accounting and reporting of awarded contracts • Other commitments and obligations (e.g., accounts payable undelivered orders)
11:45 – 12:00	Wrap-Up / Next Steps

Disclaimer: In the course of researching, developing or updating federal accounting standards, FASAB staff periodically utilizes task forces, roundtables, surveys, and other means of communication to solicit feedback from the federal community. The information contained in these minutes is intended to assist staff in preparing materials for the board's deliberations; it is not intended to reflect authoritative or formal views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Task Force on Commitments and Obligations of the U.S. Govt

Minutes from May 9, 2012, Meeting

Participants:

There were 28 individuals composed of preparers, auditors and program personnel representing the entities and organizations below either in person or via conference line. Minutes of the roundtable have been non-attributed to encourage open communication and discussion.

Agriculture, U.S. Department of (USDA)

- Aaron Prose, Office of the Chief Financial Officer (CFO)
- Richard Schupbach, Office of Inspector General (via conference line)
- Tyson Whitney, Office of the CFO/Transparency and Accountability Reporting Division

CliftonLarsonAllen LLP

- Denise Wu

Defense, U.S. Department of (DOD)

- Maryla Engelking, Office of the Under Secretary of Defense (Comptroller)
- Audrea Nelson, Office of the Under Secretary of Defense (Comptroller)

Education, U.S. Department of (Education)

- Michael Gordon, Office of the CFO/ Financial Management Operations
- Alda Giusti, Office of Elementary and Secondary Education
- Greg Spencer, Office of Inspector General

Energy, U.S. Department of (Energy)

- Marcos Garcia, Office of Financial Risk, Policy, and Controls

Federal Accounting Standards Advisory Board (FASAB)

- Wendy Payne
- Julia Ranagan
- Monica Valentine

Health and Human Services, U.S. Department of (HHS)

- Patricia Irving, Office of Finance (via conference line)
- Kimberly Wheat, Office of Grants Policy, Oversight and Evaluation

KPMG LLP

- Carl Patton
- Cathy Supernaw

Office of Management and Budget (OMB)

- Regina Kearney, Office of Federal Financial Management
- Karen Lee, Office of Federal Financial Management
- Shelly McAllister, Budget Review Division

Transportation, U.S. Department of (DOT)

- Morten Sorensen, Federal Highway Administration
- Katherine Lambert, Federal Transit Administration
- Teresa Lampkin, Office of Financial Management

Treasury, U.S. Department of (Treasury)

- Mark Reger, Deputy Assistant Secretary Accounting Policy (and FASAB board member)
- Patricia Cappello, Office of the Fiscal Assistant Secretary/Accounting Policy Division
- Karin Dasuki, Financial Management Service
- Victoria Leas, Financial Management Service

U.S. Government Accountability Office (GAO)

- Frank Synowiec, Applied Research and Methods

Introductions and Overview of Project

FASAB staff member Julia Ranagan welcomed participants and provided them with some brief background information on the reason for the task force and the objectives of the meeting.

Ms. Ranagan explained that the term "risk assumed" was first used in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, in relation to reporting for insurance and guarantees. She noted that SFFAS 5 requires that a liability be recognized for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. In addition, SFFAS 5[1] requires that information on risks assumed by the federal government be reported in required supplementary information (RSI) as the present value (PV) of unpaid expected losses, net of associated premiums, based on the risk inherent in the type of coverage in effect.

[1] As amended by SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, which reclassified risk assumed information, previously required by SFFAS 5 to be reported as required supplementary stewardship information (RSSI), to required supplementary information (RSI).

Ms. Ranagan explained that reporting of risk assumed information for insurance and guarantee programs has been inconsistent among agencies. In August 2011, the Federal Accounting Standards Advisory Board (FASAB or "the board") approved a project on risk assumed to determine if additional guidance is needed. In discussions regarding the board's technical agenda, several members of the board asked staff to look at risk assumed from a broad perspective.[2] In response to the board's direction, staff's project plan proposed a broad scope for the risk assumed project, including existing insurance and guarantee contracts based on a probabilistic estimate (the full cost of explicit risk assumed); implied guarantees resulting from disaster relief programs, certain assistance programs (particularly where a qualifying event may lead to long-term assistance), regulatory actions, related party involvements, other existing policies or programs; commitments such as contractual commitments requiring future resources or that may require future resources, treaties and other international agreements; inter-governmental financial and programmatic dependency; and, other potential risks assumed.[3]

Ms. Ranagan explained that this task force on Commitments and Obligations of the U.S. Government is the first of several task forces that will be formed to look at the need for additional reporting of risks assumed by the federal government. The scope of this task force is specifically limited to contracts, grants, treaties, and other explicit agreements that the federal government has entered into.

Ms. Ranagan stated that obligations for grants and contracts that have been awarded are reported as undelivered orders in budgetary accounting but are not typically reported as liabilities for financial statement reporting until goods and services are delivered (or a percentage of work is completed) or the grantee reports that funds have been expended. Undelivered orders are reported in the statement of budgetary resources and in a note to the financial statements as a single line. There is no accompanying narrative for the statement or the note to explain what that amount consists of.

Ms. Ranagan added that the agencies invited to participate in the task force were selected because they were determined to be the top grant and contract-awarding agencies based on a review of fiscal year (FY) 2011 data from www.USASPENDING.gov. The top four grant-making agencies are the Departments of Health and Human Services, Transportation, Agriculture, and Education, representing 87% of grant dollars reported for FY 2011. The top three contract-awarding agencies are the Departments of Defense, Energy, and Health and Human Services, representing 78% of contract dollars reported for FY 2011.[4]

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[2] Minutes from the technical agenda discussion at the April 2011 meeting are available online at http://www.fasab.gov/pdffiles/APRIL_27_28__2011.pdf; last accessed May 10, 2012.
[3] The original project plan for the risk assumed project, dated August 11, 2011, is available online at http://www.fasab.gov/pdffiles/Tab_D__RISK_ASSUMED1.pdf; last accessed May 10, 2012.
[4] Information available online at www.USASPENDING.gov; dollar amounts were calculated based on information in the system on May 10, 2012.

Ms. Ranagan asked if there were any questions about the scope or purpose of the task force before they address the specific questions she had for the group.

One participant asked if the scope of the task force would include obligations for long-term operating leases. Ms. Ranagan responded that FASAB has a separate project on leases that will focus on accounting and reporting for leases so it is not expected that leases will be addressed as part of this project. The Commitments and Obligations Task Force is primarily focused on contracts, grants, treaties and other undelivered orders beyond contracts and grants (e.g., purchase orders and blanket purchase agreements not associated with a contract).

Group Discussion

Ms. Ranagan directed participants' attention to the list of questions for the task force on pages 7 – 9 of the meeting materials, beginning with the draft definition of risk assumed.

Definition and Explanation of Risk Assumed

Ms. Ranagan asked if participants understood the scope of risk assumed based on the following draft definition, asking that participants not focus on the term "risk assumed" since it may not be the ultimate term that is used in the guidance to be developed:

> "The possible or probable risk of future outflows that the federal government is expected to incur, in the judgment of a reasonable person, as a result of its mission, operations, and current or past actions. The population of risk assumed may be determined through a review of varied information, including, but not limited to, obligations incurred, commitments undertaken, contracts signed, agency policy, legislative history, economic projections, programmatic responsibility, and risk analysis." [Excerpt from page 14 of meeting materials]

Ms. Ranagan said, in more simple terms, the topic of risk assumed by the government can be addressed by determining what actions the government has taken as of the reporting date that may result in outflows in the future and whether information about those potential outflows is appropriately reported.

Ms. Ranagan asked if any of the participants had any comments on the definition of risk assumed, specifically noting that the population of risk assumed would include grants and contracts awarded as of the reporting date.

One participant asked what the additional risk would be for a contract that is signed and obligated. Ms. Ranagan responded that the contract is obligated for purposes of budgetary reporting, is included in the statement of budgetary resources and the undelivered orders note, and is reported to USASPENDING.gov, but is not tied to the financial statements for financial reporting. The amounts included as obligations (undelivered orders) for grants and contracts are grouped in the SBR and the undelivered orders note with all open obligations and are not distinguished in any fashion. There is no way to tie the amounts reported in USASPENDING.gov to the audited financial statements.

The participant asked if the goal is for agencies to reconcile between USASPENDING.gov and the financial statements. Ms. Ranagan responded that would be an ideal outcome but may not be possible in a spreadsheet-type format. However, some sort of note disclosure that alerts readers to the fact that while liabilities and expenses have been recognized related to contracts, they only pertain to goods and/or services received and the government has signed contracts for additional goods and/or services that obligate the government to future outflows.

Another participant asked how the obligated amount would be different than a contingency, whereby the government has an obligation that is contingent upon receiving the goods and/or services. Ms. Ranagan responded that the contingency standard requires agencies to recognize a contingent liability if it is probable and reasonably estimable and to disclose a contingent liability if it is probable but not reasonably estimable. She noted that the risk assumed information would go beyond probable to include possible. For example, with insurance and guarantees, a risk assumed disclosure accounts for the probability of various outcomes using percentage of probability.

The participant then asked if we would be applying a discounted cash flow for contracts. Ms. Ranagan responded that she did not think so but it is too early to make assumptions; this first meeting is intended as an information-gathering exercise to determine how to address the disconnect between the timing of budgetary and financial statement reporting for grants and contracts.

One participant asked if non-binding agreements that the federal government enters into that have financial impacts (similar to treaties) should be considered under the umbrella of risk assumed. Ms. Ranagan replied that the proper reporting of such agreements would certainly require judgment but if the agency has behaved in a particular way in the past (i.e., generally honoring the agreements), it would certainly create an expectation that the federal government would behave in the same way in the future. She noted that this issue had arisen during the roundtable on asbestos-related liabilities. Agencies that have buildings in foreign countries that do not require asbestos remediation may still have a liability if the general practice of the agency has been to clean up hazardous substances, even though there is not a legal requirement to do so.

One participant asked what is the risk that is to be considered concerning obligations for contracts and grants; is it the risk that the obligation will increase or that the federal government will not be able to pay it? Ms. Ranagan responded that she considers the term "risk assumed" in the context of this project to be the risk of future outflows as a result of actions taken by the federal government as of the reporting date and conceded that risk is not the right term to use.

Another participant concurred that "risk" is not the right term to use and suggested a term such as "expected outflows of obligated grants" or something like that. He added that risk has a bad connotation and when making a grant, spending in the future is what was intended and is actually a good thing.

Ms. Ranagan agreed, noting that she has been careful to try to avoid using the term "loss" because the future outflows are being exchanged for goods and/or services so they are not considered losses like those arising through risk assumed related to insurance and guarantees.

The same participant added that he would recommend that the definition not refer to present value (PV) because PV adds a level of complexity that he is not sure would enhance the disclosure.

Another participant seconded that thought, adding that the note disclosures may need to discuss the additional exposures of the federal government but not attempt to do PV because she does not see the benefit of going through that exercise for grants and contracts. She would prefer that for a note disclosure, the requirement be limited to reporting on the face value and the general terms of the agreement.

Another participant responded that he would disagree, noting that if we are reporting on multi-year cash flows, it would seem appropriate to use a relevant discount rate.

The participant that originally objected to PV for grants and contracts stated that he agrees with using PV for loans for two reasons: (1) it helps direct loans and loan guarantees to be on par and allow Congress to evaluate the costs and (2) it allows the federal government to more accurately sell its loan portfolio. He does not see the same need to do PV for grants.

Ms. Ranagan responded that PV has been a point of contention in the past and any proposed measurement basis will require future deliberation so she does not want to spend a lot of time on it at this meeting. She added that face value may not be a valid disclosure in instances where you know that you only ever fully expend 95 percent of your grants, for example, so it may not be meaningful to disclose the full face value if that is not an accurate representation of actual future outflows.

Budgetary Obligations and Reconciliation of Information with USASPENDING.gov

As a result of a robust and informative discussion about the data contained within USASPENDING.GOV and how that data ties to information contained in the budgetary general ledger, the following major points were conveyed by the task force:

- The data in USASPENDING.GOV is populated by the agencies' procurement offices and not the budget offices. As a result, the award information comes from a completely separate system or database and is not fed through the general ledger.

- The data in USASPENDING.GOV is not the complete population of obligations reported for grants and contracts in the budgetary general ledger because:
    - Only awards over $25,000 are required to be reported in USASPENDING.GOV;

  - Awards to individuals (e.g., Supplemental Nutrition Assistance Program (SNAP) benefits, formerly known as food stamps) are not reported in USASPENDING.GOV; and
  - Awards that may be considered classified information are not reported in USASPENDING.GOV.

- The data in USASPENDING.GOV is reported differently from the obligations reported for grants and contracts in the budgetary general ledger because:
  - Agencies are limited to reporting information under one primary Treasury fund symbol in USASPENDING.GOV, while the award may actually be split among several Treasury fund symbols in the general ledger;
  - Agencies are permitted to aggregate information that is reported by county in USASPENDING.GOV, while it is reported at the transaction level in the budgetary general ledger;
  - Agencies are required to report information at a very detailed level in USASPENDING.GOV (e.g., zip code) that is different from the level of detail that is captured at the transaction level in the budgetary general level; and
  - There may be timing differences between when a grant or contract is awarded and when the obligation is recorded in the budgetary general ledger.

- Some agencies have made an attempt to align their data between the budgetary general ledger and USASPENDING.GOV, but the information has not been reconciled. Although the grant and contract award amounts reported in USASPENDING.GOV are for 100 percent of the award and the full amount is also obligated in the budgetary general ledger, the information is currently reported differently, thus resulting in significant difficulty in performing a reconciliation. USDA said it is currently piloting a reconciliation but their success will depend on the availability of resources; the sheer volume of transactions (17 million per year) make such a reconciliation a significant undertaking.

When asked whether contracts and grants are obligated for the full amount, participants responded that contracts are generally fully obligated upfront for the base year (not option years) and obligations for grants vary depending on the terms of the grant agreement. Obligations also depend on whether the associated funding is single-year or multi-year.

Cooperative Agreements

Ms. Ranagan asked if cooperative agreements are reported in USASPENDING.GOV and whether they should be considered similar to grants for purposes of reporting risk assumed information. Several participants confirmed that cooperative agreements are fully reported in USASPENDING.GOV and are considered similar in concept to grants for reporting purposes. One participant stated that the definition of cooperative agreements on page 16 of the meeting materials accurately defines them.

Subsidies

Ms. Ranagan noted that the consolidated financial report of the U.S. Government (CFR) reports grants and agricultural subsidies together and asked if the subsidies were considered payments to individuals. One participant responded that if the payment is made to an individual that is acting in a business capacity (e.g., John Smith LLP with a taxpayer identification number (TIN)), it is considered a payment to a business, but if the payment is made to an individual (e.g., John Smith with a social security number (SSN)), it is considered a payment to an individual. He said it is a challenge to determine the status of each payment (business or individual) so USDA currently avoids having to distinguish between the two by aggregating the payments by county and reporting all of the subsidy payments in USASPENDING.GOV in the aggregate.

Ms. Ranagan asked whether subsidies could be considered similar in concept to regular grants or are they considered spent as soon as they go out the door. One of the participants responded that USDA considers the subsidies to be "obligate and pay;" the obligation and expenditure occur simultaneously when the payment is made. Furthermore, there is no requirement for the subsidy recipients to report back on how the funds are used. With the exception of timing differences at year-end, amounts paid out for subsidies are considered expended when made; there is no outstanding balance at the end of the year.

One participant asked if the history of annual subsidies create an expectation on the part of the recipient that subsidies will continue indefinitely into the future. Another participant responded that may occur in theory but there is no obligation that can exist in advance of funding being provided by Congress.

One participant asked if obligations for entitlement grants can be estimated upfront or if they are only treated as obligate and pay. Another participant responded that at his agency, the entitlement grants are based on need and so they are funded with "such funds as needed." He said that the economic conditions in the nation dictate how much is needed and there is not an upper or lower cap on the total benefits to be paid out. Entitlement benefits are paid monthly on an obligate and pay basis. Therefore, since the amounts for entitlement benefits are obligated and disbursed simultaneously, the amount reported as an obligation and expenditure for budgetary purposes is generally the same as that which is recorded as an expense and cash disbursement in the financial statements. It was also noted that since these payments are to individuals, they are not reported to USASPENDING.GOV.

CFR Note 23. Commitments

Ms. Ranagan then directed participants' attention to the excerpt from the 2011 CFR, Note 23. Commitments, which contains a schedule of "Undelivered Orders and Other Commitments as of September 30, 2011, and 2010 (see excerpt on the following page).

Undelivered Orders and Other Commitments as of September 30, 2011, and 2010

(In billions of dollars)	2011	2010
Undelivered Orders:		
Department of Defense	315.9	348.6
Department of Education	229.2	237.5
Department of the Treasury	207.1	144.8
EOP Foreign Military Sales Program	121.4	112.4
Department of Transportation	104.7	102.1
Department of Health and Human Services	90.3	92.9
Department of Housing and Urban Development	56.9	64.8
Department of Agriculture	51.7	54.8
Department of Energy	45.7	49.2
Department of Homeland Security	36.3	37.7
Department of State	20.9	19.2
Agency for International Development	15.6	15.7
National Science Foundation	11.6	11.8
Environmental Protection Agency	10.8	11.4
Department of Justice	10.0	11.5
Export-Import Bank of the United States	9.7	5.6
All other agencies	62.1	63.8
Total undelivered orders	1,399.9	1,383.8
Other Commitments:		
Callable capital subscriptions for multilateral development banks	72.0	63.9
Fuel Purchase Obligations	8.5	7.9
Agriculture Direct Loans and Guarantees	5.9	4.8
Power Purchase Obligations	5.1	5.5
Long-term Satellite and Systems	3.2	3.9
Conservation Reserve Program	1.8	1.8
Contract Options and Negotiations	0.0	10.2
All other commitments	6.8	6.0
Total other commitments	103.3	104.0

Source: 2011 CFR, pg. 117; available online at http://www.fms.treas.gov/fr/; last accessed April 11, 2012.

Ms. Ranagan asked participants if the amounts listed for their respective agencies included all of the open contracts and awards as of the year-end, noting that the amount for HHS seemed particularly low given the amount of grants it awards, especially considering the significant increase in grant awards as a result of intervention activities.

One of the participants responded that a lot of the grants for HHS are block or entitlement grants, which are obligate and pay, and are therefore not obligated in advance of payment.

Ms. Ranagan asked if all block and entitlement grants are obligate and pay; USDA and HHS confirmed that is the case for their agencies but may not be the case for all government agencies.

Ms. Ranagan then asked if all non-discretionary grants are obligate and pay. One participant responded that formula grants are non-discretionary but they are not obligate and pay; obligations are recorded for formula grants when the award is made.

Ms. Ranagan asked how funds are set aside for obligate and pay grants to avoid deficiencies. She asked if there was a commitment made in the system for these funds or whether cuff records are maintained to ensure that the agency does not pay more than it is authorized.

One of the participants responded that Congress sets aside the authorization and funds for each of the programs to make the payments. The agency could estimate based on historical trends but actuals are not known until the grantee requests a drawdown; it would not be worth the exercise to anticipate what the requirements might be. Formula grants have a signed agreement so the amount of the obligation is known; there is no signed agreement for the entitlement and block grants and amounts are not known upfront. The participant added that since entitlement means the individuals are entitled to the funds, the agency is not limited to a certain amount; it cannot deny the payment based on availability of funds. The participant added that an agency may need to go back to Congress and request additional appropriation amounts if expenditures exceed the amount anticipated. The participant emphasized that entitlement and block grants are quite different from formula and discretionary grants with respect to available funding.

Another participant added that the amounts paid out for entitlement and block grants are driven by eligibility; if the pool of eligible recipients grows, the funding requirements will grow as a result.

A participant asked if there is an accounting transaction that occurs when the pool of eligible recipients grows prior to Congressional authorization. Another participant responded that might be possible if they were trending the information and looking at it on a daily basis, but it is just not worth the exercise to determine how much will be obligated in advance of the grantees' requests for drawdown.

To further illustrate this discussion, the following appropriation language in the 2012 consolidated appropriations bill for grants to states for Medicaid is as follows: [5]

GRANTS TO STATES FOR MEDICAID

For carrying out, except as otherwise provided, titles XI and XIX of the Social Security Act, $184,279,110,000, to remain available until expended.

For making, after May 31, 2012, payments to States under title XIX or in the case of section 1928 on behalf of States under title XIX of the Social Security Act for the last quarter of fiscal year 2012 for unanticipated costs incurred for the current fiscal year, ***such sums as may be necessary. [Emphasis added.]***

[5] Public Law 112-74: Consolidated Appropriations Act 2012; available online at http://www.gpo.gov/fdsys/pkg/PLAW-112publ74/pdf/PLAW-112publ74.pdf; last accessed May 16, 2012.

As laid out in the appropriation language above, an annual appropriation amount of $184 billion has been estimated for the Medicaid program for 2012, but then, in the next paragraph, the agency is also authorized to use "such sums as may be necessary" to make payments to states for Medicaid above and beyond what the anticipated need is, but only after May 31, 2012. Therefore, if the agency significantly underestimates its anticipated funding needs because the population of eligible participants dramatically and unexpectedly increases, an agency may need to go back before May 31, 2012, to request additional authorization.

Entitlement Grants

Ms. Ranagan asked participants if there are federal grant programs where once a recipient meets the eligibility requirements, he or she can expect to continue to receive benefits as long as he or she continues to meet the eligibility criteria or does a recipient need to reapply or prove eligibility on a regular basis. She noted that continued, uninterrupted benefits without further action on the part of the recipient may meet the definition of risk assumed.

One participant responded that, personally speaking, he would think Social Security and Medicare would fall into that category because the primary criterion is age rather than income. He said that for other programs that are based on need, he would assume that recipients would have to prove their income at least periodically to continue receiving benefits. None of the participants could provide an example of a program that does not require periodic eligibility verification.

One participant asked what we would do with that type of information because the federal government already reports risk assumed-type information for Social Security and Medicare. Ms. Ranagan replied that Social Security and Medicare is a good example of risk assumed reporting because the statement of social insurance includes estimates of future outflows net of associated inflows (e.g., Social Security taxes) for a period of 75 years. She is interested in reporting about other entitlement programs where, for example, if a recipient only needs to verify income once every three years, can one argue that the federal government has taken on three years of outflows when the recipient first signs on for the program, and at three-year intervals thereafter, as long as he or she continues to meet the eligibility criteria.

None of the participants offered comments on the specific eligibility verification requirements of the various entitlement programs within the federal government.

Department of Transportation Note 17 Commitments and Contingencies

Ms. Ranagan asked participants to take a look at page 23 of the meeting materials, which contains an excerpt from DOT's note 17, Commitments and Contingencies (see next page for excerpt) that discusses pre-authorization of certain grants to states, transit authorities, and public-use airports. Ms. Ranagan noted that this type of disclosure is not typical of agencies and asked what participants thought about it.

Excerpt from Dept. of Transportation 2011 Agency Financial Report, Note 17: Commitments and Contingencies:[17]

Grant Programs:

FHWA pre-authorizes states to establish construction budgets without having received appropriations from Congress for such projects. FHWA does not guarantee the ultimate funding to the states for these "Advance Construction" projects and, accordingly, does not obligate any funds for these projects. When funding becomes available to FHWA, the states can then apply for reimbursement of costs that they have incurred on such projects, at which time FHWA can accept or reject such requests. For the fiscal year ended September 30, 2011 and 2010 FHWA has pre-authorized $41.4 billion and $40.2 billion, respectively, under these arrangements. These commitments have not been recognized in the DOT consolidated financial statements at September 30, 2011 and 2010.

FTA executes Full Funding Grant Agreements (FFGAs) under its Capital Investment program (New Starts) authorizing transit authorities to establish project budgets and incur costs with their own funds in advance of Congress appropriating New Starts funds to the project. As of September 30, 2011 and September 30, 2010, FTA had approximately $1.6 billion and $1.87 billion respectively, in funding commitments under FFGAs, which Congress had not yet appropriated. Congress must first provide the budget authority (appropriations) to allow FTA to incur ob-ligations for these programs. Until Congress appropriates funds, FTA is not liable to grantees for any costs incurred. There is no liability related to these commitments reflected in the DOT consolidated financial statements at September 30, 2011 and 2010.

FAA's Airport Improvement Program provides grants for the planning and development of public-use airports that are included in the National Plan of Integrated Airport Systems. Eligible projects generally include improvements related to enhancing airport safety, capacity, security and environmental concerns. FAA's share of eligible costs for large and medium primary hub airports is 75 percent with the exception of noise program implementation, which is 80 percent of the eligible costs. For remaining airports (small primary, reliever, and general aviation airports), FAA's share is 95 percent of the eligible costs.

FAA has authority under 49 U.S.C. 47110(e) to issue letters of intent to enter into Airport Improvement Program grant agreements. FAA records an obligation when a grant is awarded. Through September 30, 2011, FAA issued letters of intent covering FY 1988 through FY 2026 totaling $7.5 billion. As of September 30, 2011, FAA had obligated $5.5 billion of this total amount leaving $2 billion unobligated. Through September 30, 2010, FAA issued letters of intent covering FY 1988 through FY 2026 totaling $6.5 billion. As of September 30, 2010, FAA had obligated $5.2 billion of this total amount, leaving $1.3 billion unobligated.

[17] FY 2011 Department of Transportation Agency Financial Report, Note 17, pages 76-77; available online at http://www.dot.gov/budget/2012/dot-fy-2011-afr.pdf; last accessed April 11, 2012.

A participant from DOT responded that the note should be read in context, stating that this disclosure is for pre-authorizations of certain types of grant awards that, when awarded, only represent a very small percentage of DOT's total grant obligations.

Ms. Ranagan asked why the decision was made to include this type of disclosure in the commitments and contingencies note. The participant from DOT responded that the disclosure was made because the pre-authorizations discussed in this note represent

potential commitments of DOT and these agreements are not included in DOT's obligations reported at year-end.

Mr. Reger noted that this disclosure by DOT is getting at what the board was thinking about when it initiated the project on risk assumed. He said FASAB has already addressed reporting on the two largest future outflows related to risk assumed—Social Security and Medicare—and is looking to improve reporting in other material areas where the government knows it is going to have to pay something in the future. He added that in order to improve reporting about risk assumed, we need to develop definitions that will ensure consistency in application. He emphasized that the task force needs to keep in mind that only material items would need to be disclosed.

Another participant added that discretionary grants could have a similar disclosure because the grantees can submit budgets for five years, but only the first year is funded. Information on these grants are reported in the agencies' grant systems and do not flow to the general ledger, so it would be difficult to extract out-year information for many agencies.

One participant asked what the purpose of reporting this information would be, asking if expectations by another party would be the determining factor in what to report. Mr. Reger responded that he thinks it needs to be stronger than that—it is a moral obligation of the federal government and individuals are actively relying on the government's promise to fulfill that moral obligation. The group then discussed the usefulness of reporting on implicit agreements because, while the information may be useful for decisions about resource allocation, it is not the individual agencies that have control over where funds are ultimately applied and what "promises" they can continue to uphold; that responsibility lies with Congress. Mr. Reger added that he would hope that the outcome would be reporting about really important things that may not be appropriate to report at the agency level.

Going back to DOT's note, Ms. Ranagan asked DOT if the disclosure was made because the auditors requested it or if the states felt more comfortable if DOT disclosed something about these pre-authorizations in the financial statements. A participant from DOT responded that it was audit-driven; the auditors asked DOT to make the disclosure because the amounts are material and the commitment level is quite high. Ms. Ranagan noted that the disclosure in this note contains much more detail than the undelivered orders note where all open obligations are grouped together into one line item with no narrative discussion. She asked the participant from DOT if they were comfortable with the blanket disclosure for all open obligations. The participant from DOT responded that she was fine with the disclosure on undelivered orders but the note could include more narrative about what type of material transactions (e.g., grants, contracts, etc.) make up those undelivered orders.

Department of Education's Note 21. Contingencies

Ms. Ranagan then directed participants' attention to the following excerpt from the contingency footnote from Education at the bottom of page 23 of the meeting materials:

Other Matters

Some portion of the current-year financial assistance expenses (grants) may include funded recipient expenditures that are subsequently disallowed through program review or audit processes. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Department's financial position.[18]

[18] FY 2011 Department of Education Agency Financial Report, Note 21, pages 80-81; available online at http://www2.ed.gov/about/reports/annual/2011report/agency-financial-report.pdf; last accessed April 11, 2012.

Ms. Ranagan noted that the disclosure from Education talks about grant expenses that may be disallowed in the future, resulting in what would be, in effect, a reduction in risk assumed without discussing the outstanding grant awards that add to future grant expenditures. She asked the group for their thoughts on that disclosure. A participant from Education responded that the disclosure is a management statement, not material, and akin to a contingent gain so it should probably not be included at all. A participant from OMB added that sometimes in reviewing financial statements and notes, they ask a question and the answer winds up in a note in future years. One of the auditors added that they looked at the need for a similar disclosure at other grant agencies, but decided against it since the amount was immaterial, the disclosure bordered on being a gain contingency, and the agencies usually do not end up recovering all of the money.

Treaties

Ms. Ranagan asked participants if they had any additional comments or questions before they started talking specifically about contracts. Mr. Reger asked how many participants in the meeting know if their agency has treaties and, if they do, whether they are looking at their outstanding treaties each year as they determine their contingent liabilities to determine if they have a contingent liability to record or disclose with respect to their treaty activity. A participant from DOD responded that they looked at every one of their treaties a few years ago and determined that they were all so immaterial to DOD that they do not look at them anymore. Mr. Reger asked the participant to provide Treasury with any information that they had from that review.

Adequacy of Disclosures

A participant from USDA responded that he believes the current disclosures about their grants and contracts is currently sufficient and does not believe there is a need for additional risk assumed reporting beyond what is currently required for insurance and guarantees. He said that obligations for grants and contracts are recorded and are a fair representation of USDA's responsibility. He said that while he is open to suggestions for improving disclosures, he does not see a need for additional reporting without a new definition of risk assumed and a change in discourse.

Statement of Spending

One participant added that she believes the new statement of spending being developed by OMB may address the question of what is included in undelivered orders because it will break spending down into categories such as grants, contracts, and other. Ms. Ranagan responded that she thought the information reported in the statement of spending would be derived from USASPENDING.GOV. Ms. Kearney responded that the information will come from the same budgetary information that is used to prepare the statement of budgetary resources and they hope the statement can be used as a tool to facilitate reconciliations between the statement of budgetary resources and USASPENDING.GOV.

Department of Defense's Note. 16. Commitments and Contingencies

Ms. Ranagan asked participants to take a look at page 38 of the meeting materials, which contains the following excerpt from DOD's note 16, Commitments and Contingencies, that contains a general statement of DOD's exposures as part of its contract-making activities:

Excerpt from Dept. of Defense 2011 Agency Financial Report, Note 16: Commitments and Contingencies:

Other Commitments and Contingencies

The Department is a party in numerous individual contracts that contain clauses, such as price escalation, award fee payments, or dispute resolution, that may result in a future outflow of expenditures. Currently, the Department has limited automated system processes by which it captures or assesses these potential contingent liabilities, therefore, the amounts reported may not fairly present the Department's contingent liabilities. Contingencies considered both measurable and probable have been recognized as liabilities. Refer to Note 15, Other Liabilities, for further information.[32]

[32] FY 2011 Department of Defense Agency Financial Report, Note 16, page 104; available online at http://comptroller.defense.gov/afr/fy2011/DoD_FY11_Agency_Financial_Report.pdf; last accessed April 11, 2012.

Ms. Ranagan asked if participants thought this disclosure was informative. One of the participants responded that the note was so general with no amounts that it is hard to determine what a general reader of the financial statements might glean from that type of information. A participant from DOD responded that DOD is in the process of developing systems to capture this type of information, but since its priority is on getting the statement of budgetary resources auditable by 2014, DOD will not have anything to add to this disclosure for a few more years.

Department of Health and Human Services' Note. 14. Contingencies and Commitments

Ms. Ranagan then directed participants to take a look at the top of page 38 of the meeting materials, which contains the following excerpt from HHS's note 14, Contingencies and Commitments, that contains a general statement about the agency's

obligation for cancelled appropriations with an estimated amount of payments to be made:

Excerpt from Dept. of Health and Human Services 2011 Agency Financial Report, Note 14: Contingencies and Commitments:

Obligations Related to Canceled Appropriations

Payments may be required of up to one percent of current year appropriations for valid obligations incurred against prior year appropriations that have been canceled pursuant to the National Defense Authorization Act of 1991 (P.L. 101-150). The total payments related to canceled appropriations are estimated at $1.1 billion and $1.3 billion as of September 30, 2011, and 2010, respectively.[31]

[31] FY 2011 Department of Health and Human Services Agency Financial Report, Note 14, page II-75; available online at http://www.hhs.gov/afr/2011afr.pdf; last accessed April 11, 2012.

Ms. Ranagan noted that this disclosure is also not typical of agencies and asked what participants thought about the disclosure and if it would be material to their agencies. None of the participants offered any comments on the disclosure.

Department of Energy's Note. 18. Contingencies and Commitments

Ms. Ranagan then directed participants to take a look at page 39 of the meeting materials, which contains an excerpt from Energy's note 18, Contingencies and Commitments (see next page), that contains a discussion of Energy's power and transmission commitments and irrigation assistance. She asked Energy how the decision to include this type of disclosure in the contingency note came about. The participant from Energy responded that they are material long-term commitments that are disclosed to Energy by the power marketing administrations (PMA) so Energy incorporated the disclosures into its notes.

Ms. Ranagan commented that the accompanying chart that shows the expected future obligations under long-term power sales contracts for each of the next five years and then for the remaining years was similar to an operating lease disclosure and was a good example of reporting on the type of information that the risk assumed project was looking for. Ms. Ranagan asked if Energy engaged in similar activities where they believed a similar disclosure might be relevant; no suggestions were provided.

Risk Management

Ms. Ranagan asked if any of the agencies had developed internal risk offices or risk tasks, and if so, what type of risks they were looking at. Of the participants that responded, the risk analysis being undertaken related primarily to internal controls and controls over financial reporting, particularly in response to OMB Circular A-123, *Management's Responsibility for Internal Control*,[6] and grantee compliance. One participant from USDA responded that the only areas in his agencies where they assess

[6] Available online at http://www.whitehouse.gov/omb/circulars_default/; last accessed May 17, 2012.

risk of loss are in the program agencies that deal with contingencies, such as crop insurance.

Excerpt from Dept. of Energy 2011 Agency Financial Report, Note 18: Contingencies and Commitments:

PURCHASE POWER AND TRANSMISSION COMMITMENTS AND IRRIGATION ASSISTANCE

The PMAs have entered into commitments to sell expected generation for future dates. When the PMAs forecast a resource shortage based on expected obligations and the historical record, they take a variety of steps to cover the shortage. If appropriate, the PMAs will enter into long-term commitments to purchase power for future delivery. The PMAs record expenses associated with these purchases in the periods that power is received.

As directed by legislation, BPA is required to make cash distributions to Treasury for original construction costs of certain Pacific Northwest irrigation projects that have been determined to be beyond the irrigators' ability to pay. These irrigation distributions do not specifically relate to power generation. In establishing power rates, particular statutory provisions guide the assumptions that BPA makes as to the amount and timing of such distributions. Accordingly, these distributions are recorded as program costs when paid. Future irrigation assistance payments are scheduled over a maximum of 66 years since the time the irrigation facilities were completed and placed in service. BPA is required by the Grand Coulee Dam - Third Power Plant Act to demonstrate that reimbursable costs will be returned to the Treasury from BPA within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects to the extent the costs have been determined to be beyond the irrigators' ability to repay. These requirements are met by conducting power repayment studies including schedules of distributions at the proposed rates to demonstrate repayment of principal within the allowable repayment period. Irrigation assistance excludes $40.3 million for Teton Dam, which failed prior to completion and for which BPA has no obligation to recover these costs.

The following table summarizes future purchase power and transmission commitments and irrigation assistance. The table includes firm purchase power agreements of known cost that are currently in place to assist in meeting expected future obligations under long-term power sales contracts.

FISCAL YEAR ($ IN MILLIONS)	PURCHASE POWER AND TRANSMISSION	IRRIGATION ASSISTANCE
2012	258	1
2013	236	139
2014	159	62
2015	101	85
2016	86	117
2017+	219	2,599
Total	**$ 1,059**	**$ 3,003**

Additional Comments

Ms. Ranagan asked participants if they had any other comments or questions. One of the auditor participants stated that the most important thing is the definition of risk assumed. She stated that the definition as it is currently drafted is very open-ended and uses phrases such as "judgment of a reasonable person" that may lead to omission. She said she needs a clearer understanding of what is the reporting goal and then that would allow the group to tighten up the definition so agencies do not attempt to fit things

into the definition that are not intended to be reported on. She added that she can see additional reporting on grants and contracts in a table but there are other activities that the government engages in that may not be appropriate to include in a table, but might be appropriately disclosed in a narrative fashion.

Another participant added that most of his agency's grants and contracts depend on available funding so if it does not get the funding, it will not be able to issue the grants and contracts. Ms. Ranagan replied that would refer to the legal obligation rather than the financial obligation; the same thing applies to Social Security. The Social Security Administration cannot pay out more to recipients than is in the social security trust fund, but it still reports on the amount of promised benefits that have been made.

One participant noted that the statement of spending may address some of the objectives of the risk assumed project.

One participant stated that, in addition to looking at what additional disclosures may be needed, the project should also look at what additional disclosures are currently required that are not needed. He noted that the amount of disclosures in the CFR are already getting overwhelming so it is important to consider that when proposing new disclosures. He added that the term risk assumed is archaic and we need to find a better term, suggesting a term such as "fiscal exposure" that has been used by GAO in past reports. He said the term that will be used should give the reader a better inclination as to what exactly is being reported.

Ms. Ranagan replied that the definition and terminology are first draft and clearly need work. She stated that this task force on commitments and obligations is the first task force that has been formed under the risk assumed project and FASAB staff member Monica Valentine will be leading another task force on insurance and guarantees. She noted that as staff goes through the project and receives input from the community, they will be able to better refine the definition and terminology. She noted that the main purpose of the meeting was to get a better understanding of accounting for contracts and grants and how the information is reported in the general ledger, budgetary reports, and USASPENDING.GOV. She said they accomplished that objective and noted that it was extremely helpful to get everyone's perspective at the same time.

Ms. Ranagan thanked everyone for their time and input and stated that she greatly appreciated everyone's participation.

Next Steps

FASAB staff will begin preparing draft materials for the task force to review based on the information discussed at this first meeting.

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Task Force on Risks Assumed by the U.S. Government -- Insurance and Guarantees

Final Notes from June 12, 2012 Meeting

July 13, 2012

Federal Accounting Standards Advisory Board
Task Force on Risks Assumed by the U.S. Government –
INSURANCE AND GUARANTEES
441 G St NW – Room 7B16 (Warren Room)
Tuesday, June 12, 2012
9 AM – 12 NOON

Agenda

9:00 – 9:15	Introductions and Overview of Objectives
9:15 – 10:30	Group Discussion • Draft definition of risk assumed • Risks assumed through insurance programs • Current accounting and reporting of insurance programs
10:30 – 10:45	Break
10:45 – 11:45	Group Discussion • Risks assumed through guarantees • Current accounting and reporting of federal guarantees
11:45 – 12:00	Wrap-Up / Next Steps

Disclaimer: In the course of researching, developing or updating federal accounting standards, FASAB staff periodically utilizes task forces, roundtables, surveys, and other means of communication to solicit feedback from the federal community. The information contained in these minutes is intended to assist staff in preparing materials for the board's deliberations; it is not intended to reflect authoritative or formal views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Task Force on Insurance and Guarantees of the U.S. Govt

Minutes from June 12, 2012, Meeting

Participants:

There were 23 individuals composed of preparers, auditors and program personnel representing the entities and organizations below either in person or via conference line.

Agriculture, U.S. Department of (USDA)

- Michael Drewel, Risk Management Agency, Accounting Officer (via conference line)
- Shanda Sander, Risk Management Agency, Special Assistant to Chief Financial Officer (via conference line)

Education, U.S. Department of (Education)

- David Downing, Federal Student Aid -Financial Reporting Division, Director

Federal Accounting Standards Advisory Board (FASAB)

- Wendy Payne
- Julia Ranagan
- Monica Valentine

Federal Deposit Insurance Corporation (FDIC)

- Kevin Brown, Senior Financial Analyst
- Vanessa Hester, Manager of Accounting & Tax Policy (via conference line)

Federal Emergency Management Agency (FEMA)

- Thomas Hayes, Chief Actuary

Housing and Urban Development, U.S. Department of (HUD)

- Myrna Gordan, Director, Financial Analysis and Controls Division, Office of Financial Analysis and Reporting, FHA Comptroller's Office

KPMG LLP

- Ryan Rominiecki

National Credit Union Administration

- Steve Farrar, Division of Risk Management Analyst (via conference line)

Office of Management and Budget (OMB)

- Sarah Lyberg, (via conference line)

Pension Benefit Guaranty Corporation (PBGC)

- Abinet Belachew, Controller, Financial Operations Department

- Raymond Bryant, Team Lead Staff Accountant, Financial Operations Department
- Stephen Leslie, Staff Accountant, Financial Operations Department
- Neela Ranade, Chief Negotiating Actuary

Treasury, U.S. Department of (Treasury)

- Scott Bell, Office of the Fiscal Assistant Secretary/Accounting Policy Division
- Karin Dasuki, Financial Management Service
- Victoria Leas, Financial Management Service

Veterans Affairs, U.S. Department of (VA)

- Hala Maray
- Maryanne Stupka, Chief, Actuarial Staff (via conference line)

U.S. Government Accountability Office (GAO)

- Marcia Carlsen, Financial Management and Assurance
- Darryl Chang, Financial Management and Assurance

Introductions and Overview of Project

FASAB staff member Monica Valentine welcomed participants and provided them with some brief background information on the reason for the task force and the objectives of the meeting.

Ms. Valentine explained that the term "risk assumed" was first used in Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, in relation to reporting for insurance and guarantees. In August 2011, the Federal Accounting Standards Advisory Board (FASAB or "the board") approved a project on risk assumed to determine if additional guidance is needed. In discussions regarding the board's technical agenda, several members of the board asked staff to look at risk assumed from a broad perspective.[1]

Ms. Valentine explained that this task force on Insurance and Guarantees of the U.S. Government is just one of several task forces that will be formed to look at the need for additional reporting of risks assumed by the federal government. The scope of this task force is specifically limited to insurance and guarantee agreements that the federal government has entered into. Ms. Valentine also noted the significant role of the task force in the development of the Board standards.

Ms. Valentine also highlighted the table on page 5 of the meeting materials (see Figure 1 below). The table is the GAO spectrum of fiscal exposures. The table lists the explicit liabilities, financial commitments, financial contingencies, and implicit exposures of the federal government in broad categories, such as insurance programs, loan guarantees, long-term leases, federal disaster relief, and risk assumed by insurance programs.

[1] Minutes from the technical agenda discussion at the April 2011 meeting are available online at http://www.fasab.gov/pdffiles/APRIL_27_28__2011.pdf; last accessed May 10, 2012.

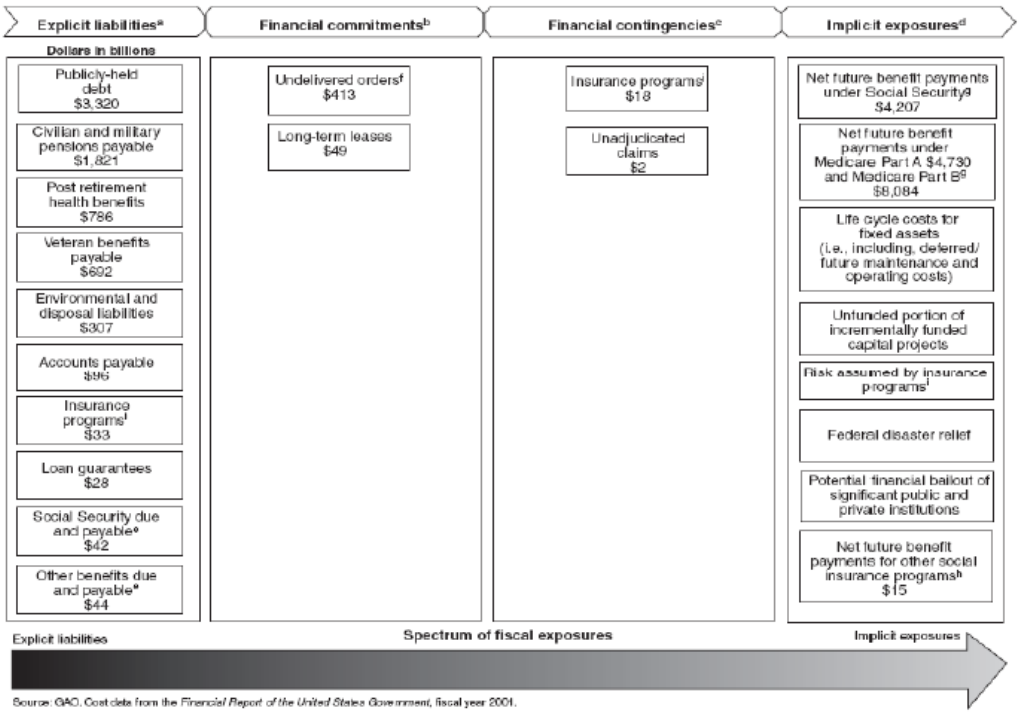

Figure 1 - FOR REFERENCE PURPOSES ONLY—Source: GAO D-03-213; available online at http://www.gao.gov/new.items/d03213.pdf; last accessed April 4, 2012

Group Discussion

Ms. Valentine directed participants' attention to the list of questions for the task force on pages 7 – 8 of the meeting materials, beginning with the draft definition of risk assumed. She then introduced the group to FASAB staff member Julia Ranagan as the lead project director for the Risk Assumed project and also noted that Ms. Ranagan would lead the discussion on the definition and explanation of risk assumed.

Definition and Explanation of Risk Assumed

Ms. Ranagan asked if participants understood the scope of risk assumed based on the following draft definition, asking that participants not focus on the term "risk assumed" since it may not be the ultimate term that is used in the guidance to be developed:

> "The possible or probable risk of future outflows that the federal government is expected to incur, in the judgment of a reasonable person, as a result of its mission, operations, and current or past actions. The population of risk assumed may be determined through a review of varied information, including, but not limited to, obligations incurred, commitments undertaken, contracts signed, agency policy, legislative history, economic projections, programmatic responsibility, and risk analysis.

Risk assumed is generally measured by the present value of unpaid expected outflows net of associated inflows (e.g., premiums), if any, based on management's best estimate of the total risk assumed." [Excerpt from page 12 of meeting materials]

Ms. Ranagan explained that the project on risk assumed is starting broad and the draft definition was intended to be broad to incorporate reporting on the risk assumed associated with all future outflows, not just losses from insurance and guarantee programs.

Ms. Ranagan referred participants to the definition on the bottom of page 12 of the meeting materials and staff's explanation of the difference between liabilities, contingencies, risk assumed, and long-term fiscal projections on page 10.

Ms. Ranagan said, in more simple terms, the topic of risk assumed by the government can be addressed by determining what actions the government has taken as of the reporting date that may result in outflows in the future and whether information about those potential outflows is appropriately reported.

Ms. Ranagan asked if any of the participants had any comments on the definition of risk assumed.

One participant asked whether risk assumed is mutually exclusive of liabilities and contingencies or whether it was all-encompassing. The participant noted that distinction should be clarified in the definition.

Loan Guarantee Discussion

Another participant asked whether loan guarantee programs would be included in the new requirements for reporting risk assumed and asked that be clarified. Loan guarantee programs currently estimate the subsidy allowance which is the federal government's best estimate of probable long-term loss and ultimate risk for loss.

The participant explained that the loan guarantee estimate includes various assumptions about cash flows and OMB provides a number of those economic projections.

The following comments were made by participants as it relates to the current reporting of federal loan guarantee programs and possible additional risk assumed reporting of loan guarantee programs.

- Possible or probable contingencies should be defined in comparison to risk assumed.
- Current loan guarantee liability is based on a best estimate.
- Should the face amount guaranteed be considered as risk assumed, even though the face amount of the guarantee as the risk of loss is not a likely occurrence?
- Sensitivity analysis/stochastic analysis are currently used to assess a program's risk.
- Current loan guarantee presentation can be retained with possible enhancements for improved reporting.

Definition and Explanation of Risk Assumed (cont.)

- *Term "Expected"*

A participant asked what the term "expected" means. Ms. Payne responded that the term can be a "soft term." In traditional accounting, losses are limited to what has occurred as of the reporting date. SFFAS 2, *Accounting for Direct Loans and Loan Guarantees*, moves towards a more statistical meaning of expectations by allowing consideration of future events expected to create losses but without the adoption of a particular method for weighing alternative outcomes. Ms. Payne said risk assumed may move beyond what has already occurred and could consider a statistical approach to considering expectations about losses. She said whether we have a soft definition of expected or a statistical definition will depend on input from the task force.

A participant from PBGC said it already does stochastic modeling to develop a range and discloses results in the footnotes.

- *Term "Inflows" versus Premiums*

Another participant noted that when estimating losses, they offset plan assets.

- *Term "Exposure"*

Another participant noted that he liked the term "exposure" that was used by GAO, instead of the term "risk assumed" when thinking about risk assumed more broadly.

- *Use of Present Value*

One participant noted that, as she mentioned in the task force on commitments and obligations held the prior month, FASAB needs to be careful that present value is only required if it is manageable for the agencies; present value calculations can be burdensome.

- *Subsidy Cost Definition*

Another participant noted that the draft definition of risk assumed sounds very much like the definition for "subsidy cost."

- *How Far into the Future*

Another participant noted that the definition and/or related requirements should specify how far into the future agencies would be expected to estimate risk assumed – one year, five years, 20 years, etc.

Another participant agreed, noting that there should be standard guidance on the timeframe for risk assumed reporting, however that may be challenging given the different characteristics of government programs.

Another participant added that their loan guarantee estimates align with expected cohort cycles.

The participant added that they have program authority issues as well and asked if they should estimate risk assumed for five years if the program is only authorized through 12/31 of the current year.

One participant noted that the principles included in the definition are fundamental to reflect the proper disclosure for future risk exposure and are basic principles for reporting.

Another participant added that the information becomes less meaningful if it is projected out too far into the future. The scope/parameter needs to be defined and the information should be useable.

One participant from PBGC noted that they project new pension plan terminations into the short-term future (for probable claims) and estimate the cost of those terminations through the duration of expected payments (i.e., the pensioner's expected lifespan).

Another participant stated that the concept of projecting future claims and the resulting impact is a slippery slope, especially considering the broad nature of risk assumed -- from hurricanes to pensions.

Another participant pointed out that the use of the phrase "in the judgment of a reasonable person" is very important.

One participant suggested that risk assumed reporting be included the Management Discussion & Analysis (MD&A) section of agencies' performance and accountability reports (PAR). Another participant suggested that risk assumed reporting be limited to narrative discussions in the PAR.

Loan Guarantee Discussion (cont.)

One participant said they already perform reestimates of the subsidy for each cohort and program area, projecting each year, and asked if there is a need for the requirements of risk assumed reporting to apply. She noted that she can see where there might be a need for minor modifications to programs under credit reform but SFFAS 2 is quite concise with respect to what is required.

Ms. Ranagan noted that more could be said about what the reestimates entail and whether they take economic projections into account.

Another participant agreed, noting that the insurance guidance is only one paragraph and could probably use more detailed guidance so agencies are reporting comparable information.

- *Pilot/Example Agency*

One participant said he had a hard time getting his mind around the scope that is being considered for risk assumed because it is such a grey area. He said it would be very helpful to see one or two agencies as pilots or examples of the type of information we are looking for and what reporting of risk assumed losses would look like. (He suggested PBGC and the Terrorism Risk Insurance Program as pilots.) He noted that because risk assumed information requires predicting future events and uncertainties it would involve a lot of assumptions.

The participant noted that for these pilots, he suggests the primary focus is on determining what additional information that is considered meaningful and useful to the citizens, citizen intermediaries, and Congress, which currently is not being reported in the financial statements. For example, what probable/possible expected losses or outflows would you like to see reported related to the Terrorism Risk Insurance Program?

He also noted that this information would be in addition to what is already required under the reporting of contingency losses, which includes expected losses that are "probable" and measurable and "reasonably possible" and measurable. Contingency losses do not include the reporting of losses that are considered a remote likelihood of occurrence or losses that are not measurable. Questions to be considered:

- How are risk assumed losses different from the reporting of contingency losses?
- Rather than developing a separate standard, could risk assumed losses be included under the definition of contingency losses – probable, reasonably possible and measurable -- but requiring more detailed guidance? Or would the reporting of risk assumed losses be considered contingency losses that are "remote" or "not measurable"?
- Does the preparer need to disclose an amount for losses or a range of losses? Given so much uncertainty in predicting the future over a long period of time, could preparers have the option to provide only narrative information?

Insurance Discussion

Ms. Valentine began the discussion on federal insurance programs by directing the group to page 14 of the meeting materials. She highlighted three definitions of insurance from *Webster's Online Dictionary*, OMB's Office of Federal Financial Management (OFFM) *Insurance System Requirements*, and SFFAS 5. She also pointed out the several types of federal insurance programs as listed in the *Budget of the U. S. Government FY 2012, Analytical Perspectives* (*Analytical Perspectives*). Ms. Valentine then directed the group to the list of questions on page 7 of the meeting materials.

The first questions highlighted two example agency financial statement disclosures related to their respective insurance programs.

a) *The National Credit Union Administration (NCUA) discloses in a note to the financial statements information about its insurance and guarantee liabilities. NCUA also reports the amount of* ***reserves recognized for credit unions at risk of failure in Required Supplementary Information*** *(RSI) – Risk Assumed Information [see excerpt from note on pages 18-20 of Attachment B]. Do you think this combination of information addresses the type of risk assumed information that should be reported in agency financial statements? Should additional information be provided? Why or why not?*

b) *The Department of Homeland Security (DHS) discloses in a note to the financial statements information about FEMA's National Flood Insurance Program (NFIP) insurance liabilities.* ***DHS also reports a range of unpaid expected losses in RSI*** *– Risk Assumed Information [see excerpt from note on page 23 of Attachment B]. Do you think this combination of information addresses the type of risk assumed information that should be reported in agency financial statements? Should additional information be provided? Why or why not?*

- *Methodology*

One participant from FDIC responded that they use a methodology that follows Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards (SFAS) 5 (superseded by FASB Accounting Standards Codification 450-20) but they limit disclosure of their analysis because it contains sensitive data.

He noted that they report losses for failed institutions and estimate a contingent loss reserve for institutions that may fail. The contingent loss reserve (CLR), calculated quarterly and in accordance with GAAP, is a liability of the Deposit Insurance Fund (DIF) for the estimated cost of anticipated failures. The horizon for anticipated failures is the 12-month period following the CLR date. The CLR is the sum of reserves for individual problem institutions – generally those that are 4- or 5-rated or for which rating changes to 4 or 5 are in process. The reserve for each problem bank is the product of its: (1) estimated probability of failure over the 12-month CLR horizon, (2) estimated loss given failure, expressed as a percent of its total assets, and (3) total assets, based on the bank's most recent call report.

He noted that they do not disclose the risk rating for institutions because it contains confidential information. Their disclosures in the financial report are minimal for that reason.

Another FDIC representative noted that GAAP (FASB) requires disclosure of exposure to certain concentrations, as well as uncertainties regarding reasonably possible material change in estimates. An example of such disclosure by the FDIC is reflected in the 2005 financial statements of the former Bank Insurance Fund. For that year, the FDIC included a disclosure about the potential impact of Hurricane Katrina on the banking industry. A more recently example on the 2011 financial statements of the Deposit Insurance Fund is the disclosure regarding the concentration of credit risk connected to receivables from resolutions. She also noted that in 2009 the FASB issued new guidance that requires more disclosures about risks and rewards of guarantees on structured transactions and a requirement to disclose an entity's involvement in the transaction.

Another participant noted that "real risk" is somewhere between remote and reasonably possible.

Ms Ranagan asked the FDIC representative if FDIC uses the contingent loss reserve model to develop the risk-based fees. Using historical fund loss and simulated income data from 1950 to the present, the FDIC analyzed how high the reserve ratio would have had to have been before the onset of the two crises that occurred since the late 1980s to have maintained both a positive fund balance and stable assessment rates throughout the period. The analysis concluded that a moderate, long-term average industry assessment rate would have been sufficient to have prevented the fund from becoming negative during the crises, though the fund reserve ratio would have had to exceed 2.0 percent before the onset of the crises.

Therefore, under provisions in the Federal Deposit Insurance Act that require the FDIC Board to set the Designated Reserve Ratio (DRR) for the DIF annually, the FDIC Board adopted in December 2010 a DRR of 2.0 percent for 2011 and voted in December 2011 to maintain a 2.0 percent DRR for 2012. The FDIC views the 2.0 percent DRR as a long-term goal and as the minimum level needed to withstand future crises of the magnitude of past crises. The 2.0 percent DRR should not be viewed as a cap on the fund. The FDIC's analysis shows that a reserve ratio higher than 2.0 percent would increase the chance that the fund will remain positive during a future economic and banking downturn similar to or more severe than past crises.

A representative from PBGC noted that PBGC estimates its actuarial-based factor using points similar to those mentioned by FDIC. The representative also stated that certain industry-based loss models were considered confidential due to the nature of information regarding potential plan terminations. The PBGC representative gave the following summary of their risk reporting.

- Probable losses: For multi-employer plans these include ongoing pension plans with a projected date of insolvency within 10 years. For single-employer plans, events that have occurred such as the plan sponsor being in bankruptcy or liquidation are used to identify probable terminations. For multi-employer or single-employer plans, the present value of future financial assistance or the present value of benefits net of plan assets is reported as a liability respectively.

- Reasonably possible: For both multi-employer and single employer plans, stochastic modeling is used to project the net financial position of the agency into the future under a number of different scenarios and the results are disclosed in PBGC's Annual Report.

- Stochastic modeling is used: For multi-employer plans, these are ongoing plans with a projected insolvency date between 10 and 20 years away. For single-employer plans, plans are identified based on credit ratings and other factors; the institutions are not in as much stress. For both multi-employer and single-employer plans, losses are disclosed in footnotes, as well as in MD&A.

A participant from FDIC noted that some of the more complex models may not be doable by all entities that would be required.

Another participant noted that entities have to be careful what information is reported because of how the reader may interpret the information.

Ms. Payne asked if agencies disclose when their long-term analysis shows they will have negative premium. One participant responded that they disclose that information as part of the financial statement package.

Ms. Valentine posed the following questions to the group as it relates to CFR reporting of Insurance in Force.

c) *SFFAS 5 does not currently require federal entities to disclose insurance in force for their insurance programs. However, the consolidated financial report of the U.S. Government (CFR) reports insurance in force for the government in the CFR Contingencies note [FY 2011 CFR, Note 19, page 112; see excerpt of note at page 25 of Attachment B]. Should all federal reporting entities be required to disclose insurance in force for their insurance programs in their financial reports? Why or why not?*

d) *If federal entities were required to disclose insurance in force information, do you think that information adequately addresses the type of risk assumed information that should be reported in agency financial statements?*

The GAO representative noted that the insurance in force amounts reported in the consolidated financial report of the U.S. Government (CFR) are not taken from agency financial reports but are specifically requested by Treasury for the CFR. (He also noted that for FDIC, the total exposure is reported in the commitments note, but Treasury requests an update because of the timing differences between the two reports.) He also suggested that the insurance in force information be removed because it is misleading and distracting. Treasury chose to leave it in and, since there is no requirement to exclude that information, it remained in the report.

A participant from RMA said insurance in force is not a realistic number.

The representative from FEMA noted that the insurance in force numbers are too overwhelming to even be imagined as a possible loss.

Most participants were not in support of the insurance in force amount because of its uncertainty and their belief that the number is not meaningful.

Other Guarantee-type Programs

Ms. Valentine briefly went over some of the federal guarantee program information on page 28 - 31 of the meeting materials. Including definitions of guarantee from *Webster's Online Dictionary*, OMB's Circular A-11, *Preparation, Submission and Execution of the Budget*: She also pointed out the several types of federal guarantee programs as listed in the *Budget of the U. S. Government FY 2012, Analytical Perspectives* (*Analytical Perspectives*). Ms. Valentine then directed the group to the following questions on pages 7 - 8 of the meeting materials.

a) *SFFAS 2, 18, and 19 outline the GAAP reporting and OMB Circular A-136 provides the financial reporting guidance for federal direct loan and loan guarantee programs under the "Federal Credit Reform Act of 1990." [see pages 32-36 of Attachment C] The reporting requirements for those direct loan and loan guarantee programs under the Act are quite extensive to ensure that the federal government's full exposure as it relates to these programs is reported in federal entity financial statements. Do you think this information being reported addresses the type of risk assumed information that should be reported in agency financial statements for loan guarantee programs? Should additional information be provided? Why or why not?*

b) *SFFAS 5 requires that all federal guarantee programs, except loan guarantee programs, recognize a liability for unpaid claims incurred, as well as reporting any related contingencies as liabilities or disclosures. What additional risk assumed information should be reported for federal guarantee programs (other than loan guarantee programs)? Please explain.*

c) *Current accounting for goods held under price support and stabilization programs is outlined in SFFAS 3: Accounting for Inventory and Related Property paragraphs 92 – 109 [see excerpts on pages 36-38 of Attachment C]. Should programs like USDA's Milk Income Loss Contract Program, administered by the Farm Service Agency through the Commodity Credit Corporation (CCC) be considered federal guarantee programs [see pages 30- 31 of Attachment C]? Why or why not?*

d) *Are there other non-loan guarantee federal programs that could be classified as guarantee programs? If so, what are they?*

The OMB representative noted that instead of adding additional complicated loan guarantee reporting requirements, narrative language explaining the current information being reported would be invaluable information.

A participant said that having narrative that explains "those tables" is far more useful than what is in those tables. He noted that reporting narrative information about things that are known but not estimable could go a very long way in informing financial statement users.

Another participant noted that additional reporting does not necessarily have to be numerically driven.

Ms. Valentine asked the group if there are other non-loan guarantee federal programs that could be classified as guarantee programs. Participants offered the following suggestions:

- FDIC's share loss program
- Federal programs that involve payment of debt not associated with a loan
- FDIC Temporary Liquidity Guarantee Program (expires 12/31/12) – temporary guarantees of senior unsecured debt issued by banks in exchange for a premium fee
- National Credit Union Administration Guaranteed Note Program (NGN)
- Treasury programs that guarantee money market funds
- FDIC indemnifications and guarantee of receivership indemnifications (included in disclosures)
- SBA surety bond guarantee programs

Final Comments

Ms. Valentine thanked everyone for their time and input and stated that she greatly appreciated everyone's participation.

Next Steps

FASAB staff will begin preparing draft materials for the task force to review based on the information discussed at this first meeting.

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