Accounting for liabilities
SFFAS No. 5

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Executive Office of the President
Office of Management and Budget

"ACCOUNTING FOR LIABILITIES OF THE FEDERAL GOVERNMENT"

Statement of Federal Financial Accounting Standards
Number 5

September 1995

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*************From Inside Front Cover**************

APPLICABILITY, MATERIALITY, AND TERMINOLOGY

These standards apply to general purpose financial reports of U.S. Government reporting entities. These standards need not be applied to immaterial items. Statement of Federal Financial Accounting Concepts No. 2 (SFFAC No. 2), "Entity and Display", lists criteria for defining Government reporting entities. Paragraph 78 of "Entity and Display" notes that some of a reporting entity's components may be required by law or policy to issue financial statements in accordance with accounting standards other than those recommended by the FASAB and issued by the OMB and the GAO, e.g., accounting standards issued by the Financial Accounting Standards Board or by a regulatory agency. Those components should continue to apply the standards used in these reports. The reporting entities of which the components are a part, however, need to be sensitive to differences that may arise from different accounting standards. If these differences are material, the standards recommended by the FASAB and issued by the OMB and the GAO should be applied. In such cases, the components would need to provide any additional disclosures or different measurements required by the accounting standards issued by the OMB and the GAO that would not be required by the other standards.

The word "disclosure" in FASAB's recommended standards indicates reporting information in notes or narrative that is regarded as an integral part of the basic financial statements, while "supplemental" indicates reporting information in schedules or narrative regarded as "required supplementary information" as that term is used in accounting and auditing standards. Government auditing standards require little auditing assurance for required supplementary information. "Other accompanying information" refers to unaudited information that accompanies the audited financial statements. "Required supplementary stewardship information" is a new category of information FASAB proposes in its exposure draft, "Supplementary Stewardship Reporting", with the expectation that OMB and GAO will in collaboration agree upon audit procedures that would be appropriate to apply to this information. These terms are intended to indicate the Board's expectations regarding the minimum auditor's responsibility for the information, not its specific location within general purpose financial reports.

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EXECUTIVE SUMMARY

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a 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. [FN 1:Liabilities 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.")]

b The Statements of Federal Financial Accounting Standards (SFFAS) and Concepts (SFFAC) referred to in this document are statements recommended by the Federal Accounting Standards Advisory Board (FASAB), approved by the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General (the Principals) and issued by the Office of Management and Budget (OMB) and the General Accounting Office (GAO).

c This Statement defines the recognition points for liabilities associated with different types of events and transactions (***Figure 1 IS AVAILABLE IN HARD COPY ONLY***).[FN 2: Recognition means reporting a dollar amount on the face of the basic financial statements.]

-- 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 services [FN 3: Goods 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.] 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).

-- 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).

d 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 disclosed [FN 4: "Disclosure" in this document refers to reporting information in notes regarded as an integral part of the basic financial statements.], or may not be reported at all, depending on the circumstances.[FN 5: In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.] Contingencies 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 paragraph 43). The amount to be recorded by the lessee as a liability[FN 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".)] 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 paragraph 50). 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 for 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 (including 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.

-- Insurance and guarantee programs - All federal insurance and guarantee programs [FN 7: Social insurance is considered to be a separate program type not included within insurance and guarantee programs. See social insurance discussion in FASAB ED, "Supplementary Stewardship Reporting."] (except social insurance and loan guarantee programs [FN 8: Accounting 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).]) should recognize a liability for unpaid claims incurred resulting from insured events that have already occurred. Insurance and guarantee programs should 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.

******* FIGURE 1 : "LIABILITY RECOGNITION SUMMARY" APPEARED HERE IN THE HARD COPY TEXT **********

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INTRODUCTION

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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. [FN 9: Adapted from Statement of Federal Financial Accounting Standards (SFFAS) Number 1, "Accounting for Selected Assets and Liabilities" (March 30, 1993), p. 25.]

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."[FN 10: OMB 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.]

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,[FN 11: Stewardship responsibilities are further discussed in "Supplementary Stewardship Reporting."] 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 programs[FN 12: Social insurance programs are income transfer programs financed by compulsory earmarked taxes and in certain cases also include

general revenues of the federal government.] 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 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."[FN 13: Statement of Federal Financial Accounting Concepts Number 1, 'Objectives of Federal Financial Reporting" (Sept. 2, 1993).]

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.

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 obligations [FN 14: The term "obligation" is used in its everyday or generic sense, not as it is used in federal budgetary accounting.] (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 Concept 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.[FN 15: See Statement of Federal Financial Accounting Concepts (SFFAC) Number 2, "Entity and Display" (April 20, 1995).]

EFFECTIVE DATE

13 The accounting 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 (***THIS MATRIX IS AVAILABLE IN HARD COPY ONLY***).

Glossary

18 The glossary defines various terms used in this Statement.

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LIABILITY STANDARDS
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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 recognize [FN 16: Recognition means reporting a dollar amount on the face of the basic financial statements.] 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.[FN 17: This 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.]

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.[FN 18: "Consequence" is defined as something of importance or significance.] 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.

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.[FN 19: Executory 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.]

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 services [FN 20: Goods 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.] 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 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. [FN 21: The 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.]

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);[FN 22: See SFFAS No. 6, "Accounting

for Property, Plant, and Equipment" for a detailed discussion of cleanup cost.]

(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.[FN 23: The 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.]

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 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. 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 liabilities covered by budgetary resources and to liabilities not covered by budgetary resources.[FN 24: See Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities", (March 30, 1993), app. A, p. 25.]

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).[FN 25: Contingencies are different from "subsequent events" as used in the accounting/audit literature. Subsequent events are events or transactions that occur subsequent to the Balance Sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements.]

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.

-- 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:

-- collectibility 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: [FN 26: The unit of analysis for estimating liabilities can vary according to the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, SFFAS Number 2, "applies to direct loans and loan guarantees on a group basis, such as a cohort or a risk category of loans and loan guarantees. Present value accounting does not apply to direct loans or loan guarantees on an individual basis, except for a direct loan or loan guarantee that constitutes a cohort or a risk category."

Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" p.9. See the standard on Insurance and Guarantees in this document for a description of incurred but not reported (IBNR) claims.]

-- A past event or exchange transaction has occurred (e.g., a federal entity has breached a contract with a nonfederal entity).[FN 27: In the case of government-acknowledged events giving rise to nonexchange or exchange transactions, there must be a formal acceptance of financial responsibility by the federal government, as when the Congress has appropriated or authorized (i.e., through authorization legislation) resources. Furthermore, exchange transactions that arise from government-acknowledged events would be recognized as a liability when goods or services are provided. For nonexchange transactions, a liability would then be recognized at the point the unpaid amount is due. Therefore, government-acknowledged events do not meet the criteria necessary to be recognized as a contingent liability.]

-- 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 more likely than not 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).

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.

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.

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.[FN 28: "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, Accounting for Property, Plant, and Equipment.] 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.[FN 29: OMB 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.[FN 30: This 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.]

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[FN 31: Figure 2 (available in Hard Copy only) lists various categories and examples of federal debt securities.]

49 Federal debt securities 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.[FN 32: For an explanation and an example of the interest method of amortization, see Appendix B of SFFAS No. 1.] 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.

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 Government[FN 33: Old 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.]

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.

**************FIGURE 2: VARIOUS CATEGORIES AND EXAMPLES OF FEDERAL DEBT SECURITIES APPEARED HERE IN THE HARD COPY TEXT **************************
[FN 34: These 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 veterans[FN 35: Veterans' 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.)] include pensions and postemployment and retirement benefits other than pensions. Pension plans[FN 36: This 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.] 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.[FN 37: Special termination benefits (such as specially authorized separation incentive programs) are considered other postemployment benefits and should be recognized as such.] 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.[FN 38: The 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.]

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.

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.[FN 39: In 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.] A subsequent section covers federal employer entities.

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."[FN 40: Adapted from Actuarial Standards of Practice No.4, "Measuring Pension Obligations" (Jan. 1990), p. 31.] 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), the best available 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.[FN 41: The

Actuarial Standards Board is a board within the American Academy of Actuaries that sets professional standards of actuarial practice.] 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 interest rate assumption should be based on an estimated long-term investment yield for the plan, giving consideration to the nature and the mix of current and expected plan investments and the basis used to determine the actuarial value of assets; or if the plan is not being funded, other long-term assumptions (for example, the long-term federal government borrowing rate). The underlying inflation rate and the other economic assumptions should be consistent. The rate used to discount the pension obligation should be equal to the long-term expected return on plan assets.

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.[FN 42: See SFFAS Number 1, "Accounting for Selected Assets and Liabilities."]

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.

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.[FN 43: The 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.]

The employer entity's contribution represents intragovernmental revenue.[FN 44: Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.]

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

Employer Entity Accounting

74 The federal employer entity should recognize a pension expense in its financial report that equals the service cost[FN 45: "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."] 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.

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:

DR. Employer's Pension Expense	$100,000
CR. Appropriations Used	$60,000
CR. 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:[FN 46: SFFAC No. 2, "Entity and Display" presents a change in the way revenue and other financing sources are reported. This illustration reflects the new concepts.]

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

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.

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

DR. Fund Balance with Treasury $120,000
  CR. Retirement Program Revenue -
    Contribution Received from Employer
    Entity $60,000
  CR. 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:

DR. Fund Balance with Treasury $XXX,XXX
  CR. 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	XX,XXX
Total other earned revenues	$ XXX,XXX

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:

DR. Pension Expense	$XXX,XXX	
CR. 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) XXX

Total pension expense ....$ XXX,XXX

**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.
****

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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	XXX,XXX
Ending liability balance	$ XX,XXX,XXX

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.[FN 47: See Appendix A: Basis for Conclusions, for a discussion of reporting medical costs for veterans.] 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.[FN 48: Accounting 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.]

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.

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.[FN 49: Adapted 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).] 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 pensions and (2) a health care cost trend assumption that is consistent with Medicare projections or other authoritative sources appropriate for the population covered by the plan. The rate used to

discount projected benefits should be equal to the long-term expected return on plan assets if the plan is being funded or on other long-term assumptions (for example, the long-term federal government borrowing rate) for unfunded plans. 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.[FN 50: See SFFAS No. 1, "Accounting for Selected Assets and Liabilities."] 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 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 for the ORB Plan--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.[FN 51: Intragovernmental revenue should be eliminated for government-wide consolidated financial statements.] An illustration of the accounting for the administrative entity (and employer entity) is provided in the following section entitled "Accounting Illustration".

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 cost[FN 52: "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".] 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.

Assumptions are as follows:

-- Total normal cost of employees for the accounting period is $10,000.[FN 53: This 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.]

-- 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:

DR. Employer's ORB Expense $10,000
CR. 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.
****

****
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.

DR. ORB Expense $XX,XXX
CR. 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	$ XX,XXX

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.
****

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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	XX,XXX
Ending liability balance......	$ X,XXX,XXX

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 Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be made.

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.[FN 54: Both the federal employee unemployment program and the federal workers' compensation program are financed by direct reimbursements from federal employers.] 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 Programs[FN 55: In the federal government, the aspects of insurance and guarantees are frequently commingled within the same program. Therefore, this Statement treats the terms as a single type of activity.]

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

98 For accounting purposes, private sector insurance and guarantee contracts are customarily divided into two types. The first type provides insurance protection for a fixed period. The insurer may cancel the coverage or adjust the

provisions of coverage at the end of any coverage period, for example, by adjusting the amount of premiums charged or changing the conditions under which coverage is provided. Most property insurance and health insurance offered by private insurers is of this type.

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

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

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.[FN 56: Further details on PBGC may be found in "Controlling Losses of the Pension Benefit Guaranty Corporation", Congressional

Budget Office, January 1993.] 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.

Accounting for Liabilities of Federal Insurance and Guarantee Programs

104 All federal insurance and guarantee programs

(except social insurance and loan guarantee programs[FN 57: Social insurance is considered to be a different type of program not included within insurance and guarantee programs. See social insurance discussion in the FASAB ED, "Supplementary Stewardship Reporting". Accounting for all federal loan guarantee programs should follow the Statement of Federal Financial Accounting Standards Number 2, "Accounting for Direct Loans and Loan Guarantees" (August 23, 1993).]) 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.

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 RSSI 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 RSSI risk assumed information.

Illustrations of the Application of the Standard

107 Table 9 [**Availiable in Hard Copy Only**] 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.[FN 58: In effect, FDIC's options are to renew the insurance coverage or to assume losses of the institution; only Congress can reduce or eliminate the deposit insurance program.] 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.

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 : "LIABILITY RECOGNITION, SUPPLEMENTARY INFORMATION AND DISCLOSURE FOR FEDERAL INSURANCE AND GUARANTEE PROGRAMS" APPEARED HERE IN THE HARD COPY TEXT **********

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.[FN 59: Whole life policies provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon

death of the insured. A level premium is usually paid for policies of this type. The premium may be paid annually or more frequently.] These programs operate in a manner similar to private sector mutual life insurance enterprises,[FN 60: A mutual company is an incorporated entity without private ownership interests which operates for the benefit of its policyholders and their beneficiaries. With limited exceptions, mutual companies issue only participating policies. In a mutual company, participating policyholders have the right to vote for members of the company's board of directors or trustees. In some states, the insurance laws provide that upon liquidation of a mutual insurance company, the net assets are distributed among the existing policyholders of the company, and the prior policyholders have no claim against such assets.] 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.

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. [FN 61: The applicable private sector standards are as follows, FASB SFAS 60 "Accounting and Reporting by Insurance Enterprises," FASB SFAS 97 "Accounting and Reporting by Insurance Enterprises for Certain Long- Duration Contracts and for Realized Gains and Losses from the Sale of Investments," and FASB SFAS 120 "Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts" and AICPA Statement of Position (SOP) 95-1 "Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises."

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

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

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

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

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

c. any premium deficiency.[FN 62: The liability for future policy benefits is consistent with the liability required by SOP 95-1. Net level premium reserve is the excess, if any, of the present value of future guaranteed death endowment benefits over the present value of future net premiums. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contracts. The dividend fund interest rate is the interest rate determined at policy issuance used to determine the amount of the dividend fund. It is the rate used to credit interest to the dividend fund, and against which experience is measured to determine the amount of the interest portion of dividends paid to individual policyholders. Terminal dividends are dividends to policyholders calculated and paid upon termination of a contract, such as on death, surrender, or maturity. If the payment of terminal dividends is probable and the amount can be reasonably estimated, the liability should be recognized. (AICPA SOP 95-1, Glossary, p. 33)]

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).

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APPENDIX A: BASIS FOR CONCLUSIONS
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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."[FN 63: P. 53, paragraph (16c).] 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.

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.[FN 64: Notwithstanding an expectation that the appropriations will be made, whether they in fact will be made is completely at the discretion of the Congress.] 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 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.[FN 65: The 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.)] 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 from nonexchange transactions would be recognized for any unpaid amounts due as of the reporting date. This includes amounts payable from the federal entity to pay for benefits, goods, or services[FN 66: Goods 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.] 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.

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.[FN 67: The 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.] 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 retirement 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 the best available 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.

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. [FN 68: CSRS 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.]

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 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 deceased) 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.

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 cost[FN 69: "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".] 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 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. [FN 70: The 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").

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.

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APPENDIX B: LIABILITY RECOGNITION AND MEASUREMENT MATRIX
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********** APPENDIX B: "LIABILITY RECOGNITION AND MEASUREMENT MATRIX APPEARED HERE IN THE HARD COPY TEXT **********

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GLOSSARY
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Actuarial cost methods - A recognized actuarial technique used for establishing the amount and the incidence of employer contributions or accounting charges for pension costs under a pension plan.

Actuarial liability - A liability based on statistical calculations and actuarial assumptions (actuarial assumptions are conditions used to resolve uncertainties in the absence of information concerning future events affecting insurance, pension expenses, etc.). (Adapted from "Webster's Ninth New Collegiate Dictionary" and "Kohler's Dictionary for Accountants" sixth edition, [Cooper & Ijiri])

Actuarial present value - The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions. (Actuarial Standards of Practice No. 4)

Aggregate entry age normal - A system of applying the entry age normal actuarial cost methodology using aggregate population models or groups instead of applying it individual by individual.

Attribution - The process of assigning pension benefits or costs to periods of employee service. [SFAS 87]

Budget Authority - The authority provided by federal law to incur financial obligations, as follows:

-- Provisions of law that make funds available for obligation and expenditure (other than borrowing authority), including the authority to obligate and expend the proceeds of offsetting receipts and collections.

-- Borrowing authority or authority to borrow and obligate and expend the borrowed funds, including issuance of promissory notes or other monetary credits.

-- Contract authority, or the making of funds available for obligation but not for expenditure. (Statutory authority under which contracts or other obligations may be entered into before an appropriation for the payment of such obligations. The later appropriation provides cash to liquidate such obligations. See OMB Circular A-34.)

-- Offsetting receipts and collections as negative budget authority and the reduction thereof as positive budget authority. (Omnibus Budget Reconciliation Act of 1990 [Pub. L. 101-508], sec. 13211)

Budget authority may be classified by period of availability (1-year, multiple-year, and no-year), by nature of authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or as gross (without reduction of offsetting collections) and net (with reductions of offsetting collections). (SFFAS Number 1, "Accounting for Selected Assets and Liabilities")

Capital leases - Leases that transfer substantially all the benefits and risks of ownership to the lessee.

Contingency - 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.

Discount rate - The interest rate used to adjust for the time value of money.

Dividend fund interest rate - 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. [AICPA SOP 95-1, Glossary, p. 33]

Earmarked taxes -Taxes levied by the federal government to finance a specific federal program.

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

Entitlement period - The period (such as, monthly) for which benefits become due.

Entry age normal actuarial method - A method under which the actuarial present value of projected benefits of each employee is allocated on a level basis over the earnings or the service of the employee between entry age and assumed exit age. The portion of this actuarial present value allocated to a valuation 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. The assumption is made under this method that every employee entered the plan (entry age) at the time of initial employment or at the earliest eligibility date, if the plan had been in existence, and that contributions have been made from the entry age to the date of the actuarial valuation. The term "aggregate entry age normal" refers to an approach whereby costs are determined for the group as a whole rather than for each individual participant separately.

Event - A happening of consequence to an entity. It may be an internal event that occurs within an entity, such as the transforming of raw materials into a product. Or it may be an external event that involves interaction between an entity and its environment, such as a transaction with another entity, an act of nature, theft, vandalism, a tort caused by negligence, or an accident. (Adapted from FASB Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements")

Exchange transaction - A transaction that arises when each party to the transaction sacrifices value and receives value in return.

Executory contract - A contract which has not been performed by all parties to it. (Trascona, Joseph L., "Business Law", William C. Brown C. Publishers, 1981)

Executory costs - Those costs such as insurance, maintenance, and taxes incurred for leased property, whether paid by the lessor or lessee. (SFAS #13)

Expected value - A statistical measurement attribute that is the sum of the products of each potential outcome multiplied by the probability of that potential outcome.

Fixed value securities - Securities that have a known maturity or redemption value at the time of issue.

Government-acknowledged events - Events that are not a liability in themselves, but are those events that are "of financial consequence" to the federal government because it chooses to respond to the event.

Government-related events - Nontransaction-based events that involve interaction between federal entities and their environment.

Insurance and guarantee programs - Federal government programs that provide protection to individuals or entities against specified risks. Because the federal government frequently commingles aspects of insurance and guarantees within the same program, this Statement treats the terms as a single type of activity. (Also see separate definition of social insurance).

Interest method - Under the interest method of amortization, an amount of interest equal to the carrying amount of the investment times the effective interest rate is calculated for each accounting period. This calculated interest is the effective interest of the investment (referred to as "effective yield" in some literature). The effective interest is compared with the stated interest of the investment. (The stated interest is the interest that is payable to the investor according to the stated interest rate.) The difference between the effective interest and the stated interest is the amount by which the discount or the premium should be amortized (i.e., reduced) for the accounting period. (SFFAS Number 1, "Accounting for Selected Assets and Liabilities").

Liability - For federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.

Measurable - Reasonably estimable.

Net level premium reserve - 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. [AICPA SOP 95-1]

Nonexchange transaction - A transaction that arises when one party to a transaction receives value without giving or promising value in return or one party to a transaction gives or promises value without receiving value in return.

Normal cost - That portion of the actuarial present value of pension plan benefits and expenses that is allocated to a valuation year by the actuarial cost method. (From Actuarial Standard of Practice No. 4)

Operating lease - An agreement conveying the right to use property for a limited time in exchange for periodic rental payments.

Other postemployment benefits (OPEB) - Forms of benefits provided to former or inactive employees, their beneficiaries, and covered dependents outside pension or ORB plans.

Other retirement benefits (ORB) - Forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, which are provided to retirees as the need for those benefits arises, such as certain health care benefits. Or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits. (FASB Statement of Financial Accounting Standard No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions")

Premium deficiency - A condition under which a liability for future policy benefits using current conditions exceeds the liability for future policy benefits using contract conditions. In such cases, the difference should be recognized as a charge to operations in the current period.

Probable - That which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven.

Projected unit credit actuarial method - A method under which the projected benefits of each individual included in an actuarial present valuation are allocated by a consistent formula to valuation years. The actuarial present value of benefits allocated to the valuation year is called the normal cost. The actuarial present value of benefits allocated to all periods before a valuation year is called actuarial liability. (Actuarial Standard of Practice No. 4)

Social insurance programs - Income transfer programs financed by compulsory earmarked taxes and also, in certain cases, general revenues of the federal government. (Also see separate definition of insurance and guarantees).

Terminal dividends - 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.

Transaction - A particular kind of external event involving the transfer of something of value concerning two or more entities. The transfer may be a two way or one way flow of resources or of promises to provide resources. (Adapted from FASB Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements")

Variable value securities - Securities that 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.

Whole life policies - Policies that provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of the insured.

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*************From Inside Back Cover***********

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General established the Federal Accounting Standards Advisory Board (the FASAB or "the Board") in October 1990 to consider and recommend accounting principles for the United States Government.

The Board communicates its recommendations by publishing recommended accounting standards after considering the financial and budgetary information needs of Congress, executive branch agencies, and other users of federal financial information. The Board also considers comments from the public on its proposed recommendations, which are published for comment as "exposure drafts." The Board's sponsors, i.e., the officials who established the Board, then decide whether to adopt the recommendations. If they do, the standard is published by the OMB and the GAO and then becomes effective.

Additional background information is available from the FASAB, including: (1) the "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board" and (2) the "Mission Statement of the Federal Accounting Standards Advisory Board."

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