
Statement of Federal Financial Accounting Standards 5: Accounting for Liabilities of The Federal Government

Status

Issued	December 20, 1995
Effective Date	for fiscal years beginning after September 30, 1996.
Interpretations and Technical Releases	Interpretation 2, <i>Accounting for Treasury Judgment Fund Transactions</i> Interpretation 3, <i>Measurement Date for Pension and Retirement Health Care Liabilities</i> Interpretation No. 4, <i>Accounting for Pension Payments in Excess of Pension Expense</i> TR 1, <i>Audit Legal Letter Guidance</i> TR 2, <i>Environmental Liabilities Guidance</i> TR 12, <i>Accrual Estimates for Grant Programs</i>
Affects	<ul style="list-style-type: none">• SFFAS 1, by amending the definition of “liability”.
Affected by	<ul style="list-style-type: none">• SFFAS 7, paragraph 36(b), affects SFFAS 5, paragraphs 35-42 (Contingencies), by creating an exception to the general principles for losses on contracts for goods made to order or services produced to order.• SFFAS 8, paragraphs 116 & 117 affect SFFAS 5, paragraphs 6, 104 and 105.• SFFAS 12 affects SFFAS 5, paragraphs 33 and 36, by changing the recognition criteria for recognizing liabilities arising from litigation.• SFFAS 17 affects SFFAS 5, by providing accounting guidance for social insurance contrary to statements in SFFAS 5, paragraphs 6, 104, and 105.• Interpretation 3 affects SFFAS 5, paragraphs 56-76, by clarifying that the measurement of pension and health care liabilities in general purpose federal financial reports does not have to be based on a full actuarial valuation as of the end of the reporting period.• Interpretation 4 affects SFFAS 5, paragraphs 71, 74, and 75, by providing accounting guidance for the exceptional circumstance where the employer entity’s total payments for FERS and CSRS exceed the related total pension expense. SFFAS 5 provides for the normal circumstance where the pension expense is equal to or more than the entity’s payment to the administrative entity.• SFFAS 25, paragraph 4, affects SFFAS 5, paragraph 106, by classifying “risk assumed” information as Required Supplementary Information (RSI) instead of Required Supplementary Stewardship Information (RSSI). The Executive Summary is also affected.• SFFAS 32 amends paragraphs 117 and 121.• SFFAS 33 amends paragraphs 65, 66, 83, 95 and 157.• SFFAS 39 amends footnote 17.

Summary

This Statement establishes accounting standards for liabilities of the federal government not covered in Statement of Federal Financial Accounting Standards Number 1, *Accounting for Selected Assets and Liabilities*, and in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*. This Statement defines “liability” as a probable future outflow or other sacrifice of resources as a result of past transactions or events.¹

This Statement defines the recognition points for liabilities associated with different types of events and transactions (See Figure 1 on page 6).²

- A liability arising from reciprocal or “exchange” transactions (i.e., transactions in which each party to the transaction sacrifices value and receives value in return) should be recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., a federal employee performs services in exchange for compensation).
- A liability arising from nonreciprocal transfers or “nonexchange” transactions (i.e., transactions in which one party to the transaction receives value without directly giving or promising value in return, such as grant and certain entitlement programs) should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services³ 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 (e.g., estimated Medicaid payments due to health providers for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity).

¹Liabilities recognized according to the standards in this Statement include both liabilities covered by budgetary resources and liabilities not covered by budgetary resources. Liabilities covered by budgetary resources are liabilities incurred that will be covered by available budgetary resources encompassing not only new budget authority but also other resources available to cover liabilities for specified purposes in a given year. Liabilities not covered by budgetary resources include liabilities incurred for which revenues or other sources of funds necessary to pay the liabilities have not been made available through congressional appropriations or current earnings of the reporting entity. Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress. (Adapted from OMB Bulletin No. 94-01, “Form and Content of Agency Financial Statements.”)

²Recognition means reporting a dollar amount on the face of the basic financial statements.

³Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

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- Government-related events are nontransaction-based events that involve interaction between federal entities and their environment. The event may be beyond the control of the entity. A liability is recognized for a future outflow of resources that results from a government-related event when the event occurs if the future outflow of resources is probable and measurable (see paragraphs 33 and 34 for the definitions of probable and measurable, respectively) or as soon thereafter as it becomes probable and measurable. Events, such as a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damage and to the extent that the amount of the payment could be estimated reliably. Government-related events also include hazardous waste spills on federal property caused by federal operations or accidents and catastrophes that affect government-owned property.
 - Government-acknowledged events are events that are of financial consequence to the federal government because it chooses to respond to the event. A liability is recognized for a future outflow of resources that results from a government-acknowledged event when and to the extent that the federal government formally acknowledges financial responsibility for the event and a nonexchange or exchange transaction has occurred. The liability for a nonexchange transaction should be recognized for any unpaid amounts due as of the reporting date and the liability for the an exchange transaction should be recognized when goods or services have been provided. The liability includes amounts due from the federal entity to pay for benefits, goods, or services 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 (Examples of government-acknowledged events include toxic waste damage caused by nonfederal entities and damage from natural disasters).

In addition to discussing the general liability recognition principle, the Statement includes several specific federal liability accounting standards which are summarized below.

- *Contingencies*—A contingency is an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. Contingent future outflows or other sacrifices of resources as a result of past transactions or events may be recognized, may be disclosed⁴, or may not be reported at all, depending on the circumstances.⁵ Contingencies

⁴“Disclosure” in this document refers to information in notes regarded as an integral part of the basic financial statements.

⁵In 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.

should be recognized as a liability when a past transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice of resources is measurable. A contingent liability should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred. 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.

- *Capital leases*—In a lease transaction, the lessee should report a liability when one or more of four specified capital lease criteria are met (see detailed criteria on page 19). The amount to be recorded by the lessee as a liability⁶ under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.
- *Federal debt*—Federal debt transactions are recognized as a liability when there is an exchange between the involved parties. Fixed-value securities are securities that have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) values net of any unamortized discount or premium. Amortization of the discount or the premium should normally follow the interest method; in certain cases, the straight line method is permitted (see page 16). Variable-value securities should be originally valued and periodically revalued at their current value on the basis of the regulations or offering language. The related interest cost of the federal debt includes the accrued (prorated) share of the nominal interest incurred during the accounting period, the amortization amounts of discount or premium of each accounting period, and the amount of change in the current value for the accounting period for variable-value securities.
- *Pensions, other retirement benefits, and other postemployment benefits*—The liability and associated expense for pensions and other retirement benefits (included health care) should be recognized at the time the employee's services are rendered. The expense for postemployment benefits should be recognized when a future outflow or other sacrifice of resources is probable and measurable based on events occurring on or before the reporting date. Any part of that cost unpaid at the end of the period is a liability. The aggregate entry age normal actuarial cost method should be used to calculate the expense and the liability for the pension and other retirement benefits for the administrative entity financial statements, as well as the expense for the employer entity financial statements. The employer entity should recognize an expense and a liability for postemployment benefits when a future outflow or other sacrifice of resources is probable and measurable on the basis of events that have occurred as of the reporting date.

⁶“The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception.” (See SFFAS No. 6, *Property, Plant, and Equipment*.)

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- *Insurance and guarantee programs*—All federal insurance and guarantee programs⁷ (except social insurance and loan guarantee programs⁸) should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. Insurance and guarantee programs recognize as an expense all claims incurred during the period, including, when appropriate, those not yet reported. The change in a contingent liability during the reporting period should also be recognized as a component of expense. Life insurance programs should recognize a liability for future policy benefits in addition to the liability for unpaid claims incurred. All federal insurance and guarantee programs (except life insurance and loan guarantee programs) should also report as required supplementary stewardship information (RSSI) the expected losses that are based on risk inherent in the insurance and guarantee coverage in force.

⁷Social insurance is considered to be a separate program type not included within insurance and guarantee programs. See social insurance discussion in [SFFAS No. 17, Accounting for Social Insurance].

⁸Accounting for 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).

Figure 1: Liability Recognition Summary

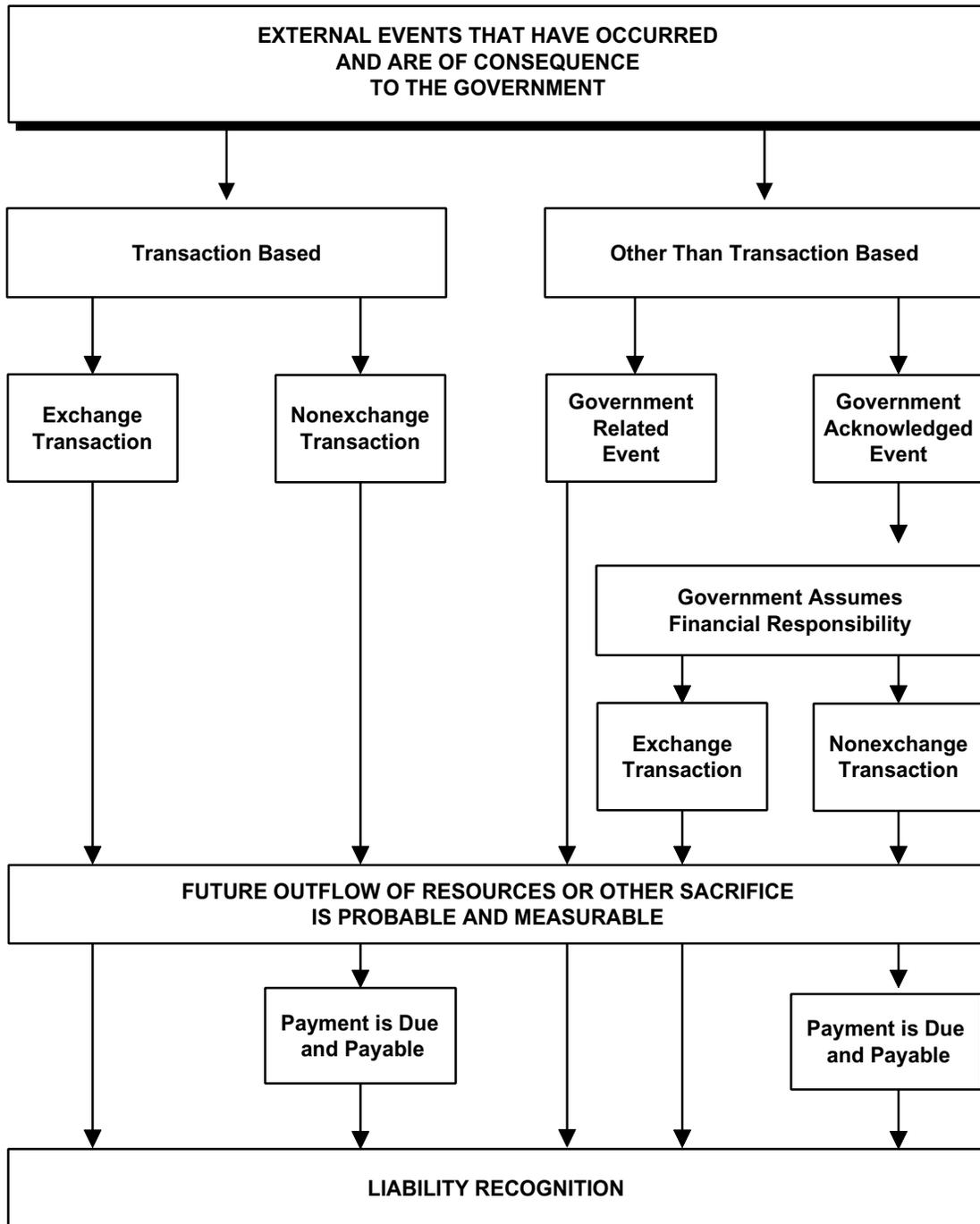


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Purpose

1. The purpose of this Statement is to establish accounting standards to recognize and measure liabilities in general purpose federal financial reports, which are issued for both internal and external users. Appendixes provide background, rationale, and examples of how to apply this standard to liabilities associated with federal programs' transactions and events.

Scope

2. This Statement articulates a general principle that should guide preparers of general purpose federal financial reports. It also provides more detailed guidance regarding liabilities resulting from deferred compensation, insurance and guarantees (except social insurance), certain entitlements, and certain other transactions. The Statement addresses liabilities not covered in Statement of Federal Financial Accounting Standards (SFFAS) Number 1, *Accounting for Selected Assets and Liabilities*, and in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees*.
3. The concept of a liability in this document is consistent with those in Statements Number 1 and 2. The definition amends the stated definition of a liability in SFFAS Number 1. This Statement establishes accounting for liabilities not covered in SFFAS No. 1 and 2. Statement Number 1 addresses only those selected liabilities that routinely recur in normal operations and are due within a fiscal year. The liabilities covered in Statement Number 1 are accounts payable, interest payable, and other current liabilities, such as accrued salaries, accrued entitlement benefits payable, and unearned revenue.¹

¹Adapted from Statement of Federal Financial Accounting Standards (SFFAS) Number 1, *Accounting for Selected Assets and Liabilities* (March 30, 1993), par. 96.

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4. Statement Number 2 addresses liabilities specifically arising from direct loans and loan guarantees. Loan guarantees are “any guarantee, insurance, or other pledge with respect to the payment of all or part of the principal or interest on any debt obligation of a nonfederal borrower to a nonfederal lender, but they do not include the insurance of deposits, shares, or other withdrawable accounts in financial institutions.”²
 5. The general conceptual definition of “liability” underlying this Statement is similar in some respects to that articulated by the Financial Accounting Standards Board (FASB) but the FASAB made certain modifications to the private sector concept to apply it within the federal context. Also, as is explained in the Basis for Conclusions, the specific standards dealing with pensions, other retirement benefits, and postemployment benefits differ from those the FASB has published.
 6. This Statement requires certain disclosures about existing liabilities. The Statement, however, does not fully address information about stewardship responsibilities, including social insurance,³ related to future financial reporting periods. Such information may be reported in a supplementary stewardship report, pursuant to standards now being developed (see FASAB’s ED, *Supplementary Stewardship Reporting*). Information about projected future outflows is vital to making informed decisions about public policies, including the level of benefits promised under current law and the level of revenues/premiums required to liquidate the liability (if any).
 7. The recognition of social insurance programs⁴ presented the Board with significant theoretical and practical problems. The exposure process for the draft liability standard brought forth strongly held positions about social insurance. Upon reconsideration of the issues the Board concluded that, regardless of the technical merits of the arguments concerning the nature of social insurance programs, it was questionable whether adequate information concerning social insurance could be presented by means of a single, point-in-time number on a Balance Sheet. The Board modified the draft standard so it would require several measures of social insurance to be presented. The Board decided that, given the sensitivity and magnitude of social insurance, the new proposal should receive additional exposure to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and presented

²OMB Circular No. A-11 as cited in Statement of Federal Financial Accounting Standards Number 2, *Accounting for Direct Loans and Loan Guarantees* (August 23, 1993), p. 46.

³Stewardship responsibilities are further discussed in *Supplementary Stewardship Reporting*.

⁴Social insurance programs are income transfer programs financed by compulsory earmarked taxes and in certain cases also include general revenues of the federal government.

in the *Supplementary Stewardship Reporting* Exposure Draft. (For more details see the Basis for Conclusions).

Objectives Of Federal Financial Reporting

8. When developing accounting standards for the federal government, the significant environmental differences between the federal government and the private sector must be kept in mind. Statement of Federal Financial Accounting Concepts Number 1, *Objectives of Federal Financial Reporting*, discusses the federal accounting and financial reporting environment. It notes the following:

The federal government is unique, when compared with any other entity in the country, because it is the vehicle through which the citizens of the United States exercise their sovereign power. The federal government has the power through law, regulation, and taxation to exercise ultimate control over many facets of the national economy and society. All other entities within the nation, both public and private, operate within the context of laws, oversight, and accountability established by the national government. The federal government is accountable only to its citizens. It is politically accountable to the electorate, but no higher agency has the power to demand an accounting from the government.

9. The objectives of federal financial reporting were designed to guide the Board in developing accounting standards to enhance the financial information reported by the federal government. The four objectives are discussed under the headings (1) budgetary integrity, (2) operating performance, (3) stewardship, and (4) systems and control. These objectives were used as a basis to develop the Liability Statement. The Board believes that the operating performance objective has special relevance to decisions about recognition and measurement of liabilities in general purpose federal financial reports. That objective reads as follows:

Federal financial reporting should assist report users in evaluating the service efforts, cost, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.⁵

10. At the same time, the Board recognizes that the third objective, dealing with stewardship, is equally important.

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

⁵Statement of Federal Financial Accounting Concepts Number 1, *Objectives of Federal Financial Reporting* (Sept. 2, 1993).

Federal financial reporting should provide information that helps the reader to determine:

- whether the government's financial position improved or deteriorated over the period;
- whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due; and
- whether government operations have contributed to the nation's current and future well-being.

Examples of information relevant to this objective include:

- the amount of assets, liabilities, and net assets (or net position);
- an analysis of government debt, its growth, and debt service requirements;
- changes in the amount and service potential of capital assets; and
- the amount of contingent liabilities and unrecognized obligations⁶ (such as the probable cost of deposit insurance).

Accordingly, information about projected future responsibilities and resources is as important as information about assets, liabilities, revenues, and expenses.

Entity And Display

11. SFFAC Number 2, *Entity and Display*, is a concept statement that provides a framework for defining the meaningful reporting units for general purpose federal financial reports with consideration of the relationships among the budgetary, organizational, and programmatic units. The Concepts Statement also describes in general terms the nature of general purpose federal financial reports, including their names and formats. Agreement on the concepts of entity and display is necessary to establish standards for presenting general purpose federal financial reports.
12. The Entity and Display and Liability Statements are interrelated in several ways. Decisions on each affected the other. For example, the Entity and Display Concept Statement suggests what reporting units should report liabilities and, in general terms, how these liabilities should be displayed. The provisions of the Concept Statement that contemplate presentation of information about future stewardship responsibilities as well as information about events and transactions that have occurred are related to the selection of events and transactions to be recognized.⁷

⁶The term "obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.

⁷ See Statement of Federal Financial Accounting Concepts (SFFAC) Number 2, Entity and Display (April 20, 1995).

Effective Date

13. The accompanying standards presented in this Statement become effective for fiscal periods beginning after September 30, 1996. Earlier implementation is encouraged.

Structure Of This Document

14. This document has three sections, two appendixes, and a glossary. The first section, the executive summary, precedes this section. This introduction constitutes the second section. The remaining section and appendixes are described below.

Liability Standards

15. This section presents a definition and criteria for recognizing a liability and related disclosure requirements. It also provides specific standards for contingencies, capital leases, federal debt, pensions, other postemployment and retirement benefits, and insurance (other than social insurance) and guarantees.

Appendix A: Basis for Conclusions

16. This appendix summarizes considerations that members of the Board deemed significant in reaching the conclusions in the Statement.

Appendix B: Liability Recognition and Measurement Matrix

17. The Liability Recognition and Measurement Matrix illustrates the measurement attributes and recognition points for several transactions and events.

Appendix C: Glossary

Glossary [omitted – see Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1]

18. The glossary defines various terms used in this Statement.

Liability Standards

Definition And General Principle For Recognition Of A Liability

19. A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize⁸ probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.⁹

Events And Transactions

20. The existence of a past event (which includes transactions) is essential for liability recognition. An event is a happening of financial consequence to an entity.¹⁰ An event may be an internal event that occurs within an entity, such as transforming raw materials into a product. An event may also be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, a theft, vandalism, an injury caused by negligence, or an accident.
21. As the term is used in this Statement, a **transaction** involves the transfer of something of value. Transactions may be either exchange transactions or nonexchange transactions. The distinction between exchange and nonexchange transactions is important in determining the point of liability recognition in federal accounting.

⁸Recognition means reporting a dollar amount on the face of the basic financial statements .

⁹This document uses the term “nonexchange transaction” in a way similar to FASB’s “nonreciprocal transfer.” That is, it implies a one-way flow of resources, services, or promises between two parties. “Transaction” in the phrase “nonexchange transaction” does not include reclassification, closing, and similar “internal” entries to the accounting records, though some accountants use the term in that broader sense. “Probable” means more likely than not. “Measurable” means reasonably estimable.

¹⁰“Consequence” is defined as something of importance or significance.

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22. An **exchange transaction** arises when each party to the transaction sacrifices value and receives value in return. There is a two-way flow of resources or of promises to provide resources. In an exchange transaction, a liability is recognized when one party receives goods or services in return for a promise to provide money or other resources in the future.¹¹
23. An example of an exchange transaction occurs when a federal employee performs services in exchange for compensation. The compensation includes current salary and future retirement benefits. An exchange transaction occurs because both parties (the employee and the employer) receive and sacrifice value. The expense is recognized in the period that the exchange occurs. The compensation liability includes unpaid salary amounts earned and the cost of future retirement benefits related to current period services.
24. A **nonexchange transaction** arises when one party to a transaction receives value without directly giving or promising value in return. There is a one-way flow of resources or promises. For federal nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services¹² 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 for service that has been rendered and that will be financed by the federal entity but have not yet been reported to the federal entity) .
25. Many grant and certain entitlement programs are nonexchange transactions. When the federal government creates an entitlement program or gives a grant to state or local governments, the provision of the payments is determined by federal law rather than through an exchange transaction.
26. An **event** is defined as a happening of financial consequence to an entity. For federal financial reporting, some events may be other than transaction based and these events may be classified in one of two categories: (1) government-related events or (2) government-acknowledged events.
27. **Government-related events** are nontransaction-based events that involve interaction between the federal government and its environment. The event may be beyond the control of the federal entity. In general, a liability is recognized in connection with government-related events on the same basis as those that arise in exchange transactions. Events, such as

¹¹Executory contracts where goods and services have not been received are not generally recognized as liabilities in financial accounting, although they are generally recognized as obligations in governmental budgetary accounting.

¹²Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of the disaster relief beneficiaries.

a federal entity accidentally causing damage to private property, would create a liability when the event occurred, to the extent that existing law and policy made it probable that the federal government would pay for the damages and to the extent that the amount of the payment could be estimated reliably.¹³

28. Government-related events include:

(1) cleanup from federal operations resulting in hazardous waste that the federal government is required by statutes and/or regulations, that are in effect as of the Balance Sheet date, to clean up (i.e., remove, contain, or dispose of);¹⁴

(2) accidental damage to nonfederal property caused by federal operations; and

(3) other damage to federal property caused by such factors as federal operations or natural forces.¹⁵

29. Government-related events resulting in a liability should be recognized in the period the event occurs if the future outflow or other sacrifice of resources is probable and the liability can be measured, or as soon thereafter as it becomes probable and measurable.

30. **Government-acknowledged events** are those nontransaction-based events that are of financial consequence to the federal government because it chooses to respond to the event. The federal government has broad responsibility to provide for the public's general welfare. The federal government has established programs to fulfill many of the general needs of the public and often assumes responsibilities for which it has no prior legal obligation.

31. Consequently, costs from many events, such as toxic waste damage caused by nonfederal entities and natural disasters, may ultimately become the responsibility of the federal government. But these costs do not meet the definition of a "liability" until, and to the extent that, the government formally acknowledges financial responsibility for the cost from the

¹³The vast majority of claims against the United States Government stemming from tortious government conduct are adjudicated under the Federal Tort Claims Act (FTCA), which provides for both administrative and judicial resolution. Administrative awards under the established threshold are paid from agency appropriations. Administrative awards in excess of the established threshold are paid from the judgment appropriation. Court judgments and compromise settlements by the Department of Justice are paid from the judgment appropriation regardless of amount. This Act means that, for certain types of events it is not necessary for the government to acknowledge financial responsibility separately for each individual event as is the case for events described in paragraph 30.

¹⁴See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, for a detailed discussion of cleanup cost.

¹⁵The subjects of valuing assets and of measuring asset impairments—thus measuring the loss to be recognized—are beyond the scope of this Statement. See SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, for a discussion on the impairment or loss of federal property.

event and an exchange or nonexchange transaction has occurred. In other words, the federal entity should recognize the liability and expense when both of the following two criteria have been met (1) the Congress has appropriated or authorized (i.e., through authorization legislation) resources and (2) an exchange occurs (e.g., when a contractor performs repairs) or nonexchange amounts are unpaid as of the reporting date (e.g., direct payments to disaster victims), whichever applies.

32. The following example illustrates the liability recognition of government-acknowledged events. A tornado damages a U.S. town and the Congress appropriates funds in response to the disaster. This event is of financial consequence to the federal government because the federal government chooses to provide disaster relief to the town. Transactions resulting from this appropriation, including disaster loans, outright grants to individuals, and work performed by contractors paid by the federal entities, are recognized as exchange or nonexchange transactions. In the case of exchange transactions, amounts payable for goods and services provided to federal entities are recognized when the goods are delivered or the work is done. In the case of nonexchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. The liability includes amounts due from the federal entity to pay for benefits, goods, or services 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.

Probable Future Outflow Or Other Sacrifice Of Resources

33. "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic with the exception of pending or threatened litigation and unasserted claims.^{15a} The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to

^{15a} The concept of probability is imprecise and difficult to apply with respect to most legal matters. The "more likely than not" phrase suggests greater precision than is attainable when assessing the outcome of matters in litigation. Accordingly, in the context of assessing the outcome of matters of pending or threatened litigation and unasserted claims, and recognizing an associated liability, "probable" refers to that which is likely, not to that which is more likely than not. Note that the remaining two criteria for recognizing a liability—that is, a past event or exchange transaction has occurred and the future outflow or sacrifice of resources is measurable—also must be met before recognizing a contingent liability in matters involving litigation.

liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.¹⁶

Measurability

34. “Measurability” means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable. Liabilities reported in the financial report are measured by different attributes specified by various accounting standards. Several different measurement attributes are used for different items in present practice (e.g., fair market value, current cost, present value, expected value, settlement value, and historical cost).

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.

¹⁶See Statement of Federal Financial Accounting Standards Number 1, *Accounting for Selected Assets and Liabilities*, (March 30, 1993), app. A, par. 95.

¹⁷Contingencies 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.

- 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.

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.

¹⁸The 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.

¹⁹In 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.

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

Capital Leases

43. **Capital leases** are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria, the lease should be classified as a capital lease by the lessee:
 - The lease transfers ownership of the property to the lessee by the end of the lease term.
 - The lease contains an option to purchase the leased property at a bargain price.
 - The lease term is equal to or greater than 75 percent of the estimated economic life of the leased property.
 - The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property. If a lease does not meet at least one of the above criteria it should be classified as an operating lease.

44. The amount to be recorded by the lessee as a liability under a capital lease is the present value of the rental and other minimum lease payments during the lease term, excluding that portion of the payments representing executory cost to be paid by the lessor.²⁰ However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the liability should be the fair value. If the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated.
45. The discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate. The lessee's incremental borrowing rate shall be the Treasury borrowing rate for securities of similar maturity to the term of the lease.
46. During the lease term, each minimum lease payment should be allocated between a reduction of the obligation and interest expense so as to produce a constant periodic rate of interest on the remaining balance of the liability.²¹

²⁰The cost of general property, plant, and equipment acquired under a capital lease shall be equal to the amount recognized as a liability for the capital lease at its inception." See SFFAS No. 6, Accounting for Property, Plant, and Equipment.

²¹OMB Circular No. A-11, "Preparation and Submission of Annual Budget Estimates," explains the measurement of budget authority, outlays, and debt for the budget in the case of lease-purchases and other capital leases. Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," provides the requirements under which a lease-purchase or other capital lease has to be justified and the analytical methods that need to be followed.

Federal Debt And Related Interest Cost

47. This standard applies to all securities or other debt instruments issued by the U.S. Treasury or other federal agencies. It encompasses debt issued to the public and debt issued to federal accounts by other federal accounts.²²
48. Accounting for the federal debt should identify the amount of the outstanding debt liability of the federal government at any given time and the related interest cost for each accounting period. This entails valuing securities initially at their sales price or proceeds, ultimately at the amount paid to the holder at maturity, and in the intervening period in a way that fairly expresses the federal government's liability.

Accounting For Federal Debt Securities

49. Federal debt securities²³ fall into two major categories for accounting purposes: fixed value securities and variable value securities.

Fixed Value Securities

50. Fixed value securities have a known maturity or redemption value at the time of issue. These securities should be valued at their original face (par) value net of any unamortized discount or premium. Securities sold at face (par) have no discount or premium and should be valued at face (par). Securities sold at a discount will increase in value between sale and maturity; securities sold at a premium will decrease in value. Amortization of the discount or premium may follow the straight line method or the interest method.²⁴ Either method is acceptable in the cases of
 - short-term securities that have a maturity of 1 year or less, and
 - longer-term securities for which the amount of amortization under the straight-line method would not be materially different from the amount of amortization under the interest method.
51. In all other cases, the interest method for amortizing any discount or premium should be used.

²²This includes but is not limited to debt issued by the U.S. Treasury to trust funds, agency borrowings from Treasury, and trust fund borrowings from other trust funds.

²³Figure 2 lists various categories and examples of federal debt securities.

²⁴For an explanation and an example of the interest method of amortization, see Appendix B of SFFAS No. 1.

Variable Value Securities

52. Variable value securities have unknown redemption or maturity values at the time of issue. Values of these securities can vary on the basis of regulation or specific language in the offering. These securities should be originally valued and periodically revalued at their current value, on the basis of the regulations or offering language.

Related Interest Cost

53. The related interest cost of the federal debt include:
- the accrued (prorated) share of the nominal interest incurred during the accounting period,
 - the amortization amounts of discount or premium for each accounting period (based on the same amortization method used to account for the related debt liability) for fixed value securities, and
 - the amount of change in the current value for the accounting period for variable value securities.

Retirement Prior To Maturity

54. For those securities that are retired prior to the maturity date due to a call feature of the security, or because they are eligible for redemption by the holder on demand, the difference between the reacquisition price and the net carrying value of the extinguished debt should be recognized currently in the period of the extinguishment as losses or gains.

Old Currencies Issued By The Federal Government²⁵

55. Pursuant to federal law, old currencies issued by the federal government and not yet redeemed or written off are identified as a federal debt liability at face value and do not bear any interest.

²⁵Old currencies include National and Federal Reserve Bank Notes, Old Demand Notes, Old Series currency, and silver certificates classified as public debt pursuant to 31 U.S.C. 5119.

Figure 2: Various Categories And Examples Of Federal Debt Securities²⁶

Federal Debt Instruments				
Debt Category	Subcategory	Term	Redeemable	Accounting Method
Marketable Debt	Treasury Bills	Up to 1 yr	At maturity	Liability at face value net of unamortized discount Straight line method of amortization of discount
	Treasury Notes	2 to 10 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
	Treasury Bonds	10 to 30 yrs	At maturity	Liability at face value net of unamortized discount and premium Straight line method of amortization of discount and premium
Non-Marketable Debt	Government Account Series:			
	Par Values	Various	On demand	Par value, no discount or premium to be amortized
	Market Based	Various	On demand	Liability at face value net of unamortized discount and premium Interest method of amortization of discount and premium
	U.S. Savings Bonds:			
	E/EE bonds	10 to 40 yrs	On demand after 6 months	Current value
	H/HH bonds	10 to 30 yrs	On demand after 6 months	Par value, no discount or premium to be amortized
	State & Local Government Securities	Various	On demand	Par value, no discount or premium to be amortized
	Domestic Series			
	Zero-Coupon bonds	20 to 40 yrs	At maturity	Liability at face value net of unamortized discount Interest method of amortization of discount
	Foreign Series			
Treasury bills	Up to 1 yr	On demand	Liability at face value net of unamortized discount Straight line method of amortization of discount	
Zero-Coupon bonds	20 to 30 yrs	At maturity (1 bond)	Liability at face value net of unamortized discount Interest method of amortization of discount	
		On demand (2 bonds)	Current value.	

²⁶These tables are intended to illustrate current practice only and are not to be considered authoritative.

Pensions, Other Retirement Benefits, And Other Postemployment Benefits

56. Employee benefits of federal civilian and military personnel and veterans²⁷ include pensions and postemployment and retirement benefits other than pensions. Pension plans²⁸ provide benefits upon retirement and may also provide benefits for death, disability, or other termination of employment before retirement. Pension plans may also include benefits to survivors and dependents, and they may contain early retirement or other special features. The actuarially determined liability and expense of the plan, including all its provisions, is part of the pension plan's liability and expense estimate.
57. In addition to or in lieu of pension benefits, a liability for postemployment and other retirement benefits may be incurred outside the pension plan. Postemployment benefits other than pensions (OPEB) include all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.²⁹ Inactive employees are those who are not currently rendering services to their employers and who have not been terminated, but who are not eligible for an immediate annuity, including those temporarily laid off or disabled. OPEB include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment and workers' compensation benefits paid by the employer entity.³⁰
58. Retirement benefits other than pensions (ORB) are all forms of benefits to retirees or their beneficiaries provided outside the pension plan. Examples include health and life insurance. Retirement health care benefits are the primary ORB expense. They present unique measurement problems.

²⁷Veterans' compensation included in this category is a measurable program benefit that directly relates to a veteran's prior military service and is not the type of benefit included in general fund benefit programs. For example, compensatory income payments for injuries sustained in the line of duty (i.e., VA disability compensation benefits) are employee benefits, while entitlement benefits (i.e., VA pension) are accounted for as general fund benefits. (Also see Appendix A: Basis for Conclusions.)

²⁸This standard addresses "defined benefit plans," which define the future benefits that will be paid in terms of such factors as age, years of service, or compensation. The amount of benefit depends on a number of future events incorporated in the plan's benefit formula.

²⁹Special termination benefits (such as specially authorized separation incentive programs) are considered other postemployment benefits and should be recognized as such.

³⁰The terms "employer entity" and "administrative entity" are used in this document to distinguish between entities that employ federal workers and thereby generate the employee costs, including pension cost, and those that are responsible for managing and/or accounting for the pension or the other employee plan. For example, entities that receive "salaries and expense" appropriations are employer entities, while the Office of Personnel Management is an administrative entity because it administers the civilian retirement benefit plans.

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59. Pension benefits, OPEB, and ORB are exchange transactions because the employee performs service in part to receive the deferred compensation provided by the plans (such as future pension and medical care benefits). For pension and other retirement benefits, the expense is recognized at the time the employees' services are rendered. For OPEB, the expense is recognized at the time the accountable event occurs. Any part of that cost unpaid at the end of the period is a liability.
60. This Statement is intended to specify the accounting objectives. With regard to pensions and ORB, if estimates, averages, or such devices can reduce the cost of applying this Statement, their use is appropriate provided the results do not materially differ from a detailed application of the standard.

Pensions

61. Pension benefits include all retirement, disability, and survivor benefits financed through a pension plan, including unfunded pension plans. Federal civilian and military employees are covered primarily under the following three defined benefit retirement plans: Civil Service Retirement System (CSRS), Federal Employees Retirement System (FERS), and Military Retirement System (MRS). To the extent that federal employees are covered by social insurance programs (such as Social Security), the taxes they pay to the program and the benefits they will eventually receive are to be accounted for on the same basis used to account for other program participants. However, the payments to social insurance plans that agencies must make are operating costs. Similarly, to the extent that federal employees are covered by defined contribution plans (i.e., the Thrift Savings Plan, which is like a 401(k) plan), federal payments to the plan are expenses, but the plan itself is not covered under this standard.
62. This Statement establishes standards of accounting for pension expense and related pension liability for federal government employers and administrative agencies.

Accounting for the Pension Plan

63. This section covers federal pension plans. The entity that administers the plan (i.e., the "administrative entity") should account for and report the plan in accordance with this standard.³¹ A subsequent section covers federal employer entities.

³¹In addition to the requirements of this standard, which deals with general purpose financial reports, federal plans report annually pursuant to P.L. 95-595, which calls for statements of net assets available for benefits, a statement of accumulated benefits, and other statements. The reporting requirements of Public Law 95-595 were rescinded by Public Law 105-362, Federal Reports Elimination Act of 1998.

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64. **Attribution Methods**—The “aggregate entry age normal” actuarial cost method should be used to calculate the pension expense, the liability for the administrative entity financial statements, and the expense for the employer entity financial statements. The aggregate entry age normal method is one under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages; and it should be applied to pensions on the basis of a level percentage of earnings. The portion of this actuarial present value allocated to a valuation year is called the “normal cost.” The portion not provided for at a valuation date by the actuarial present value of future normal cost is called the “actuarial accrued liability.”³² The plan, however, may use other actuarial cost methods if it explains why aggregate entry age normal is not used and if the results are not materially different.
65. **Assumptions**—For financial reports prepared for the three primary federal plans (CSRS, FERS, and MRS), actuarial estimates of assumptions should be used to calculate the pension expense and liability. The selection of all actuarial assumptions should be guided by Actuarial Standards of Practice No. 4, *Measuring Pension Obligations*, as revised from time to time by the Actuarial Standards Board.³³ Accordingly, actuarial assumptions should be on the basis of the actual experience of the covered group, to the extent that credible experience data are available, but should emphasize expected long-term future trends rather than give undue weight to recent past experience. Although emphasis should be given to the combined effect of all assumptions, the reasonableness of each actuarial assumption should be considered independently on the basis of its own merits and its consistency with each other assumption.
66. In addition to complying with the guidance in the preceding paragraph, the discount rate assumption for present value measurements of pension liabilities should be the interest rate on marketable Treasury securities of similar maturities to the cash flows of the payments for which the estimate is being made. The discount rates should be matched with the expected timing of the associated expected cash outflow. Thus, each year for which cash flows are projected should have a separate discount rate associated with it. However, a single average discount rate may be used for all projected future payments if the resulting present value is not materially different than the resulting present value using multiple-rates. The underlying inflation rate and the other economic assumptions should be consistent. The discount rates should reflect average historical rates on marketable Treasury securities rather than give undue weight to recent past experience with such rates. Historical experience should be the basis for expectations about future trends in marketable Treasury securities. In developing

³²Adapted from Actuarial Standards of Practice No. 4, *Measuring Pension Obligations* (Jan. 1990), p. 31.

³³The Actuarial Standards Board is a board within the American Academy of Actuaries that sets professional standards of actuarial practice.

the average historical Treasury rates, a minimum of five historical rates as of the appropriate reporting dates should be used for each maturity. The historical rates used to calculate the average should be sequential (e.g. 2003-2007). For example, for an average historical Treasury rate to be used as the discount rate as of the end of the fiscal year 2007 for a payment due in 10 years, i.e., in 2017, a minimum of five 10-year Treasury rates should be used. Thus, the rate on 10-year Treasury securities as of the end of fiscal year 2007 would be one rate, the rate on 10-year Treasury securities as of the end of fiscal year 2006 would be another rate, etc., until, at a minimum, the rates on 10-year Treasury securities for the years 2003 through 2007 were included in the average. The number of historical rates used for the average, e.g., five yearly rates, should be consistent from period to period. The entity should explain that its accounting policy is to be consistent in this regard from period to period. For cash flows that are projected to occur in future years for which Treasury securities are not available or that extend beyond the maturities for which Treasury securities are available, e.g., beyond the 30-year security, the preparer should incorporate in the assumed discount rate expected re-financing rates extrapolated from historical Treasury borrowing rates.

67. The administrative entity should disclose the assumptions used. Administrative entities are encouraged to consult with one another to achieve the maximum consistency among assumptions used for financial reports. Smaller federal administrative entities may employ the assumptions used by any of the three primary plans where appropriate or their own assumptions. If they use assumptions that differ from all of the primary plans, a footnote should explain how and why the assumptions differ from one of those plans.
68. **Assets** should be reported separately from the pension liability rather than reporting only a net liability. Assets of federal pension plans should be carried at their acquisition cost, adjusted for amortization, if appropriate. For investments in market-based and marketable securities, the market value of the investment should be disclosed.³⁴
69. **Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses**—Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior service. This results in a gain to the extent that previously recognized benefits are reduced. As explained in the next paragraph, the accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the pension liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

³⁴See SFFAS Number 1, *Accounting for Selected Assets and Liabilities*.

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70. The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.
71. **Accounting by the Administrative Entity**— The administrative entity should account for and report the pension liability in its financial report, using the aggregate entry age normal actuarial method. The liability is the actuarial present value of all future benefits, based on projected salaries and total projected service, less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. Projected salaries should reflect an estimate of the future compensation levels of the individual employees involved, including future changes attributed to the general price level, productivity, seniority, promotion, and other factors.
72. The administrative entity should report a pension expense for the net of the following components:
- normal cost;
 - interest on the pension liability during the period;
 - prior (and past) service cost from plan amendments (or the initiation of a new plan) during the period, if any; and
 - actuarial gains or losses during the period, if any.

The individual components should be disclosed.

73. The administrative entity should report revenue for the sum of amounts received from the employer entity representing contributions from:
- the employer entity and
 - its employees.³⁵

The employer entity's contribution represents intragovernmental revenue.³⁶

An illustration of the accounting for the administrative entity (and the employer entity) is explained in the following section entitled "Accounting Illustration."

³⁵The administrative entity may also receive financing from the General Fund to cover prior service or other cost for which contributions from employer entities are not provided.

³⁶Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

Employer Entity Accounting

74. The federal employer entity should recognize a pension expense in its financial report that equals the service cost³⁷ for its employees for the accounting period, less the amount contributed by the employees, if any. The measurement of the service cost should require the use of the plan's actuarial cost method and assumptions, and therefore the factor to be applied by the employer entities must be provided by the plan and/or the administrative entity.
75. The employer entity's pension expense should be balanced by: (a) a decrease to its "fund balance with Treasury" for the amount of its contribution to the pension plan, if any; and if this does not equal the full expense, by (b) an increase to an account representing an intragovernmental imputed financing source entitled, for example, "imputed financing - expenses paid by other agencies." The latter represents the amount being financed directly through the pension plan's administrative entity.
76. In special instances when an employer entity is also the administrative entity, that is, when there is no separate pension plan (e.g., the Coast Guard), the employer entity should report the liability and recognize the pension expense for all components of cost. The liability and the expense should be accounted for as described in the preceding section for the administrative entity without reference to transactions with external employer entities.

Accounting Illustration

77. Tables 1-4 provide an example in which the employer entity recognizes an "employer's pension expense" in an amount equal to the service cost attributable to its employees during the accounting period, less the employees' own contributions. The expense in this example is more than the contribution that the employer entity is required by law to pay. The difference between the employer's pension expense and the employer's contribution is credited to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The employer entity transfers its contribution and that of its employees to the administrative entity.
78. The administrative entity recognizes revenue for: (1) contributions from the employer entity, (2) contributions from the employees, and (3) interest on the plan's investments. The administrative entity recognizes expense for the net of the pension cost components.

³⁷"Service cost" is defined as the actuarial present value of benefits attributed by the pension plan's benefit formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost."

Assumptions are as follows:

- Total normal cost of employees for the accounting period is \$160,000.
- The employer's pension expense is \$100,000. The employer entity would calculate its pension expense on the basis of information received from the plan and/or the administrative entity. Its pension expense is equal to its share of the service cost of its employees' pensions.
- According to current law, the employer entity is authorized in its appropriation to pay \$60,000 for employee pensions.
- The employees contribute \$60,000 to the pension fund.
- No general fund appropriations made directly to the administrative agency are involved in these transactions, as they could be under actual operations.

Entry #1 – Employer entity’s entry to record pension expense:

	Debit	Credit
Employer’s Pension Expense	\$100,000	
Appropriations Used		\$60,000
Imputed Financing - Expenses Paid by Other Entities		\$40,000

Table 1

Employer Entity’s Other Financing Sources as They Should Appear on Its Statement of Changes in Net Position

FINANCING SOURCES:³⁸

Appropriations Used.....	\$60,000
Imputed financing.....	\$40,000

Note: Imputed financing covers the difference between (1) the employer entity’s contribution transferred to the administrative entity pursuant to law (exclusive of the employees’ contributions) and (2) the employer’s pension expense calculated on the basis of information received from the administrative entity--as shown immediately below.

Employer Entity’s Cost as It Should Appear on the Statement of Net Cost

COST :

Employer’s pension cost	\$100,000
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Note: This is the employer entity’s service cost of employee pensions. The employer entity would calculate this amount using factors provided by the plan and/or the administrative entity. Also to be transferred to the administrative entity is the amount withheld from employees’ wages, as called for under the terms of the plan. The employees’ contribution is not an expense of the employer entity.

Note: The above table and those that follow in the sections on pensions and ORB are presented for illustrative purposes only; the responsibility for defining the form and content of a financial statement prepared pursuant to the Chief Financial Officers Act, as amended, is the responsibility of the Office of Management and Budget.

³⁸SFFAC No. 2, *Entity and Display*, presents a change in the way revenue and other financing sources are reported. This illustration reflects the new concepts.

Entry #2 -- Administrative entity's entry to record revenue received from employer entity:

	Debit	Credit
Fund Balance with Treasury	\$120,000	
Retirement Program Revenue - Contribution Received from Employer Entity		\$60,000
Retirement Program Revenue - Contribution Received from Employees		\$60,000

Entry #3 -- Administrative entity's entry to record revenue from interest on investments in Treasury securities:

	Debit	Credit
Fund Balance with Treasury	\$XXX,XXX	
Interest Revenue		\$XXX,XXX

Table 2

Administrative Entity's Revenue as It Should Appear on the Statement of Net Cost

LESS OTHER EARNED REVENUES:

Contributions received from employer entities.....	\$60,000
Contributions received from employees.....	60,000
Interest on investments	<u>XX,XXX</u>
Total other earned revenues.....	<u>\$ XXX,XXX</u>

Note: Contributions are amounts transferred to the administrative entity from the employer entity representing its contribution--and that of its employees--for the employees' pensions.

Entry # 4 -- Administrative entity's entry to record its pension expense:

	Debit	Credit
Pension Expense	\$XXX,XXX	
Pension Liability		\$XXX,XXX

Table 3

Administrative Entity's Pension Expense

Normal cost	\$160,000
Interest on pension liability	XXX
Prior serv. costs (gains) (if any)	XXX
Actuarial gains (losses) (if any).....	<u>XXX</u>
 Total pension expense	 <u>\$ XXX,XXX</u>

Note: The \$160,000 represents 100 percent of the normal cost—as calculated by plan actuaries—for the one employer entity in this example. According to law, \$60,000 of this amount is to be contributed by the employer entity and \$60,000 is to be contributed by the employees themselves. The remaining \$40,000 is a liability of the pension plan (covered by future financing sources). The pension expense is reported on the Statement of Net Cost in accordance with paragraph 72.

Table 4

Administrative Entity's Pension Liability:

Beginning balance	\$ XX,XXX,XXX
Add: additional pension expense incurred (as calculated in table 3).....	XXX,XXX
Less: payments made to beneficiaries	<u>XXX,XXX</u>
 Ending liability balance.....	 <u>\$ XX,XXX,XXX</u>

Note: The liability balance should be reported on the administrative entity's Balance Sheet.

Other Retirement Benefits (ORB)

79. ORB include all retirement benefits other than pension plan benefits.³⁹ ORB are provided outside the pension plan by an employer to a former employee or the employee's beneficiary upon retirement. The predominant ORB in the federal government is retirement health care benefits, and they are the focus of this section.⁴⁰
80. Future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare (part A). Also, medical plans do not vest like pensions in which, after a fixed number of years of service, an employee has a right to receive payment. To receive ORB benefits the employee must retire with health care benefits provided by the organization.
81. This Statement establishes standards of accounting for ORB expense and related ORB liability for federal government employers and administrative agencies.

³⁹See Appendix A: Basis for Conclusions, for a discussion of reporting medical costs for veterans.

⁴⁰Accounting for life insurance is described in a separate section of the liability standard. However, to the extent that premiums paid by covered individuals and employer entities do not fully cover the retirement life insurance cost of employees, the employer entities would account for the additional cost as described in this section.

Accounting for the ORB Plan

82. **Attribution Method**—The aggregate entry age normal actuarial cost method should be used to calculate the ORB expense and liability for the administrative entity’s financial statements, and the expense for the employer entity’s financial statements. As indicated in the pension section, aggregate entry age normal is a method under which the actuarial present value of projected benefits is allocated on a level basis over the earnings or the service of the group between entry age and assumed exit ages. It should be applied to ORB on the basis of service rendered by each employee. The portion of this actuarial present value allocated to a valuation year is called the normal cost. The portion not provided for at a valuation date by the actuarial present value of future normal cost contributions is called the actuarial accrued liability.⁴¹ Unlike federal pensions, retiree health care benefits do not depend on future salary levels of individual employees but rather are allocable to each employee on a per person basis. Plans may use other actuarial cost methods if they explain why aggregate entry age normal is not used and if the results are not materially different.
83. **Assumptions**—Amounts calculated for financial reports prepared for ORB plans should reflect (1) general actuarial and economic assumptions that are consistent with those used for federal employee pensions and (2) a long-term health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The discount rate assumption for present value measurements of ORB liabilities should be developed in accordance with paragraph 66 of this standard. The administrative entity should disclose the assumptions used.
84. **The accrual period** should be based on expected retirement age rather than the age when the employee first becomes eligible.
85. **Assets** should be reported separately from the ORB liability rather than merely reporting the net liability. Assets of federal ORB plans should be carried at their acquisition cost, adjusted for amortization, if appropriate.⁴² For investments in market-based and marketable securities, the market value of the investment should be disclosed.
86. **Past Service Cost, Prior Service Cost, and Actuarial Gains and Losses**—The standard for ORB is the same as that for pensions. Past service costs result from retroactive benefits granted when a new plan is initiated. Prior service costs result from retroactive benefits granted in a plan amendment. A plan amendment may also reduce benefits attributed to prior

⁴¹Adapted from Actuarial Standards of Practice No. 4, p. 31. Also see Actuarial Standard of Practice No. 6, *Measuring and Allocating Actuarial Present Values of Retiree Health Care and Death Benefits*, Actuarial Standards Board (1988).

⁴²See SFFAS No. 1, *Accounting for Selected Assets and Liabilities*.

service resulting in a gain to the plan to the extent that previously recognized benefits are reduced. The accounting for such gains should be consistent with accounting for retroactive benefit increases. Actuarial gains and losses are changes in the balance of the ORB liability that result from (1) deviations between actual experience and the actuarial assumptions used or (2) changes in actuarial assumptions.

87. The administrative entity should recognize all past and prior service costs (or gains) immediately, without amortization. Similarly, the administrative entity should recognize all actuarial gains and losses immediately, without amortization.
88. **Accounting by the Administrative Entity**—The ORB plan should be accounted for in a way that is very similar to that described above for pensions. The administrative entity should account for and report the ORB liability in its financial report, using the aggregate entry age normal method. The liability is the actuarial present value of all future benefits less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. The administrative entity should report an ORB expense for the net of the following components:
- normal cost,
 - interest on the ORB liability during the period,
 - prior (and past) service costs from plan amendments (or the initiation of a new plan) during the period, if any,
 - any gains/losses due to a change in the medical inflation rate assumption; and
 - other actuarial gains or losses during the period, if any.

The individual components should be disclosed.

89. The administrative entity should report revenue for the sum of amounts received, if any, from the employer entity representing contributions from:
- the employer entity and
 - its employees.

The employer entity's contribution represents intragovernmental revenue.⁴³ An illustration of the accounting for the administrative entity (and employer entity) is provided in the following section entitled "Accounting Illustration".

⁴³Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.

Employer Entity Accounting

90. The federal employer entity should account for and report the ORB expense in its financial report in a manner similar to that used for pensions. The employer's ORB expense should be recognized in an amount equal to the total service cost⁴⁴ for its employees for the accounting period, less the amount contributed by its employees, if any. The measurement of the service cost requires use of the plan's actuarial cost method and assumptions. The cost factor should be provided to the agencies on a per employee basis by the administrative entity and/or the plan.
91. The employer entity's ORB expense should be balanced by (a) a decrease to the employer entity's "fund balance with Treasury" for the amount of its contributions to the ORB plan, if any; and, if this does not equal the full expense, (b) by an increase to an account representing an intragovernmental financing source entitled, for example, "imputed financing - expenses paid by other entities." The latter represents the amount being financed directly through the ORB plan.
92. In special instances when an employer entity is also the administrative entity, the employer entity should report the liability and recognize the ORB expense for all components of cost. For example, the entity is paying its retirees' ORB on a pay-as-you-go basis. The liability and the expense should be accounted for as described in the preceding section for the administrative entity accounting without reference to transactions with external employer entities.

Accounting Illustration

93. Tables 5-8 provide an example where the employer entity recognizes an "employer's ORB expense" in an amount equal to the service cost attributable to its employees during the accounting period. In this example, neither the employer entity nor its employees contribute to the plan. The employer's ORB expense is offset by a credit to the employer entity as a financing source ("imputed financing-expenses paid by other entities"). The administrative entity recognizes a revenue and other financing source for contributions from the General Fund. The administrative entity recognizes an expense for the total ORB expense.

⁴⁴"Service cost" is defined as the actuarial present value of benefits attributed to services rendered by employees during an accounting period. The term is synonymous with "normal cost".

Assumptions are as follows:

- Total normal cost of employees for the accounting period is \$10,000.⁴⁵
- The employer’s ORB expense is \$10,000. The employer entity should calculate its expense on the basis of factors received from the plan and/or the administering entity. For example, the plan-supplied factor is \$100 per employee (or full-time equivalent); if the employer has 100 employees, the expense would be \$10,000. (The employer’s ORB expense equals the service cost of its employees’ retirement health care.)
- The employer and employees do not make contributions to a fund. The cost of retirement health care is paid for by General Fund appropriations directly to the administrative entity on a pay-as-you-go basis.

Entry #5 – Employer entity’s entry to record ORB expense:

	Debit	Credit
Employer’s ORB Expense	\$10,000	
Imputed Financing-Expenses Paid by Other Entities		\$10,000

Table 5

Employer Entity’s Other Financing Sources as They Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:

Imputed financing Expenses paid by other entities ... \$10,000

Note: Imputed financing “Expenses paid by other entities” covers the annual expense for the employer entity’s employees as shown immediately below.

Employer Entity’s Cost as It Should Appear on the Statement of Net Cost

COST :

Employer’s ORB cost\$10,000

Note: This is the annual ORB service cost of the employer entity’s employees. The employer entity would calculate this amount using factors provided by the administrative entity.

⁴⁵This is the amount attributable to the government for its share of future medical care costs for future retirees. Although this simplified illustration does not show contributions other than those from the General Fund, current retirees pay premiums for their health insurance that partially defray the cost of the program. Federal civilian retirees pay approximately 25-30 percent of the total health benefit premium.

Table 6

Administrative Entity's Other Financing Sources as It Should Appear on the Statement of Changes in Net Position

FINANCING SOURCES:

Appropriations used..... \$ XX,XXX

Note: Since, in this example, contributions are not required from the employer entity or its employees, all benefits must be paid with appropriations from the General Fund.

Entry #6 -- Administrative entity's entry to record its ORB expense.

	Debit	Credit
ORB Expense	\$XX,XXX	
ORB Liability		\$XX,XXX

Table 7

Administrative Entity's ORB Expense

Normal cost.....	\$ 10,000
Interest on ORB liability	XX,XXX
Prior service costs (gains) (if any)	XX
Actuarial gains (losses) (if any)	XX
 Total ORB expense.....	 <u>\$ XX,XXX</u>

Note: The \$10,000 represents 100% of the service cost attributable to the employer entity in this example, as calculated by plan actuaries. The ORB expense (as calculated above) would be reported on the Statement of Net Cost in accordance with paragraph 88.

Table 8

Administrative Entity's ORB Liability

Beginning balance	\$ X,XXX,XXX
Add: additional ORB expense incurred (as calculated in table 7).....	XX,XXX
Less: payments made on behalf of beneficiaries.....	<u>XX,XXX</u>
Ending liability balance.....	<u>\$ X,XXX,XXX</u>

Note: The liability balance should be reported on the administrative entity's Balance Sheet.

Other Postemployment Benefits (OPEB)

94. OPEB are provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans. Inactive employees are those who are not currently rendering services to the employer but who have not been terminated, including those temporarily laid off or disabled. Postemployment benefits can include salary continuation, severance benefits, counseling and training, continuation of health care or other benefits, and unemployment, workers' compensation, and veterans' disability compensation benefits paid by the employer entity.
95. The employer entity should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. For example, a reduction in force may require an employer entity to make severance payments, unemployment reimbursements, or other payments in future periods. Similarly, an injury on the job may require the employer entity to make short- or long-term reimbursements to the federal workers' compensation program. A long-term OPEB liability should be measured at the present value of future payments. This will require the employer entities to estimate the amount and timing of future payments, and to discount the future outflow using the interest rate on marketable Treasury securities of similar maturity to the period over which the payments are to be made. The discount rate assumption for present value measurements of OPEB liabilities should be developed in accordance with paragraph 66 of this standard.
96. Most OPEB liabilities should be short-term because the benefits will be paid in the near future. Some OPEB, however, could be longer term. For example, a liability for workers' compensation or veterans' disability compensation might be long-term for some injuries

since federal employer entities might be required to reimburse the program for many years.⁴⁶ Also, certain specially authorized separation incentive programs could provide for payments that extend over many future years.

Insurance And Guarantees

Nature Of Federal Insurance And Guarantee Programs⁴⁷

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

⁴⁶Both the federal employee unemployment program and the federal workers' compensation program are financed by direct reimbursements from federal employers.

⁴⁷In 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.

(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.

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

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

Accounting For Liabilities Of Federal Insurance And Guarantee Programs

104. All federal insurance and guarantee programs (except social insurance and loan guarantee programs⁴⁹) 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 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.

⁴⁹Social 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).

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 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.

⁵⁰In 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.

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.

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	<u>CLAIMS + IBNR FOR FLOODS TO END OF PERIOD</u>	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	<u>CLAIMS + IBNR FOR DAMAGE TO END OF PERIOD</u>	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	<u>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.</u>	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	<u>CLAIMS + IBNR FOR LOSSES TO END OF PERIOD</u>	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	<u>CLAIMS + IBNR: PV OF UNFUNDED GUARANTEED BENEFITS FOR PLANS TERMINATED OR MORE LIKELY THAN NOT TO BE TERMINATED</u>	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	<u>CLAIMS + IBNR (PLUS RESERVE FOR CURRENT CASH VALUE, IF NECESSARY)</u>	<u>LIABILITY FOR FUTURE POLICY BENEFITS (NET APV OF POLICIES IN FORCE).</u> 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.

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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.
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.

⁵¹Whole 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.

⁵²A 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.

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

⁵³The 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.

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.

⁵⁴The 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]

Appendix A: Basis For Conclusions

122. This appendix summarizes considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.
123. This Statement addresses recognition and measurement of liabilities in the general purpose financial reports of federal reporting entities. The unique circumstances of the federal government, most notably its role as the vehicle through which citizens express their sovereign power, meant that the Board had to resolve some new issues in order to define exactly how to apply accrual concepts in federal financial reports.
124. The Board's deliberations on liabilities were based on certain ideas about the distinction between exchange and nonexchange transactions, the importance of reporting cost of services provided by the federal government, and the impact of information on decisionmakers. These ideas are explained in the following paragraphs.
125. Many users of federal financial reports are familiar with accounting concepts and standards published by the Financial Accounting Standards Board (FASB) for private sector entities, and the Governmental Accounting Standards Board (GASB) for state and local government entities. Because such users might assume that identical concepts and standards are used by the federal government if differences are not explained clearly, this appendix compares certain concepts underlying the federal standard with concepts that govern recognition and measurement of liabilities in financial reports of private sector entities and state and local governments in the United States. Finally, this appendix also explains the basis for specific conclusions regarding social insurance, contingencies, federal employee pensions, other retirement benefits, other postemployment benefits, and insurance and guarantee programs.

Exchange And Nonexchange Transactions

126. As noted in SFFAC No. 1, *Objectives of Federal Financial Reporting*: “The accounting process begins with recording information about transactions between the government (or one of its component entities) and other entities, that is, inflows and outflows of resources or promises to provide them.”⁵⁵ In some transactions, consideration of value is exchanged: there is a reciprocal or two-way flow. Other transactions, such as grants and other transfer payments are nonexchange transactions (i.e., there is a nonreciprocal transaction—normally a one-way flow).
127. The federal government is the vehicle through which citizens of the nation exercise their sovereign power. In this role, the federal government is responsible for taking collective action at the national level “to promote the general welfare.” Thus the government undertakes many programs that do not involve reciprocal transfers between the government as an entity and its counterparties. Examples include disaster relief, grants to state and local governments, subsidies, and other transfer programs for individuals. The federal government has a propensity to assume such burdens because it is the agent by which the society, through its elected officials, accomplishes transfers between groups of citizens to enhance their well-being.
128. A taxpayer or a donor may, in fact, receive a benefit of some sort, such as the opportunity to live in a safe, secure environment; to improve one’s standard of living; and to receive specific benefits, such as visits to national parks and travel over highways. But it is not ordinarily said that the benefit to the individual taxpayer or donor is of value comparable to that of the consideration given. Therefore, these are classified as nonexchange transactions. For this Statement, the significance of the distinction between exchange and nonexchange transactions arises from the nature of the obligation that is created when one party to a transaction provides a product or service to the other party in return for a promise that something of value will be exchanged for it.
129. Obligations become legally enforceable claims against the federal government in different ways and at different points within transaction cycles that relate to various programs. An important factor in distinguishing between various programs is whether an exchange is involved. For example, the federal government may not contract for and receive goods or services and then arbitrarily decide not to honor the contract. Similarly, under existing law, the federal government may be financially responsible for certain damage and injury it causes.

⁵⁵SFFAC No. 1, paragraph (16c).

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130. In other cases, the obligation may be more a matter of what is perceived as equitable and good public policy than a legally enforceable claim. Although there may be a high probability that a grant, a subsidy, or an income transfer will be made or will continue in future years, the recipients of such grants, subsidies, or transfers do not have a right to receive such payments in the future from the federal government as do those who receive payments in exchange for service they have performed.
131. However, it is possible to make meaningful estimates of the future amounts required to continue present policies regarding such programs. These estimates are relevant to certain decisions and should be disclosed or otherwise reported, as discussed further in *Supplementary Stewardship Reporting*. In the context of the Board's definition, however, estimates of future nonexchange payments should not be recognized as a current period liability. On the other hand, any payments due as a result of past events but unpaid at the end of the period constitute a liability.
132. In the case of federal liabilities, some future outflows of resources are so likely that they should be recognized as accounting liabilities in general purpose federal financial reports before all the other events necessary to create a legally enforceable claim against the government exists.⁵⁶ Two important examples of such substantive accounting liabilities are the pensions and retirement health care promised federal workers in return for their service.
133. An exchange can in substance be said to have occurred in such cases, even if the government has not yet made an outlay of cash or other financial resources. Service has been exchanged for a promise of future payment or health care. Such charges are properly assignable to the current period in financial reports. This exchange implies, for example, that general purpose federal financial reports should recognize the financial effects of the promise to provide health care to retired federal workers as that obligation accrues during their years of service, regardless of whether the budget includes a provision for this item. This is true even though unfunded liabilities of the federal government reported on the financial statements cannot be liquidated without the enactment of an appropriation. Also, as a sovereign entity, the payment of all liabilities other than for contracts can be abrogated by the federal government.

Conclusion On Social Insurance

134. The recognition, measurement and display of obligations for social insurance programs presented the Board with significant theoretical and practical problems. From the theoretical

⁵⁶Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress.

perspective, the Board considered whether social insurance programs resulted in exchange or nonexchange transactions, or whether they contained both exchange and nonexchange features. The Board also considered the problems of articulation between the operating statement and the Balance Sheet, specifically whether the process of reporting a year-to-year change in a Balance Sheet liability might affect the usefulness of an operating statement measure of performance. Finally, the Board considered the difficulty of determining an appropriate measure of the obligation assumed, whether such a measure were to be presented on the face of the Balance Sheet or in the notes.

135. In the exposure draft *Accounting for Liabilities of the Federal Government*, the majority of the Board concluded that social insurance programs were entitlement programs developed to carry out the sovereign responsibilities of the government, financed primarily by compulsory earmarked taxes. The Board favored characterizing social insurance obligations as nonexchange transactions, and limiting recognition of a liability to any unpaid amounts due as of the reporting date. A significant majority of the respondents, however, agreed with an alternative view, which expressed the notion that social insurance programs contained both exchange and nonexchange features, and that there was a need for recognizing a liability at least equal to the present value of future payments due to recipients currently eligible for benefits.
136. Upon reconsideration of the issues, the Board concluded that the most appropriate approach from both the Balance Sheet and Statement of Net Cost perspectives would be: (1) to include a line item entitled “social insurance obligations” in a separate section of the Balance Sheet following the liability section and before the equity section; (2) to make note disclosure of supplementary data resulting from several approaches for measuring the obligation, and (3) to report the annual financial outflows of current financial resources on the Statement of Net Cost. The Board also decided that, given the sensitivity and magnitude of social insurance, this new position should receive additional exposure, to allow users to review it and comment. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the liability standard and consolidated in Supplementary Stewardship Reporting.

Impact Of Communicating Information In General Purpose Federal Financial Reports

137. FASAB recognizes that extensive information about probable and possible future federal outlays is available now in many special purpose reports on various federal programs. In that sense, the financial reports prepared pursuant to this Statement are not likely to reveal information that is new in an absolute sense. Analysts working for the various executive agencies, congressional committees, private interest groups, “think tanks” and universities

are, collectively, aware of this information and much more. Nevertheless, the Board believes that presenting liabilities and stewardship responsibilities in the general purpose federal financial reports can be valuable in several ways. There are at least four reasons for this belief.

138. First, analysts typically know a lot about certain programs, but only those programs. Currently it is difficult, if not impossible, to assemble comprehensive information prepared on a comparable basis for the federal government as a whole. In many cases, this is also true for significant component units. General purpose federal financial reports attempt to provide a way of presenting comprehensive information.
139. Second, much of this information has no impact on individual decisionmakers, such as program managers, unless it is conveyed in a way that facilitates, or even requires, suitable attention to it. For example, information about federal pension plans and retirement benefits conveyed in an actuarial report or in the narrative section of the *Budget of the United States Government* may have an impact on certain congressional decisions, but is unlikely to influence managers' decisions about whether to use federal employees, invest in labor-saving equipment, or contract out to accomplish a given task. If the information is to have such an impact, it must be reported in a way more directly associated with the activities the manager is responsible for. Associating the expenses and liabilities reported in the general purpose federal financial report with the outputs of responsibility centers is able to accomplish this direct association.
140. Third, the mere requirement to assemble and report these data will, in some cases, affect federal managers, who, like everyone, tend to manage what they measure. Some observers believe, for example, that the prospect of having to comply with FASB's Statement 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, caused corporate managers and others to focus increased attention on the need to manage the cost of promises they had made to provide health care to retirees, even before the statement became effective.
141. Fourth, financial reports prepared and audited pursuant to federal accounting standards may reasonably be expected to possess a certain credibility and to command a certain amount of attention from various users, sufficient to affect decisions about federal government public policy. They will provide a source of information that should complement what is provided by the *Budget of the United States Government*. An important collateral benefit arises from the processes of preparing, auditing, and publishing annual financial statements. Experience demonstrates that these processes improve the reliability of information and of control systems, thereby enhancing both decisionmaking and accountability in general.

Relationship To Liability Recognition Principles Used By Nonfederal Entities

142. FASB defines the basic principles that govern liability recognition by private sector entities in the United States.⁵⁷ Government corporations follow those standards in their separately issued financial statements. Probably most readers of this Statement are familiar with these principles. Probably most users of federal financial reports are accustomed to seeing other financial reports prepared according to these principles.
143. FASAB's principle for liability recognition differs from FASB's. The difference can be seen as a modification made necessary by the sovereign nature of the federal government. FASAB contemplates a liability standard within the context of a reporting model that provides much greater emphasis on publicly reporting certain stewardship responsibilities than does the reporting model used by private sector organizations. This kind of reporting model is necessary because of the federal government's responsibility for the general welfare of the nation and its resulting willingness to take on obligations.

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

⁵⁷The Governmental Accounting Standards Board (GASB) has not published a concept statement on financial statement elements as FASB has done in Concept Statement Number 6 and has not defined "liability" per se. In the current state and local governmental accounting model, a fund liability is "the amount left unpaid at the end of the reporting period that normally would be liquidated with expendable available financial resources. The remainder of the liability should be reported in the General Long-Term Debt Account Group (GLTDAG)." National Council on Government Accounting Statement (NCGAS) Number 4, par. 17. (See GASB *Codification of Governmental Accounting and Financial Reporting Standards*, section 1500.)

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 services⁵⁸ 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.

Conclusion On Pensions, Other Retirement Benefits And Other Postemployment Benefits

Pensions - Projected Salary Levels

148. A primary objective for federal financial reporting is to measure accurately the full cost of employer entity services to the public. The methods used to account for pensions, ORB, and OPEB in general purpose financial reports should accurately measure the full cost of an employer entity's services. Since federal pension benefits are based on final salaries, whatever method is used for the annual cost and accrued liability of federal pensions must include projected future salaries that reflect an estimate of the compensation levels of the individual employees involved (including future changes attributable to the general price level, seniority, promotion, and other factors). They are part of the obligation that the federal government is incurring.

⁵⁸Goods or services may be provided under the terms of the program in the form of, for example, contractors providing a service for the government on the behalf of disaster relief beneficiaries.

Accounting For The Pension Plan

Attribution Methods

149. The major federal pension plans use an actuarial cost method for funding purposes known as aggregate entry age normal (AEAN). Various actuarial cost methods exist. All the methods regarded as acceptable methods for advance funding of private pension plans recognize the cost of an employee's pension benefits during the employee's years of service, but the different actuarial methods recognize the cost in different patterns over time. The AEAN method is intended to produce a periodic pension cost that is a level percent of payroll.
150. That is, AEAN is a method under which the present value of projected benefits of each employee is allocated on a level basis (such as a constant percentage of salary) over the service of the employee between entry age and assumed exit age. The portion of this present value allocated to each year is called the normal cost. The portion of this present value not provided for at a valuation date by the present value of future normal cost is called the actuarial accrued liability.
151. FASAB considered the method used by the Financial Accounting Standards Board in Statement of Financial Accounting Standards (SFAS) No. 87, *Employer Accounting for Pensions* (the projected unit credit, or PUC), as well as AEAN. FASB concluded that PUC gave a better measure of the employer's obligation for the benefits earned by the employees at a particular point in time. It therefore said that PUC provides a better measure of the value of the benefits that accrue during the year. However, FASAB heard testimony from an OPM actuary that results from these two methods were similar for federal plans. FASAB concluded that AEAN is a sound measure of the accruing expense.
152. FASAB concluded that any method of assigning the value of benefits that are earned over the entire career to particular years of service involves a process of estimation. It is, of course, reasonable to assume that the benefits accrue in some sort of systematic and uniform fashion and not, for example, all at once when the employee becomes eligible. Assuming that the benefits accrue as a uniform percentage of salary each year (as is done with AEAN for pensions) is a reasonable approach. AEAN is particularly useful within an organization when measuring costs over time because it provides that a dollar of salary always equals a fixed percent of pension, regardless of the year involved. Thus, inflation is factored into the calculation automatically.
153. FASAB specified the AEAN for several reasons. First, as stated, AEAN is a reasonable and systematic way of allocating costs evenly over the service lives of employees. Second, the major federal retirement systems [the Military Retirement System (MRS), the Civil Service Retirement System (CSRS), and the Federal Employees Retirement System (FERS)] use AEAN, and in two cases (FERS and MRS) charge "full cost" in the budget under a statutory

requirement.⁵⁹ Finally, exact comparability with private-sector entities is not relevant. Minor differences in the size of the pension liability and expense calculated pursuant to this Statement and SFAS 87 clearly would not have a material impact on investor's assessment of the credit-worthiness of the U. S. government.

154. Since there are several acceptable attribution methods and several small pension plans in addition to the three major plans, FASAB decided that the use of methods other than AEAN was permitted provided the results were not materially different from those of AEAN. A material difference between the expenses and the liabilities for federal plans based solely on the choice of attribution method would destroy the comparability and impair the usefulness of the information for users other than investors.
155. FASAB recognizes also that other attribution methods might be useful for other purposes. For example, a method that calculates the vested benefits accrued by employees to date, at current salary levels, would be useful as a measure of the accumulated amount the plan would owe if it were to terminate. Such calculations would be for special purpose reports not covered by this Statement.

Assumptions

156. There are three objectives for actuarial assumptions. First, FASAB considers it extremely useful to have consistent assumptions among accounting, budgeting, and actuarial statements to the extent it is possible to do so while attaining the objectives of federal financial reporting.
157. Second, assumptions ought to be consistent across federal employee pension, other retirement benefit, and other postemployment benefit systems. Assumptions need not be identical because the conditions facing each plan may objectively differ, but they should be rationally related (thus, the standard calls for financial reports to be prepared on the basis of reasonable estimates for actuarial assumptions). Also, the standard allows the smaller plans to use the assumptions provided by any of the three primary plans or to use their own assumptions if they explain how and why they are different from one of the major plans.

⁵⁹The CSRS statute calls for procedures that are generally construed as entry age normal. "Full cost," of course, depends on the method selected. For example, prior service cost is amortized in FERS over 30 years pursuant to the funding method; it would be recognized over a shorter period (years of expected future service of the group or 15 years) under SFAS 87. It should be recognized in full immediately under the terms of this standard, but only in financial reports of the agency that administers the pension plan and in the consolidated financial statements of the United States, not in the employer agency's financial statements. Thus, "full cost" in this sentence must be read in a generic way, that is, as a statement of the general intent underlying the law.

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158. Third, assumptions ought to reflect the underlying economic substance of the transaction. They should reflect the entity's past experience and current expectations regarding cost trends. They should reflect the similarities of and differences between two sets of economic phenomena rather than forcing artificial uniformity.
159. FASAB concluded also that the discount rate should reflect the long-term expected return on plan assets rather than a current market rate on debt of comparable maturity (the discount rate called for by SFAS 87). The long-term expected rate reduces volatility, reflects the actual experience and expectations of the primary federal plans, and is consistent with the assumptions used in the budget. The Governmental Accounting Standards Board uses a similar approach for the discount rate for state and local government pensions for similar reasons.

Prior Service Cost

160. Prior service costs (or gains) are the costs (or gains) of retroactive benefits granted (or reduced) in a plan amendment. Under the current budgetary system, prior service costs are funded in the budget through General Fund appropriations over 30 years. The employer entities under MRS and FERS—which are intended to be fully funded—are not charged in their budgets for prior service cost (nor are they credited for gains), but rather the General Fund is charged for these costs.⁶⁰
161. As stated in the Statement, FASAB believes that prior service costs, interest on the pension (or ORB) liability, and actuarial gains and losses are expenses of the federal government as a whole and are best accounted for by the administrative entity. Some respondents did not agree that employer entities should recognize only the “normal” or “service” cost element. The respondents suggested that the employer entity should recognize all elements of the pension (or ORB) expense: service costs, prior service costs, actuarial gains and losses, and interest on the pension liability. In general, these respondents believe that the full cost of products and services produced by the employer entity includes these elements, and that the full cost thus defined is relevant to various decisions such as comparing the cost of outputs and services with alternative providers.
162. The Board considered these views, but it continues to believe that employer component entities of the U. S. Government should usually recognize only the service cost element of pension (and ORB) expense in their general purpose financial reports. (Exceptions will arise in cases such as the Coast Guard, where the employer entity is also the administrative entity

⁶⁰CSRS also receives General Fund appropriations for this purpose, but the appropriations are based on statutory provisions and are less than they would be under a fully funded approach. Because of this, the CSRS funding approach is not being used as an example of budgetary treatment to be contrasted with the accounting treatment.

for the plan). The Board is aware that its approach may appear to differ from the approaches taken by FASB and GASB in this regard. However, neither of those Boards focused, in their standards on pensions and other retirement benefits, on reporting by component entities of a larger reporting entity comparable to the Government of the United States. All elements of pension (and ORB) expense should be recognized in the consolidated financial statements of the United States Government; however, the Board believes that prior service cost and other non-service cost are not useful for most managerial or policy decisions at the program level. They are sunk costs (or sunk gains) attributable to services rendered in prior years, or otherwise are not under the control of program management. FASAB continues to believe that having non-service elements of cost reported by the administrative entity best reflects the federal environment and organizational structure.

163. The Board recognizes that some analysts might, for some purposes, want to consider an alternative measure of compensation cost, e.g., one that includes interest on the part of the pension (or ORB) liability that relates to current workers, or one that recognizes some non-service costs over the workers' years of expected service. Special analyses and reports will always be necessary for special purposes. General purpose financial reports must, by definition, focus on the most common needs of users of those reports.
164. For similar reasons, FASAB also continues to believe that prior service costs (or gains) should be recognized immediately, without amortization, by the administrative entity, and in federal government-wide financial reports. FASAB sees no benefit to delaying recognition of a cost and a liability or to reducing volatility in the general purpose financial report of the administrative entity. FASAB was not persuaded that the benefit (or the cost) derived in future periods from increased (or decreased) pension benefits was sufficiently tangible in the federal context to warrant delayed recognition by means of amortization over future periods. Examples of plausible future benefits or costs would be, increased (decreased) employee productivity or reduced (increased) turnover.
165. FASAB recognizes that, for funding purposes, prior service costs for CSRS, FERS, and MRS are amortized through appropriations over a number of years. Funding decisions, however, should not be determinative for accounting recognition of cost. Deciding when and how to fund an obligation is not an accounting issue.

Actuarial Gains and Losses

166. Actuarial gains and losses result from (1) deviations between actual experience and the actuarial assumptions used and (2) changes in actuarial assumptions. Actuarial assumptions are essentially long-range estimates about future events and necessarily vary from actual experience.

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167. Actuarial gains and losses and prior service costs (or gains) have similar characteristics. They are both determined after the accounting period in question has concluded, and both relate to the past (either prior service or prior experience). The difference between actuarial gains and losses and prior service costs (or gains) is that the former are the normal result of actuarial estimation and may occur annually, while prior service costs are incurred only when the plan is amended. Also, actuarial gains and losses may tend to even out over time, unlike prior service costs.
168. FASAB concluded that actuarial gains and losses should receive the same treatment as prior service costs (or gains). They should be charged to the administrative entity. The employer entities should recognize an expense only for the service cost⁶¹ of their employees for the period less the amount contributed by the employees, if any. Like prior service costs, the actuarial losses are sunk costs (or sunk gains) attributable to services rendered in prior years and therefore should be excluded from data used for managerial or policy decisions.
169. For the same reasons as were given for prior service costs, actuarial gains and losses should be recognized immediately by the administrative entity. There is no benefit in delaying recognition or reducing volatility in the cost measures and the financial reports of the administrative entity.

Recognition and Measurement

170. The Board's conclusions discussed immediately above are reflected in the accounting treatment of pensions. The employer entity should recognize an annual pension expense as a cost of operations. When the employer entity's contributions are less than its pension expense, the employer entity should recognize an imputed financing source for the expenses paid by other entities. To the extent that it receives contributions from the employer entity, the administrative entity should recognize an intragovernmental revenue.
171. These transactions are intragovernmental. For purposes of federal government-wide consolidated financial reports, the employer's pension expense should be offset against (1) the administrative entity's contributions received from employer entities and (2) the employer entity's imputed financing source, if applicable.
172. The administrative entity should report the pension liability. An increase in the liability during the accounting period is an expense to the administrative entity. The liability is increased by the net total of the pension cost components [normal cost, interest on the pension obligation, prior service costs (gains), and actuarial gains (losses)]. Thus, the

⁶¹"Service cost" is defined as the actuarial present value of benefits attributed by the plan's benefits formula to services rendered by employees during an accounting period. The term is synonymous with "normal cost".

administrative entity should be providing information not only about the actuarial liability but also about the relationship between the full cost and the revenue from employees, employer entities, interest, and Treasury contributions.

173. Recognizing the pension cost components in the administrative entity and also the normal cost in the employer entities accomplishes two objectives. First, the full cost and actuarial liability are summarized and presented in one place, i.e., in the administrative entity's operating results and Balance Sheet. Second, each employer entity reports its respective normal cost as a cost of providing service. This is essential to report properly the cost of delivering federal government services. These entries are eliminated during consolidation for federal government-wide financial statements and, thus, no double counting occurs.

Other Retirement Benefits

174. FASAB concluded that ORB are similar to pension benefits and should be accounted for in a similar way unless differences in substance dictate otherwise. The predominant other retirement benefit in the federal government is health care benefits for retirees. These are long-term and require actuarial estimation.
175. FASAB recognizes that future health care benefits present unique measurement problems. They are more uncertain than pensions since they depend on the changing patterns of health care delivery and utilization, on the price trends for medical care, and on the benefits provided by social insurance programs like Medicare.
176. Also, some federal retiree health benefits are provided directly in federal government hospitals and domiciliary facilities. The liability in these cases also depends on the amount that the Congress will appropriate in the future to pay for the benefits, so the expense and liability are more difficult to measure. Notwithstanding the measurement difficulties, because of the importance of approximating the cost of services rendered at the time the service is rendered, FASAB believes that in most cases, the ORB costs and liabilities should be measured for federal programs. However, as noted in the discussion starting with paragraph 182, VA medical care cost would be recognized in the period medical care service is rendered.

Accounting For The Other Retirement Benefits Plan

Attribution Method

177. Unlike the situation regarding federal pension plans, there is no established attribution method for federal retirement medical care. Although there are current proposals to do so, the costs are not currently being funded.

178. For retirement health care, FASAB found no compelling reason to prefer an approach other than the aggregate entry age normal used for pensions. The employer's service cost however, should be calculated differently for health care than for pensions. For the pensions, costs are calculated as a percent of payroll, but retirement health care benefits are paid for each individual retiree regardless of prior salary. Cost, therefore, should be calculated on a per person basis because that accurately represents how the cost is incurred.

Assumptions

179. Although the general assumptions employed for ORB should be the same as those for pensions, the health care cost trend assumption is unique. The standard gives general guidance regarding the use of "Medicare projections or other authoritative sources" for the trend assumption in order to achieve consistency and set broad guidelines for the estimates. The health care cost assumption should reflect these sources adjusted for any factors unique to the organization.

Other Postemployment Benefits

180. OPEB represent operating expenses of the federal employer entity. Some might argue that OPEB, like pensions and ORB, should be accrued as employees perform services, as a cost of operations, because (1) they believe the event is occurring as the employees perform service, (2) future OPEB payments are probable, and (3) they can be measured. FASAB was not persuaded that there was an adequate nexus between these cost and the employee's daily, ongoing service; or that these costs were sufficiently probable at that point to warrant accrual.

181. FASAB believes that an accrual based on the occurrence of an actual event, such as a job-related injury or a decision to reduce the entity's workforce generally, is a reasonable approach. Such an event makes the future outflow of resources probable and measurable, may involve long-term accruals in some cases, and provides an accurate measure of expense in a way that is the least burdensome to the reporting entities.⁶²

⁶²The federal workers' compensation and unemployment insurance programs are different from the programs applicable to nonfederal workers. The benefits for federal employees under these programs are financed by direct reimbursement from employer entities. Usually the reimbursement period for workers' and unemployment compensation is short-term, but under certain conditions, workers' compensation may extend for many years.

VA Medical Care Cost

182. Although it might appear that medical benefits provided by the Department of Veterans Affairs should be treated like other retirement or medical benefits, there are significant differences between the two. Most often retiree medical benefits are provided through a health insurance provider, which receives premium payments from the former employer. But, with VA medical benefits, the former employer (the government) provides the medical services through VA facilities to veterans on an “as needed” and an “as available” basis versus payment of health insurance premiums for each veteran.
183. Eligibility for VA hospital care and nursing-home care is divided into mandatory and discretionary categories. VA must provide hospital care to veterans with service-connected disabilities and others in the mandatory category. Hospital care is considered discretionary if the veteran has income above a specified limit and a non-service-connected injury. Veterans in the discretionary category may be required to pay fees to receive VA hospital care. In addition, VA medical care is financed by annual appropriations. The entitlement to receive care does not guarantee any particular level of care. The Congress decides annually how adequately VA medical care will be funded.
184. The Board believes that VA medical benefits, for both mandatory and discretionary programs, are best measured by the annual cost incurred rather than by actuarially determined charges during the veteran’s military service. Medical care for veterans does not satisfy the probability or reasonably measurable criteria in this standard at earlier dates, and therefore future medical benefits do not constitute a long-term liability to be recognized in the Balance Sheet. The Board believes VA medical benefit liability and related expenses should be recognized in the period medical care service is rendered. The entity should consider, however, what disclosures would be appropriate for these costs under the contingency standard.

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*).

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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.
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.
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.

Appendix B: Liability Recognition And Measurement Matrix

Federal Program Categories	Expense	Liability
General fund benefit programs—financed by general revenues	<ul style="list-style-type: none"> • Aid to Families with Dependent Children • Medicaid • Food Stamps • Special disabled coal miner benefits • VA pension⁶³ 	Recognize expenses when payments are made or unpaid amounts are due as of the reporting date. This includes amounts due from the federal entity as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.
Employee benefits	<ul style="list-style-type: none"> • Federal employee pension and ORB benefits • Military pension and ORB benefits 	Recognize expense as employee services are performed.
	<ul style="list-style-type: none"> • VA disability compensation⁶⁴ • FECA—workers' compensation • OPEB 	Recognize expense when relevant event occurs and program participant is determined eligible for compensation.

⁶³This program is an entitlement program that veterans may be eligible for if they have limited income when they have 90 days or more of active military service, at least one day of which was during a period of war. Their discharge from active duty must have been during a period of war. Their discharge from active duty must have been under conditions other than dishonorable. They must be permanently and totally disabled for reasons neither traceable to military service nor to willful misconduct. [Department of Veterans Affairs, *Federal Benefits for Veterans and Dependents*, 1993 Edition].

⁶⁴Disability compensation is paid to veterans who are disabled by injury or disease incurred or aggravated during active military service in the line of duty. The service of the veterans must have been terminated through separation or discharge under conditions that were other than dishonorable. Monetary benefits are related to the residual effects of the injury or disease. [Department of Veterans Affairs, *Federal Benefits for Veterans and Dependents*, 1993 Edition].

Federal Program Categories		Expense	Liability
Insurance and guarantees	Fixed period—annual: <ul style="list-style-type: none"> • Federal Crop Insurance Corp. • National Flood Insurance Fund • Federal Deposit Insurance Corp. 	Recognize an expense for claims of the period, including IBNR, i.e., insured events that occur.	Recognize liability for unpaid claims of the period, including IBNR, i.e., insured events that occur.
	Fixed period—multi-year: <ul style="list-style-type: none"> • Overseas Investment • Noncancelable or renewable: <ul style="list-style-type: none"> • Pension Benefit Guaranty Corp. 		
	Noncancelable or renewable: <ul style="list-style-type: none"> • Veterans Life Insurance Trust Fund • Employees' Life Insurance Fund 	Recognize expense on the basis of risk assumed.	Recognize liability based on risk assumed (plus cash surrender value if relevant)
Capital leases		Recognize interest expense as lease payments are made.	Recognize a liability (the present value of future lease payments) when there is agreement between the federal government and the lessor.
Federal debt	<ul style="list-style-type: none"> • Treasury debt to federal agencies • Federal agency debt to the Treasury • Federal debt to the public 	Recognize accrued (prorated) share of the nominal interest incurred during the accounting period, amortized discount or premium, and the amount of any change in current value for the accounting period for variable-value securities.	Recognize a liability at the par value of the security net of any unamortized discount or premium.

Appendix C: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary” on page 1.