CHAPTER 3

Risk Financing and Related Insurance Issues

Primary Pronouncements: GASB Statement 10, GASB Statement 30
Primary Codification Section References: C50, Po20

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QUESTIONS AND ANSWERS

3.1 Introduction

3.2 Public Entity Risk Pools

3.3 Definition and Scope

3.4 Determining What Is a Pool

Nonauthoritative Appendix 3-2 contains a decision diagram and examples that can be used to assist in determining whether an entity is a public entity risk pool and how it should be reported.

3.4.1. *Q*—What factors should be considered in determining whether an entity should be accounted for as a public entity risk pool for the purposes of applying Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* as amended?

A—In determining if an entity is a public entity risk pool, all factors should be considered together. Paragraphs 10−12 of Statement 10 define a public entity risk pool as:

> a cooperative group of governmental entities joining together to finance an exposure, liability, or risk. Risk may include property and liability, workers' compensation, or employee health care. A pool may be a stand-alone entity or be included as part of [another] governmental entity that acts as the pool's sponsor.
>
> A governmental entity that is a pool's sponsor may also participate in the pool for its own risk management function. . . .
>
> Stand-alone pools are established under authorizing statute by agreement of any number of state and local governmental entities. Stand-alone pools are sometimes organized or sponsored by municipal leagues, school associations, or other types of associations of governmental entities. A stand-alone pool is frequently operated by a board that has as its membership one member from each participating government. It typically has no publicly elected officials [of its own] or power to tax.

Paragraph 76, as amended, further clarifies the possibilities for entities to be considered public entity risk pools. It provides:

> If an entity provides insurance or risk management coverage *separate from its own risk management activities* to individuals or organizations outside the governmental reporting entity and there is material transfer or pooling of risk among the participants, that activity should be accounted for as a public entity risk pool. . . . If an entity provides risk transfer or pooling coverage *combined with its own risk management activities* to individuals or organizations outside its reporting entity, those activities should continue to be reported in a governmental fund or an internal service fund only as long as the entity is the predominant participant in the fund. If the entity is not the predominant participant in the fund, then the combined activities should be reported as a public entity risk pool, using an enterprise fund and the accounting and reporting requirements in paragraphs 19−50 [as amended]. . . . [Footnote reference omitted.]

Applying the definitions in paragraphs 10−12 and paragraph 76, as amended, the key characteristics of a public entity risk pool can be derived as follows:

a. *The pool should comprise primarily governmental entities.* It was intended that the provisions of Statement 10, as amended, specifically in paragraph 76, as amended, apply to risk financing groups of primarily state and local governments, while recognizing that there may be some cases where the group has a minority of participants—in terms of both representation and risk coverage—that are nongovernmental.
b. *The pool should be a cooperative effort.* It was intended that participants would work together to finance risk. Evidence of a cooperative effort may be voluntary participation in the activity—even if participation is a participant's last recourse. If a cooperative effort does not exist, then a governmental program may actually exist, and contributions from participants may actually be fees, assessments, or taxes—not premiums (required contributions). A governmental program could be accounted for in the general fund, a special revenue fund, or an enterprise fund depending on its nature. Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* paragraphs 29−32, offers guidance on when the general fund or a special revenue fund can be used. Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* paragraphs 66 and 67, as amended, offers guidance on when an enterprise fund can be used.

Furthermore, the types of risks or benefits covered by a potential pool are required to be within the scope of Statement 10, as amended. Otherwise, the provisions of Statement 10, as amended, for public entity risk pools are not applicable.

3.4.2. *Q*—Is an entity required to transfer or pool risk in order to be considered a public entity risk pool?

A—No. The transfer or pooling of risk is not required to occur for an entity to be considered a public entity risk pool, but it is required to occur to meet the definition in Statement 10, paragraph 13, for risk-sharing pools. For example, a group of governments created a pool for losses related to law enforcement vehicles. Each participating government makes an annual payment from which claims against only that participant are paid. The payment cannot be used to pay claims of other participants. This example meets the definition of a public entity risk pool without transfer of risk. Paragraphs 18−50 of Statement 10, as amended by Statement No. 30, *Risk Financing Omnibus,* apply only to risk-sharing pools. If the transfer or pooling does not occur, then paragraph 51 applies. (See Questions 3.5.1 and 3.5.2 for discussions of pools without transfer of risk.)

3.4.3. *Q*—If a government, such as a state, sponsors a cooperative group of primarily nongovernmental entities that have joined together to finance risk and risk is transferred from the participating entities, is the arrangement a public entity risk pool?

A—No. If a risk financing group consists primarily of nongovernmental participants and there is a transfer of risk from the participants to the group, then an insurance enterprise exists, not a pool. Insurance enterprises should be reported in an enterprise fund using the provisions of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* paragraphs 400−430.

3.5 Types of Public Entity Risk Pools

3.5.1. *Q*—Does paragraph 51 of Statement 10 apply to a banking pool, as defined in paragraph 13?

A—Yes. Although paragraph 51 specifically addresses claims-servicing pools (account pools), it also applies to a banking pool arrangement that does not involve any transfer of risk. The banking pool will have revenue and administrative costs for loans it makes to pay claims for members.

Accordingly, it should report assets or liabilities for net amounts collected or due from members and paid or to be paid to settle claims.

However, if this arrangement involves any acceptance, sharing, or pooling of risk, it is more in the nature of a risk-sharing pool and should be reported using the guidance in paragraphs 19−50 of Statement 10, as amended.

3.5.2. *Q*—Do pools that act only as insurance-purchasing pools (risk-purchasing groups) represent transfer of risk?

A—No. If a pool serves *only* to achieve economies of scale by purchasing commercial insurance products for its participants, and it does not retain or engage in the acceptance, transfer, or pooling of risk among participants, the participants in the pool have effectively transferred risk to commercial insurers—not to the pool—through policies obtained by the pool. Only the provisions of Statement 10, paragraphs 18 and 51, apply to this type of pool, which will have service revenue and administrative costs for procuring and maintaining policies for participants. The amounts collected from members and remitted to the insurance carriers would be recorded as additions to and deductions from a liability account, rather than as revenue and expense of the risk pool.

3.5.3. *Q*—Can a pool have the characteristics of more than one type of pool, as defined in paragraph 13 of Statement 10?

A—Yes. Paragraph 13 defines four types of pools: risk-sharing, insurance-purchasing, banking, and claims-servicing. Further, that paragraph states that ". . . a pool could serve only one or several of these functions" (the four basic types of pools). As an example, members of a property and liability public entity risk pool may pay actuarially determined contributions (premiums). These contributions may be used to pay claims up to an aggregate amount of $10 million and to procure excess insurance for claims that surpass the $10 million threshold. In this instance, the pool is both a risk-sharing pool (for aggregate claims of $10 million or less) and an insurance-purchasing pool (for aggregate claims over $10 million).

In any case, if there is any aspect of the pool that qualifies as risk-sharing or risk transfer among pool participants, or if the pool retains any risk, the pool should be accounted for as a risk-sharing pool. For example, if only 5 percent of a pool's activities (that is, risk covered) involves pooling of risk and the remaining 95 percent involves purchasing commercial policies for participants' risks, the pool should be accounted for as a risk-sharing pool. The requirements of paragraphs 18−50 of Statement 10, as amended, should be applied to the risk-sharing activities, and the requirements of the last two sentences of paragraph 51 should be applied to the insurance-purchasing activities.

3.5.4. *Q*—If premiums are not based on an actuarial evaluation or an analysis of anticipated losses, can a pool still be considered risk sharing?

A—Yes. The basis by which premium charges are assessed by a pool is not relevant to the risk-sharing determination.

3.6 Pool Sponsors

3.6.1. *Q*—For the purposes of applying paragraph 76 of Statement 10, as amended, what distinguishes the *predominant* participant in a risk management activity?

A—Paragraph 76, as amended, states:

> If an entity provides risk transfer or pooling coverage *combined with its own risk management activities* to individuals or organizations outside its reporting entity, those activities should continue to be reported in a governmental fund or an internal service fund . . . only as long as the entity is the predominant participant in the fund.

In paragraph 126 of the Basis for Conclusions, it was acknowledged that determining whether the entity (the sponsor) providing risk transfer or pooling coverage is the predominant participant would require "preparer and auditor judgment." One possible way to make this evaluation would be to look at some objective measurements. For example, payroll costs may be used as a basis for evaluating whether an entity is the predominant participant in a risk financing arrangement it sponsors for workers' compensation coverage. The types of risk coverage provided in a risk financing arrangement for property and liability coverage may also be used as a basis for evaluating whether an entity is the predominant participant. For example, a sponsor that has significant activities with higher risk than other entities—for example, an airport, a landfill, public transit, or a police force—may be the predominant participant.

3.6.2. *Q*—Can a state or local governmental entity have some involvement with a risk pool without participating (sharing or transferring risk, purchasing insurance, providing funds for losses, or using claims servicing) in the pool?

A—Yes. An entity, such as a state, can sponsor a pool without being a participant. As a sponsor, it may provide administrative services and account for the pool's activities in a separate fund. The accounting for the pool should be guided by paragraphs 19−50 of Statement 10, as amended, if there is sharing or pooling of risk. The accounting should be guided by paragraph 51 if there is no sharing or pooling of risk. In either case, the pool should be reported in an enterprise fund, in accordance with paragraph 18.

3.7 Unemployment Compensation

3.7.1. *Q*—Are unemployment compensation claims that are provided under the joint state and federal unemployment insurance system within the scope of Statement 10?

A—Paragraph 3 excludes from the scope of Statement 10 the recognition and measurement of liabilities for unemployment compensation claims. National Council on Governmental Accounting (NCGA) Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences,* as amended, and NCGA Interpretation 9, *Certain Fund Classifications and Balance Sheet Accounts,* as amended, provide guidance on those claims.

3.7.2. *Q*—If governments join together to finance unemployment compensation for their employees who are not eligible for benefits under the joint state and federal unemployment insurance system (for example, seasonal employees), is Statement 10 applicable?

A—Although paragraph 3 excludes from the scope of Statement 10 the recognition and measurement of liabilities for state or federal unemployment compensation claims, paragraph 1g states that the scope of the Statement includes "other risks of loss of participating entities assumed under a policy or participation contract issued by a public entity risk pool." Encompassed within this broad language would be unemployment insurance that is separate from the joint state and federal unemployment insurance system and that is offered to local government employers through public entity risk pools.

3.8 Recognition and Measurement

3.9 Fund Type to Use

3.10 Revenue Recognition

3.11 Premiums

3.11.1. *Q*—When should premiums generally be recognized as revenue?

A—Statement 10, paragraph 19, states:

> Premiums or required contributions ordinarily should be recognized as revenue over the contract period in proportion to the amount of risk protection provided. For those few types of contracts for which the period of risk differs significantly from the contract period, premiums should be recognized as revenue over the period of risk in proportion to the amount of risk protection provided. That generally results in premiums being recognized as revenue evenly over the contract period (or the period of risk, if different), except for those few cases in which the amount of risk protection changes according to a predetermined schedule.

For example, Pool A assesses premiums based on the experience of the individual participating governments. The policy between each participant and Pool A is for one year. Because the policy period is one year, the revenue should be recognized by Pool A evenly over the year unless "the amount of risk protection changes according to a predetermined schedule." If Pool A's fiscal year is different from the policy year, the pool should report a liability in the statement of net position to the extent that the policy year extends beyond the fiscal year being presented.

Besides premiums, pools may also derive revenue from assessments. These assessments generally are supplemental contributions required from participants when the pool's revenues are not sufficient to cover losses. Paragraph 5 of Statement 30 provides that "[premium] deficiencies resulting from risk-sharing pool participation contracts also should be reported as revenue and assessments receivable at the time the pool determines that a deficiency is reasonably estimable, provided that the pool has an enforceable legal claim to the amounts and their collectibility is probable." Pooling agreements usually specify if the pool has a right to assess participants to cover excess losses.

3.11.2. *Q*—When should the cost recovery method or the deposit method be used for premium revenue recognition?

A—In applying the provisions of Statement 10, paragraph 20, these two methods should be used only if *both* of the following two conditions are met:

a. The premiums are subject to adjustment because of provisions in the policy that make the ultimate premium dependent on some future measurements or loss experience.
b. The ultimate premium cannot be reasonably estimated.

For example, if $30,000 of premium revenue subject to adjustment has been received for the fiscal year on a retrospective policy and there is $10,000 in estimated claim costs for insured events for the same period, the cost recovery or deposit method should be used. Under the cost recovery method, revenue recognized in the current reporting period would be limited to $10,000. Additional revenue would be recognized in an amount equal to estimated claims costs as insured events occur

until the ultimate premium can be reasonably estimated. Under the deposit method, no revenue would be recognized until the ultimate premium can be reasonably estimated.

3.11.3. *Q*—What is the difference between recognizing revenue under the cost recovery method and recognizing revenue under the deposit method?

A—Under both methods, revenue is not fully recognized until the ultimate premium can be reasonably estimated. The methods differ regarding the recognition of revenue before the ultimate premium is known. With the cost recovery method, premiums are recognized as revenue throughout the duration of the policy, but only to the extent that claims costs have been incurred. The remainder of the premiums are recognized as revenue only when the ultimate premium is reasonably estimable. On the other hand, the deposit method does not recognize any premiums as revenue through the duration of the policy. Only when the ultimate premium is reasonably estimable are premiums recognized as revenue.

The cost recovery method may be more appropriate for retrospectively rated policies. Ultimate premiums for those types of policies are typically based on claims experience. Throughout the policy period, as events that trigger coverage occur and claims costs are incurred, premium revenue can be recognized to the extent that claims costs are probable and estimable. The deposit method may be more appropriate for reporting-form policies, where, for example, the ultimate premium is based on a value of property (for property coverage) or on payroll (for workers' compensation coverage) at some point in the future. At the point that the valuation is made, the ultimate premium can be determined.

3.12 Distributions, including dividends and refunds

3.12.1. *Q*—How do policyholder dividends (returns of contribution) differ from experience refunds?

A—Policyholder dividends are returns of premiums to participants based on the loss experience of the pool or of a specific class of policies, whereas an experience refund is based on an individual policyholder's experience. For example, if each participant's share is based on some predetermined allocation basis, which may be specified in the pooling agreement, the amounts returned are dividends. On the other hand, if the total amount to be returned to participants is based on the total loss experience of the pool but each participant's share of the total amount is based on its own experience, the amounts returned are experience refunds.

Paragraph 32 of Statement 10 provides for the accounting of dividends, and paragraph 33 provides for the accounting of experience refunds.

3.12.2. *Q*—A state government's risk pool has experienced high investment returns and wishes to make a distribution to pool participants. How is the distribution reported?

A—This distribution is based "on the experience of the pool" (Statement 10, paragraph 32) and should be reported as a policyholder dividend.

3.12.3. *Q*—Are policyholder dividends charged as a reduction of pool net position?*A*—No. Paragraph 32 of Statement 10 provides that dividends "should be accrued as dividends expense using an estimate of the amount to be paid." That expense should be recognized in the operating statement as an expense of the pool. If the policyholder dividend represents a return to participants on excess premiums for future catastrophe losses, the amount of the dividend should still be accrued as dividends expense.

3.12.4. *Q*—Do pools need to keep records of each participant's share in the results of the pool by policy year, based on the provisions of Statement 10, as amended?

A—No. Although a pooling agreement may provide that a record of each participant's share in the results of the pool be kept by policy year, there is no specific requirement for this record keeping in Statement 10, as amended. However, this type of information may be needed for the calculation of policyholder dividends when the pool has a favorable loss experience overall or for a class of policies (as provided in paragraph 32), or for the calculation of experience refunds (as provided in paragraph 33). If the pooling agreement provides for assessments when the pool has adverse experience, individual account information may be necessary for this allocation as well. Furthermore, this type of information may be needed if the pool is terminated.

3.12.5. *Q*—A risk pool is dissolving and distributing significant resources to pool participants. How is the distribution reported?

A—Capital distributions should be reported as such on the statement of revenues, expenses, and changes in net position, below the "Income before other revenues, expenses, gains, losses, and transfers" subtotal.

3.13 Premium deficiency

3.13.1. [Not used in GASBIG 20XX-1]

3.13.2. *Q*—How should a premium deficiency be calculated?

A—The premium deficiency calculation determines if unearned revenues are sufficient to meet claim costs, claim adjustment expenses, and policyholder dividends expected to be incurred over the remainder of the policy term. The premium deficiency should be adjusted in future periods as expected costs become incurred costs so that no liability remains at the end of the period covered by the contracts. Although these deficiencies appear to relate only to future periods, they are the result of the pool's current-period underwriting efforts.

The calculation required by Statement 30, paragraph 4, as amended, should include the following:

a. *Unearned premiums*—The amount entered into the equation here should be the amount reported as a liability at the statement of net position date.
b. *Expected claims costs*—This amount depends on the types of policies involved.
   (1) If policies are occurrence based, this amount should include expected claims for *events* that the pool expects to occur after the statement of net position date and during the remainder of the policy period.
   (2) If policies are claims-made policies, this amount should be based on claims that the pool expects to be reported or filed between the statement of net position date and the date that the policy expires.
   (3) If policies are claims-paid policies and the liability for claims is not fixed until the pool has actually paid the claim, this amount should be based on expected claims to be paid after the statement of net position date but during the remainder of the policy period. However, if the policies are claims-paid policies and under any circumstances could provide for payment of claims on a claims-made basis, this amount should be based on claims that the pool expects to be reported or filed between the statement of net position date and the date that the policy expires.

   For all types of policies, this amount should include future development on claims incurred after the statement of net position date. (See Question 3.17.1 for a discussion of incurred but not reported [IBNR] claims.)

c. *Expected claim adjustment expenses*—This amount should include claim adjustment expenses, both allocated and unallocated (as defined in paragraph 23 of Statement 10), to be incurred in the course of investigating and settling *expected* claims. (See Questions 3.16.2 and 3.16.3 on claim adjustment expenses.)
d. *Expected dividends to policyholders or pool participants*—These are *expected* amounts of dividends, which are defined in paragraph 32 of Statement 10.
e. *Anticipated investment income*—The inclusion of this element is optional, as indicated in footnote 6 of Statement 10; however, pools are required to disclose whether this income has been considered in determining if a premium deficiency exists. If used, the anticipated investment income should be based on the investment of remaining cash from premium revenues (earned and unearned) on hand at the statement of net position date for the period from that date until all related claims are settled. This calculation should take into account the fact that the amount of remaining cash from premium revenues will decline as claims and related expenses are actually paid. If all premiums have already been used for policy claims at the statement of net position date, it would be inappropriate to report anticipated investment income.

Incurred maintenance costs, which are defined in paragraph 31 of Statement 10, and acquisition costs should not be used in the calculation. Because these costs are period costs and cannot be attributed to past or future events, the Board intended to emphasize that there should be no *expected* policy maintenance costs or acquisition costs associated with a premium deficiency.

If the sum of expected claims costs (item b), expected claim adjustment expenses (item c), and expected dividends (item d) reduced by anticipated investment income (item e) (if used), exceeds unearned premiums (item a), then a premium deficiency exists.

As discussed in paragraph 34 of Statement 10, this calculation ordinarily would not be done on an individual contract basis. Any liability that is reported as a result of this calculation should meet the same recognition criteria as other liabilities. That is, it should be probable and reasonably estimable, as discussed in paragraph 22 of Statement 10.

An example of a premium deficiency calculation appears in nonauthoritative Appendix 3-3 of this Implementation Guide.

3.13.3. *Q*—Should assessments of policyholders or participants be recognized for purposes of the premium deficiency calculation?

A—No. For the purposes of determining a premium deficiency, assessments should not be included in the calculation. However, assessments may be made as the result of a premium deficiency and should be recognized in accordance with paragraph 5 of Statement 30, as amended.

3.13.4. *Q*—If premiums are lowered to reduce accumulated pool net position, are there any specific disclosure requirements or accounting or financial reporting considerations? Likewise, if future premiums are raised as a de facto method of making assessments for a pool, is a specific disclosure required?

A—If premiums are lowered, the possibility that a premium deficiency exists should be considered. Premium deficiencies should be calculated and recognized in accordance with paragraph 34 of Statement 10 and paragraphs 4 and 5 of Statement 30, as amended. (See Question 3.13.2.)

However, Statement 10 does not require a specific disclosure for either situation. The results of both situations should be obvious from the statement of revenues, expenses, and changes in net position in the financial statements.

It is normal that premiums for future periods are adjusted to some extent based on the results of current and prior periods because the results are the basis for calculations of premium requirements. However, paragraph 7 of Statement 30 provides that, if changes in a pool's loss, expense, reinsurance, excess insurance, or other transactions materially affect a pool's financial statements and those changes are not fairly disclosed or presented in the 10-year revenue and claims development table, the pool should disclose or present additional details "to keep the [10-year revenue and claims development table] from being misleading or to keep trends from becoming obscured." These additional details may be needed especially if only certain contract types are affected.

3.13.5. [Not used in GASBIG 20XX-1]

3.14 Expense and Liability Recognition and Measurement

3.15 Acquisition costs

3.15.1. [Not used in GASBIG 20XX-1]

3.16 Claim adjustment expenses

3.16.1. *Q*—If a pooling agreement specifies that, upon dissolution, all participants will assume the cost of overhead for servicing the remaining outstanding claims of the pool, does the pool still need to accrue these overhead costs, which include unallocated claim adjustment expenses?

A—Yes. Accounting requirements should be applied with the presumption that the pool is a going concern. Unallocated claim adjustment expenses are incurred by the pool when the claim itself is incurred and should be reported at the same time. The fact that these costs may be paid by pool participants in the event that the pool dissolves should not result in the liability's not being reported by the pool, nor should it result in a receivable from participants being reported by the pool.

3.16.2. *Q*—How should unallocated claim adjustment expenses be calculated?

A—Unallocated claim adjustment expenses are "costs that cannot be associated with specific claims but are related to claims paid or in the process of settlement, such as salaries and other internal costs of the pool's claims department" (Statement 10, paragraph 23). Along with allocated claim adjustment expenses, the unallocated expenses are to be accrued with related liabilities for unpaid claims. Guidance on determining the liability may be found in nonauthoritative commercial insurance accounting literature, such as the American Institute of Certified Public Accountants' (AICPA) Audit and Accounting Guide, *Audits of Property and Liability Insurance Companies;* publications of professional actuarial societies; and other industry publications. For pools using a third-party administrator, an additional source may be the service agreement, which should specify how these expenses are to be assigned to claims.

3.16.3. *Q*—If a public entity risk pool is required to pay a fee to the state based on its claims payments during the year, should that amount be included as part of the claim adjustment expenses related to the settlement of the claims?

A—Yes. The fee should be accrued as claim adjustment expenses; it is a cost of settling claims. Some would argue that the charge has a direct relationship with the payment of the claims, not with

the process of settling the claims. However, paragraph 23 of Statement 10 requires all costs of settling claims to be accrued as claim adjustment expenses. That paragraph does not make distinctions about the nature of settlement costs except to classify them as allocated or unallocated.

3.17 Incurred but not reported claims

3.17.1. *Q*—What are incurred but not reported (IBNR) claims?

A—According to footnote 5 of Statement 10, IBNR claims include three components:

a. Known loss events that are expected to later be presented as claims—for example, a risk pool that is aware of an on-the-job injury for which no formal claim has been filed.
b. Unknown loss events that are expected to become claims—for example, a risk pool that is unaware of on-the-job injuries that have occurred and have not been filed but based on historical experience, has an expectation of claims to be filed.
c. Expected future development on claims already reported—for example, a risk pool that is unaware of the full extent of damages from a storm for a claim that has been filed.

IBNR is largely an estimate of loss and claim adjustment expenses associated with future likely activity on incurred claims based on historical actual results that establish a reliable pattern.

3.17.2. *Q*—How are IBNR claims to be estimated and recognized?

A—IBNR claims generally are estimable. Initially, it may take time to accumulate a history of the proper data if those data are not currently available. If the historical results of an entity are not representative, supplementary analysis, including use of historical actual results of other entities with similar structure, risk assumptions, and risk exposure, should be considered. Other factors to be considered are changes in operations or operating environment, demographic changes, and statutes and regulations.

Other sources of data may also be used. For example, the AICPA Audit and Accounting Guide, *Health Care Entities*, Chapter 8, provides nonauthoritative guidance on the use of statistical and other data to estimate the amount and probability of medical malpractice IBNR claims for a hospital. The concepts in that guide can be applied to risks other than healthcare. In any case, the help of an actuary may be desirable, although the GASB does not require that an actuary's services be used.

Paragraph 22 of Statement 10 requires recognition of claims costs, including future development on claims, and related liabilities if they are both probable and reasonably estimable. However, paragraph 27 requires disclosure of the nature of the contingency and a statement that an estimate cannot be made in situations in which a loss is probable but has not been accrued because it is not estimable. (Paragraph 27 also requires disclosure when a loss is reasonably possible but not probable. The disclosure of a reasonably possible loss should include an estimate of possible loss or range of loss; otherwise, it should include a statement that an estimate cannot be made.)

3.17.3. *Q*—Do claims-made policies have IBNR claims?

A—Yes. IBNR claims may arise from future development in the valuation of claims reported during the policy year. In addition, depending on the policy, IBNR claims may arise from claims reported after the policy year during a specified time period allowed in the policy or for claims reported under tail coverage in force on the policy.

3.18 Recoveries from subrogation

3.18.1. *Q*—If a public entity risk pool has the right of subrogation on claims, what should be the accounting treatment of the recovered amounts when the related claims have already been paid?

A—Paragraph 22 of Statement 10 requires that estimated recoveries from subrogation on unpaid claims be deducted from the liability for unpaid claims costs. Estimated recoveries on settled claims also should be deducted from the liability for unpaid claims, unless amounts receivable from subrogation were not reasonably estimable and, therefore, were not recognized until received. In these cases, subrogated amounts should be reported as a reduction of current-period claims expense when received. (See the example in Illustration 1 of nonauthoritative Appendix 3-4.)

3.19 Reinsurance and excess insurance

3.19.1. *Q*—Is all reinsurance or excess insurance purchased by a pool to be accounted for as provided in Statement 10, paragraph 37, irrespective of the preparer's ability to determine the likelihood of collectibility of reinsurance or excess insurance by the pool?

A—No. Only the amounts of reinsurance or excess insurance recoveries that are collectible should be reported in the net receivable for paid claims and claim adjustment expenses. Likewise, only the collectible amounts of reinsurance or excess insurance recoveries should be used to offset liabilities for unpaid claims.

3.19.2. *Q*—If, by participating in an excess pooling arrangement, a public entity risk pool assumes, either directly or indirectly, risk of loss from other participants in the excess pooling arrangement, how should such an assumption of risk by the pool be reported?

A—If the excess pooling arrangement provides for the excess pool to assume risk from a participating pool, then the arrangement should be reported as reinsurance in accordance with paragraphs 37 and 38 of Statement 10, as amended, and amounts recoverable should be reported as assets or reductions in unpaid claims liabilities, as appropriate. If there is no intended transfer of risk, the excess pooling arrangement should be reported in accordance with paragraph 39, and amounts paid by the participating pool to the excess pool should be reported as deposits.

Furthermore, it is essential that a participating pool determine if it has any liability for losses and claim adjustment expenses of the excess pooling arrangement, just as entities participating in a pool should ascertain whether liabilities should be accrued for assessments from a pool or for a pool's inability to cover claims costs (paragraph 69, as amended, and paragraph 70). To the extent that amounts are probable and reasonably estimable, a pool should report a liability for claims costs (including IBNR and related claim adjustment expenses) of the excess pooling arrangement that will be assumed by the pool. If these costs are not estimable or are only reasonably possible, then disclosure of the contingency should be made in accordance with paragraph 27.

The disclosures on reinsurance transactions required by paragraph 6 of Statement 30 should include a full description of the excess pooling arrangement, including the pool's rights and responsibilities and the type of coverage.

3.19.3. [Not used in GASBIG 20XX-1]

3.19.4. [Not used in GASBIG 20XX-1]

3.20 Deductibles and self-insured retentions

3.20.1. *Q*—What are loss deductibles and self-insured retentions (SIRs), and how should they be accounted for by a pool?

A—Loss deductibles and SIRs are that portion of a claim for which a pool participant is responsible and for which risk has not been pooled. For example, a pooling agreement may stipulate that all participants are responsible in some manner for the first $100,000 of all claims submitted. The way that the $100,000 is handled differentiates a deductible from an SIR. If the participants are required to pay the first $100,000 before the pool is obligated to pay on claims or if the participants are required to deposit with the pool all or part of the $100,000 at the inception of the policy, there is an SIR arrangement. However, if the pool pays entire claims and then collects the $100,000 from participants or reimburses the participants for an amount net of the $100,000, there is a deductible arrangement. Furthermore, when deductibles are used, the pool generally is responsible for claim adjustment on the claims covered by deductibles, whereas a pool generally is not responsible for claim adjustment on the claims covered by SIRs.

If the pooling agreement provides for SIRs, the pool needs only to consider, but not report, the amount of claims that are to be paid directly by the participants (or with participant deposits) in calculating claims liabilities in accordance with paragraphs 22−27 of Statement 10, as amended. (See the example in Illustration 2 of nonauthoritative Appendix 3-4.)

3.21 Annuity contracts

3.21.1. *Q*—When can a claim liability be removed from the statement of net position?

A—Paragraph 26 of Statement 10, as amended, provides that, if an annuity contract is purchased in the claimant's name to satisfy a claim liability *and* the likelihood that the pool will be required to make future payments (for example, because an insurance company or institution may not fulfill its obligations on the annuity) is remote, then the pool should remove the annuity contract and the covered liability from the statement of net position. A pool usually pays a lump sum for an annuity contract. That lump sum plus the earnings on it is used to make periodic payments, fixed or variable in amount, to the claimant under the terms of a settlement with the claimant. However, the pool is generally not completely relieved of responsibility. It should evaluate whether the insurance company or institution from which the annuity contract was purchased can fulfill its obligations to pay out the required annuities.

Unless the claimant has provided the pool with a signed agreement releasing the pool from any and all further obligation, the pool should still include the liability amount in the disclosure of aggregate outstanding liabilities removed from the statement of net position, as required by paragraph 49h, as amended. The requirement for this off–statement of net position settlement of claims liabilities is provided because the substance of these transactions is similar in nature to transactions involving in-substance defeasance of debt.

3.21.2. *Q*—Do annuity contracts that are held by the pool but that designate the claimant as the annuitant (payee) qualify as being "in the claimant's name"?

A—Yes, provided that the pool cannot unilaterally change that designation. The intent of "in the claimant's name" is to distinguish the contracts from those that are held for general investment or other purposes. When contracts are purchased only in the name of the pool or in a name that can be changed unilaterally by the pool, there is nothing that would distinguish the contracts from any other investment. It would be inappropriate to treat these types of investments as having defeased a specific claim liability, in accordance with Statement 10, paragraph 26, as amended.

3.22 Discounting

3.22.1. *Q*—Are all claims liabilities required to be discounted?

A—No. Paragraph 24 of Statement 10 provides that presenting claims liabilities at the discounted present value of estimated future payments is neither mandated nor prohibited. However, discounting is required for structured settlements if they "represent contractual obligations to pay specific amounts on fixed or determinable dates." Implicit in these settlements is the time value of money.

Discounting for all claims liabilities is not required because of the "softness" of estimates and all the variables that need to be considered, such as interest rates, settlement dates, and amounts to be paid on future dates. Because payment dates and amounts are fixed or determinable for structured settlements, the time and payout rate variables have been removed, thereby making estimation of a present value more certain.

3.23 Investments

3.23.1. [Not used in GASBIG 20XX-1]

3.23.2. [Not used in GASBIG 20XX-1]

3.24 Real estate

3.24.1. *Q*—A pool owns a building, of which 50 percent is used for the pool's office and 50 percent is rented out. Paragraph 48 of Statement 10 requires that a real estate asset with mixed use should be classified based on its predominant use. What should the accounting be in this situation?

A—The pool should look to the future use of the building. If it anticipates using more of the building for its own operations in the future, it should classify it as a capital asset. If the pool anticipates that it will be renting out more of the space in the building, it should classify and account for the building as an investment. However, if no change in the use of the building is expected, the asset may be reported as either an investment or a capital asset. If the building is reported as a capital asset, the pool should also report net investment income from the building, consisting of rental income less depreciation (for that portion of the building that is rented out) and rental expense. In either case, depreciation related to the pool's use of the building should be reported as operating expense and not as a reduction of the investment income. Statement 10 requires that, if the pool reports the building as an investment, it should not impute rental income from itself when reporting investment income.

3.25 Disclosures and Required Supplementary Information

3.26 Note Disclosures

3.26.1. *Q*—What public entity risk pool disclosures are required to be presented in the financial statements of a financial reporting entity in which a public entity risk pool is included?

A—Paragraph 49 of Statement 10, as amended, which discusses disclosures, does not provide for this situation. The provisions of Statement No. 14, *The Financial Reporting Entity,* paragraphs 61−63, as amended, should be applied.

3.27 Description of pool and responsibilities

3.27.1. *Q*—What types of disclosures should be provided in the description of the risk transfer or pooling agreement?

A—These disclosures should provide meaningful information to financial statement users, including the primary users identified in paragraph 5 of Statement 10:

a. Pool participants and those considering pool participation
b. Legislative and oversight bodies (such as state regulatory bodies)
c. Reinsurers and excess insurers
d. Investors and creditors.

The disclosures should provide a frame of reference for understanding the structure, operating results, loss experience, and financial stability of the pool. Disclosures that may be considered include composition of the participants (members) of the pool; how participants are admitted, including, for example, whether entry is limited by class of entity or by application of underwriting standards; what kinds of risks are being pooled (what coverage is being provided); statutes authorizing the pool or under which the pool is organized; how the pool is governed or administered; circumstances under which refunds or dividends are made to participants; whether the pool is subject to regulation by or reporting to any regulatory body; and whether the obligations of the pool are backed or guaranteed, in whole or in part, by any state or federal guaranty fund.

3.27.2. *Q*—What types of disclosures should be provided in the description of the rights and responsibilities of the pool?

A—These disclosures should provide financial statement users with a frame of reference for understanding the rights and responsibilities of the pool with respect to current and former participants. They also provide users with information that may assist in assessing the financial stability of the pool. Disclosures that may be considered include handling of claims; limitations on payment of claims; coordination of purchase of commercial insurance, if any; ability to make assessments against members (participants), including limitations on the amounts that can be assessed; and accessibility of the pool by other entities.

3.27.3. *Q*—What types of disclosures should be provided in the description of the rights and responsibilities of pool participants?

A—These disclosures should provide financial statement users with a frame of reference for understanding the rights and responsibilities of current and former pool participants both to the pool and to other current or former participants of the pool. Disclosures that may be considered include membership requirements, including any obligations to remain a member for specified time periods; withdrawal requirements, including any required period of advance notice to the pool before withdrawal and any obligations for unpaid claims; responsibilities for any deficiencies in pool equity; and requirements to pay any loss deductibles or SIRs and related claims administration costs on claims submitted.

3.27.4. *Q*—In describing risk transfer, should the description include *risk transfer to the participant* from the pool or other participants (for example, assessments) as well as transfer of risk from the participant to the pool?

A—Yes. This information allows financial statement users to assess the interdependence between the pool and its participants and among participants. Risk transfer to the participant from the pool is different from risk retention by the participant. Risk that is retained by a participant is generally a defined amount of risk related to the participant's own claims costs and is not transferred to another party, such as a pool. Risk that is transferred from the pool to a participant may involve risk related to claims costs of other participants that, if they exceed a certain threshold or if they exceed related premiums earned by the pool, will be transferred back to all participants from the pool through assessments or similar mechanisms.

3.27.5. *Q*—Statement 34 requires a management's discussion and analysis (MD&A). Should MD&A be prepared for risk pool financial statements?

A—Risk pools that are separate legal entities should prepare an MD&A. Statement 34, paragraphs 134 and 138, provides relevant guidance.

3.28 Basis for estimating liabilities

3.28.1. *Q*—If the basis changes for estimating liabilities for unpaid claims and claim adjustment expenses, should this change be disclosed?

A—Although there is no specific requirement in paragraph 49b of Statement 10, disclosure is required by Statement 62, paragraph 85, to the extent that the effect of a change in the basis for estimating liabilities is significant or that failure to disclose such changes might be misleading or might obscure trends. This disclosure should include a description of the basis used for estimating liabilities before and after the change and an estimate of the effect of the change on the financial statements. For example, if the XYZ Workers' Compensation Pool changes the basis for estimating workers' compensation liabilities, it would disclose information similar to the following in the notes to the financial statements for the fiscal year: "For the current fiscal year, the pool estimated unpaid claims and claim adjustment expenses to be $250,000, based on the average aggregate number of employees on the payrolls of all participants during the fiscal year. In prior years, unpaid claims and claim adjustment expenses had been estimated based on aggregate payroll costs for all participants for the fiscal year. If these amounts had been estimated using the prior years' basis for estimation, the unpaid claims and claim adjustment expenses reported in the financial statements would have been $225,000."

3.28.2. *Q*—Why is it important to consider "societal and economic factors" in estimating the ultimate cost of settling claims?

A—Paragraph 49b of Statement 10 requires that note disclosures state that the effect of those factors is included in the estimation because of the profound effect those factors may have on claims. The legal standards to which governments are accountable are rapidly expanding at the same time that the demands of citizens are growing. The use of litigation as a method of resolving disputes is ever increasing while, at the same time, liberalization of doctrines such as comparative negligence and joint and several liability have made governments more attractive targets for litigation.

3.29 Acquisition costs

3.30 Face and carrying amount of liabilities

3.31 Anticipated investment income for premium deficiency

3.31.1. *Q*—When a pool considers anticipated investment income in determining if a premium deficiency exists, what information or assumptions should be disclosed?

A—Statement 10, paragraph 49e, requires only a disclosure of whether anticipated investment income is used in calculating a premium deficiency. There are no additional disclosure requirements.

3.32 Reconciliation of unpaid claims

3.32.1. *Q*—Should the disclosure of the reconciliation of unpaid claims liabilities include IBNR claims as well as claims that have already been reported?

A—Yes. If IBNR claims are probable and reasonably estimable, they are required to be included in the total unpaid claims accrual. Therefore, they should be included in the reconciliation of unpaid claims liabilities as required in paragraph 49g of Statement 10. In addition, the expected future development on existing claims, which is another component of IBNR, should be included in the total unpaid claims accrual and, accordingly, in the reconciliation of unpaid claims liabilities. If, however, IBNR claims are disclosed only, in accordance with paragraph 27, because of an inability to estimate the amount or because claims are only reasonably possible and, thus, are not included as liabilities on the statement of net position, then this reconciliation would not include them either. However, *IBNR claims generally are estimable.*

3.32.2. *Q*—Does the reconciliation in Statement 10, paragraph 49g, include unallocated claim adjustment expenses?

A—Yes. These expenses should be an integral part of the total claim and claim adjustment expenses that are in the reconciliation. Paragraph 23 provides that both allocated and unallocated claim adjustment expenses should be included in the determination of the liability for unpaid claims and claim adjustment expenses.

Nonauthoritative Appendix 3-8 of this Implementation Guide provides illustrations of the 2-year reconciliation of total claim liability by type of contract and the 10-year revenue and claims development table.

3.33 Annuity contracts

3.34 Loss contingencies

3.35 Required Supplementary Information

3.35.1. *Q*—What information is required to be presented in required supplementary information (RSI) in separately issued public entity risk pool reports?

A—As discussed in paragraph 7 of Statement 30, RSI consists of two tables:

a. A 10-year revenue and claims development table
b. A 2-year reconciliation of total claims liabilities by type of contract.

The 10-year revenue and claims development table shows trends in current claims and development in prior years' claims. It also shows, over time, how well a pool is performing its underwriting function and its claims estimation (loss reserving) function.

The two-year reconciliation of total claims liabilities by type of contract provides additional information about the pool's operations. For example, disaggregated claim liability information shows the extent to which changes in liabilities for claims costs and related expenses are due to current claims versus developments in prior years' claims.

3.35.2. *Q*—What information is required to be reported as RSI in the reports of a financial reporting entity in which a public entity risk pool is included?

A—Paragraph 7, footnote a, of Statement 30, as amended, provides that, if a pool is included as part of another financial reporting entity *and* the pool does not issue a separate report, the information required by that paragraph should be presented after the notes to the reporting entity's financial statements. If the reporting entity issues a comprehensive annual financial report or presents a statistical section together with its basic financial statements, included pools may present the RSI as operating information in the statistical information.

Neither paragraph 7 of Statement 30, as amended, nor Statement 10, as amended, addresses the situation when a pool is included as part of another financial reporting entity, *but* the pool issues a separate report. However, paragraph 78 of Statement 10, as amended, requires the financial statements of the reporting entity to emphasize disclosures about the primary government's participation in the pool and to include a reference to the separate report of the pool.

3.36 SEC requirements

3.36.1. [Not used in GASBIG 20XX-1]

3.37 Reconciliation with financial statements

3.37.1. *Q*—If a pool's data are maintained on a policy-year basis, should the two-year reconciliation of total claims liabilities (Statement 10, paragraph 49g) and two-year reconciliation of claims liabilities by type of contract (Statement 30, paragraph 7b) be presented on a policy-year basis?

A—No. The reconciliation should tie to the financial statements. To determine the year-end liability, the data should be re-sorted into a fiscal-year basis. The initial effort may be difficult, but this should facilitate preparation of financial statements, disclosures, and RSI in future years.

3.37.2. *Q*—If a pool's accident year (for occurrence-based policies), report year (for claims-made policies), or policy year is different from its accounting or fiscal year, should all of the data in the 10-year revenue and claims development table tie to the financial statements?

A—No. Only the information required by paragraphs 7a(1) and 7a(2) of the 10-year revenue and claims development table are based on fiscal-year information and should tie to the financial statements. Those amounts should be presented on an accrual basis.

It was anticipated that the information required by paragraphs 7a(3)–7a(7) of the 10-year table would not necessarily tie into the financial statements if they are on an accident-, report-, or policy-year basis. (See Statement 30, paragraph 7, and paragraphs 36 and 37 in the Basis for Conclusions section of that Statement.)

3.38 Unallocated claim adjustment expenses

3.38.1. *Q*—What unallocated claim adjustment expenses are to be included in the 10-year revenue and claims development table?

A—Unallocated adjustment expenses are one of two components to line 2. They include costs related to settling claims that cannot be attributed to specific claims. This component may include, for example, salaries paid to claims department staff or costs related to a fixed-fee contract with a claims adjusting service (where payments made to the service company have no direct correlation with claims adjusted). The second component of line 2 consists of the "other costs" of the pool, as

defined in paragraph 31 of Statement 10. Other costs are generally the administrative or overhead costs of the pool—costs not related to settling claims or to acquiring or renewing participation contracts.

3.39 Inclusion of IBNR claims

3.39.1. *Q*—Do estimated incurred claims and expenses and reestimated incurred claims and expenses in the 10-year revenue and claims development table include both known claims and IBNR claims?

A—Yes. IBNR claims should be included in the 10-year revenue and claims development table if those claims are eligible to be accrued as liabilities for financial statement purposes because the amounts are probable and estimable. That is, the claims should be included if they are eligible for accrual based on paragraph 22 of Statement 10. *IBNR claims generally are estimable*.

3.40 Discounted amounts

3.40.1. *Q*—Should discounted claim amounts be reported in the 10-year revenue and claims development table?

A—Paragraph 7 of Statement 30 neither requires nor prohibits discounting of liabilities in the 10-year revenue and claims development table. However, if discounted claims liabilities are presented in the financial statements (as allowed or required in Statement 10, paragraph 24), discounted claims amounts should be reported in the 10-year revenue and claims development table.

3.41 Policy-year basis

3.41.1. *Q*—Is it necessary to convert claims development triangles (used by a pool, for instance, in underwriting) that are prepared on another basis to a policy-year basis for the 10-year revenue and claims development table?

A—No. Paragraph 7 of Statement 30 amends Statement 10 to allow presentation of claim information on an accident-year basis (for occurrence-based policies) or report-year basis (for claims-made policies), as long as one basis is consistently applied. Incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned to the accident, report, or policy year in which the event that triggered coverage under the pool's contract occurred. The purpose of the table is to determine trends in the underwriting success of the pool.

Incurred claims costs and allocated claim adjustment expenses (including IBNR) for each policy or contract are assigned to the accident, report, or policy year in which the event that triggered coverage (for example, the incident giving rise to a claim in an occurrence-based policy, the reporting of a claim in a claims-made policy, or the payment of a claim in a claims-paid policy) under the policy or contract occurred.

Occurrence-based coverage

For occurrence-based coverage for which (a) *all* participants have a common insurance policy or participation contract renewal date and (b) *all* insurance policies or participation contracts have a coverage period that is the same as the pool's fiscal year, the policy-year basis is the same as the fiscal-year basis.

For occurrence-based coverage for which (a) *all* participants have a common policy or contract renewal date and (b) *any* policy or contract issued by the pool has a coverage period that is *not* the same as the pool's fiscal year, data should be converted to an accident- or policy-year basis by

reassigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year in which the event that triggered coverage under the policy or contract occurred.

For occurrence-based coverage for which participants have policy or contract renewal dates that fall at various times during the pool's fiscal year, data should be converted to an accident- or policy-year basis by reassigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year in which the event that triggered coverage under the policy or contract occurred.

Claims-made coverage

For claims-made coverage, the policy or contract to which incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned is the reporting period in which the event that triggered coverage (generally the reporting of a claim) under the policy or contract occurred.

Claims-paid coverage

For policies or contracts with claims-paid or cash flow coverage provisions, the policy or contract to which incurred claims costs and allocated claim adjustment expenses (including IBNR) should be assigned is the reporting period in which the event that triggered coverage (generally the payment of a claim) under the policy or contract occurred. However, if claims-paid policies may become occurrence-based or claims-made policies, the following applies:

- If, under any circumstance, a policy or contract issued by the pool would provide coverage on an occurrence basis, the policy or contract should be accounted for as occurrence-based coverage.
- If a policy or contract issued by a pool would provide coverage on an occurrence basis and on a claims-made basis (such as in a claims-made policy that contains a policyholder right to convert to an occurrence-based coverage or in an occurrence-based policy that contains an insurer right to convert the policy to claims-made coverage), the policy or contract should be accounted for as occurrence-based coverage.
- If, under any circumstance, a policy or contract issued by the pool would provide coverage on a claims-made basis, the policy or contract should be accounted for as claims-made coverage.

Other types of coverage

For all other types of coverage, conversion is required, as necessary, so that incurred claims costs and allocated claim adjustment expenses (including IBNR) are assigned to the policy year in which the event that triggered coverage under the policy or contract occurred.

3.41.2. *Q*—If the policy year for a policy or participation contract is not the same as the fiscal year of the pool, what date within the policy or contract period should be used for purposes of assigning incurred claims costs and allocated claim adjustment expenses (including IBNR) to the policy year?

A—The annual inception date or renewal date of the policy or contract should be used. A standard policy year is not assumed for the 10-year revenue and claims development table. For example, during 20X2, the pool may have issued three different policies (contracts)—one started on January 1, another on March 1, and the third on June 1. Claims on all three policies will be included in the claims development for policy year 20X2, even though the one-year period in each contract is different and some of the covered events may physically occur in 20X3. If the claims for all three policies are consistently reported, the table will provide information on trends in loss development on claims.

3.42 Additional disclosures

3.42.1. *Q*—What are some examples of circumstances that should be evaluated for disclosure of changes in a pool's loss, expense, reinsurance, or excess insurance, or other transactions that materially affect amounts presented in the 10-year revenue and claims development table, as required by Statement 30, paragraph 7?

A—The premiums charged by the pool are based on certain assumptions and are calculated so that revenues will be sufficient to cover expenses for each contract type. If those assumptions do not come to fruition, it is possible that premiums will not be adequate to meet claims obligations or that premiums are excessive. Examples include:

a. Change in limits, terms, or conditions of reinsurance or excess insurance
b. Inability or unwillingness of reinsurers or excess insurers to pay losses and related expenses
c. Change in the risk retention (net of reinsurance or excess insurance) of the pool
d. Change in commission (recovery of acquisition or other costs) paid by reinsurers or excess insurers (per paragraph 38 of Statement 10)
e. Change in rating systems—for example, how exposure is determined or premium charges are allocated among participants
f. Emergence or existence of dissimilar loss patterns between types of contracts issued
g. Change in the mix (as a percentage of total) of premium dollars by type of contract
h. Change in claims policy, underwriting policy, or claims reserving policy
i. Change in types, limits, or scope of coverages provided by the pool to participants
j. Dissimilarities in effect of loss reserve discounting by type of contract or by year
k. Dissimilarities in loss and claim adjustment expense payout patterns by type of contract or by year
l. Dissimilarities in percentage of unallocated claim adjustment expense by type of contract or changes from year to year
m. Emergence of dissimilar patterns of claims count by type of contract or by year
n. Imminent or pending litigation, other adjudication, or arbitration that has the potential of materially affecting assumptions regarding information reported in RSI.

These types of events, if significant, may signal a potential change in claims development and in the sufficiency of the pool's resources to fulfill its obligations. The additional disclosures should help financial statement users understand the effects of these changes.

3.42.2. *Q*—Is there a preferred format for disclosing changes in a pool's loss, expense, reinsurance, excess insurance, or other transactions that materially affect amounts presented in the 10-year revenue and claims development table, as required by Statement 30, paragraph 7?

A—No. These disclosures may be presented in narrative form or in tabular form, whichever format best conveys the information in a meaningful manner to likely users of public entity risk pool financial reports.

3.43 Presentation

3.43.1. [Not used in GASBIG 20XX-1]

3.43.2. *Q*—Should prior years' experience be restated in the 10-year revenue and claims development table if there have been changes in coverage or accounting practices during the 10-year period?

A—Generally, changes in coverage are prospective, but changes in accounting methods may affect prior years. Each year, a revised estimate of the net incurred claims and claim adjustment expenses should be presented for each policy year on line 6 of the table. Line 7 shows the cumulative change in the estimates. Prior-year information on lines 3−6 should not be retroactively restated; that information represents the best estimate at the time it was presented. However, lines 1 and 2 are based on fiscal-year information that ties to the financial statements. To the extent that prior-year financial statements are restated, the table should be modified on those two lines. The nature and effect of any of these changes should be disclosed.

3.43.3. *Q*—If a primary government includes more than one public entity risk pool, can the disclosures required by Statement 10 and Statement 30 be combined with RSI for the pools?

A—Most of the disclosures for the pools can be combined. However, the disclosure provisions in Statement 14, paragraphs 61−63, as amended, should be applied. (See Question 3.26.1.)

The 10-year revenue and claims development table required by Statement 30, paragraph 7a, and the reconciliation of total claims liabilities by type of contract required by paragraph 7b should be presented separately for each pool unless the underwriting for each pool is the same. The extent of any RSI presentation depends on the materiality of the pool, as discussed in Statement 14, paragraph 63, as amended.

3.44 Source of underlying loss data

3.44.1. *Q*—Does the source of underlying loss data need to be disclosed?

A—This information is not required by Statement 10, as amended, or Statement 30, as amended. It may be presented if the financial statement preparer believes that it enhances the disclosures required by Statement 10, paragraph 49, subparagraphs b and d, or if it explains trends in the 10-year revenue and claims development table required by Statement 30, paragraph 7, as amended.

3.45 Reinsurance recoveries

3.45.1. *Q*—How should reinsurance recoveries be treated in the 10-year revenue and claims development table?

A—Amounts in the 10-year table are shown gross (as defined by Statement 30, paragraph 7a(3)). This may necessitate a separate set of claims records for actuarial purposes, showing all claims with future development. This information could be combined with reinsurance information to derive the necessary amounts to meet the requirements of Statements 10 and 30, as amended.

3.46 Pools Not Involving Transfer or Pooling of Risk

3.47 Entities Other Than Pools

3.48 Definition and Scope

3.48.1. *Q*—What is an ‘‘entity other than a pool’’?

A—For the purposes of Statement 10, an entity other than a pool is any state or local governmental entity financing risk that does not meet the definition of a public entity risk pool in paragraphs 10−13. (See Question 3.4.1.) The state or local governmental entity may be a general government (such as a state, county, or municipality), a public benefit corporation or authority, a public employee retirement system, a utility, a hospital, or a college or university.

3.49 Fund Classification

3.49.1. *Q*—Should *all* risk financing of an entity be reported either exclusively in the general fund (or a special revenue fund) or exclusively in an internal service fund?

A—If a single fund is used to account for an entity's risk financing activities, that fund should be a governmental fund (for example, either the general fund or a qualifying special revenue fund), or an internal service fund. The intention of Statement 10 is to preclude the use of fiduciary funds, because it is believed that there is no fiduciary or trust relationship in risk financing activities. As a result, a fund that is used to provide risk management—and is used for no other function—should be an internal service fund, regardless of the number of separate funds performing that function (for example, one fund for workers' compensation and another for general liability). Alternatively, if separate internal service funds have not been established, a governmental fund should be used to report all of these activities.

Statement 10, as amended, does not require that all of a government's risk financing be classified in a single fund type. Therefore, a governmental entity can account for one form of risk financing in a governmental fund and another form in an internal service fund.

Furthermore, risk financing can still be accounted for in an enterprise fund or a special revenue fund for risk within the fund. However, risk financing cannot be provided to other funds of the entity without reporting the risk financing activity as an internal service fund or incorporating it into a governmental fund.

3.49.2. [Not used in GASBIG 20XX-1]

3.49.3. *Q*—When should risk financing activities be reported in a governmental fund (for example, either the general fund or a qualifying special revenue fund) versus in an internal service fund?

A—Neither classification is preferred; however, there may be circumstances in which one is considered more appropriate. The use of an internal service fund may be appropriate when a governmental entity wants to segregate certain risk financing activities from its other activities, either for management and analysis or for financial statement presentation. Use of an internal service fund may also be appropriate when a government intends to recover the cost of its risk financing activities from other units of the government or when a government wants to allocate charges and possibly accumulate future catastrophe reserves. For some governments, however, risk financing activities are seen merely as a function of a governmental government—not of the individual units of the government. In these cases, the use of a governmental fund may be desirable. Although the advantages of using an internal service fund were recognized, it is noted in paragraph 119 of the Basis for Conclusions that the use of an internal service fund is not required because ". . . consistent with the objective of minimizing the number of funds used by a governmental entity, [Statement 10, as amended] does not mandate use of internal service funds. . . ."

3.49.4. *Q*—A government retains risk for active employee health benefits—not for postemployment benefits— by establishing a fund for current claims using a formal trust agreement. Statutes require that the fund be reported as a trust fund. What type of fund should be used for financial statement purposes?

A—Although a trust fund may seem appropriate because of the trust agreement and legal requirement, Statement 10, as amended, requires that if a government uses a single fund to account for its risk financing activities, that fund could be the general fund, a special revenue fund, or an internal service fund for GAAP-basis financial statement purposes; the use of a trust fund is

precluded. (See Question 3.49.1.) Therefore, the legal basis will be different from the GAAP basis. NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* under the heading "Conflicts between Legal Provisions and GAAP," indicates that "conflicts between legal provisions and GAAP do not require maintaining two accounting systems. Rather, the accounting system may be maintained on a legal-compliance basis, but should include sufficient additional records to permit GAAP-based reporting" (paragraph 13); and "the basic financial statements of governmental units should be prepared in conformity with GAAP" (paragraph 11).

An internal service fund can be used to segregate the health benefits fund from other general governmental activities, and it can be used effectively to charge premiums to other units of the government, if necessary, as discussed in paragraph 66 of Statement 10, as amended. Alternatively, the general fund or a qualifying special revenue fund can be used to account for this program.

3.49.5. [Not used in GASBIG 20XX-1]

3.50 Employee Benefits

3.50.1. *Q*—Does Statement 10, as amended, apply to long-term disability benefits provided by employers to active and retired employees?

A—Determination of the applicable accounting and financial reporting requirements that an employer should follow for disability benefits depends on:

a. Whether the disability benefits are provided through a defined benefit pension plan or are provided separately, and
b. Whether the benefits are expected to be provided to *disability-retired* employees or to *temporarily disabled* employees pending their expected return to active status.

Long-term disability benefits that are provided through a defined benefit pension plan are classified as pension benefits. An employer should account for and report such benefits in conformity with the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* as amended, or Statement No. 68, *Accounting and Financial Reporting for Pensions*, as applicable. Long-term disability benefits that are provided separately from a defined benefit pension plan and are expected to benefit disability retirees are classified as other postemployment benefits. An employer should account for and report those benefits in conformity with the requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* as amended. Short-term disability benefits that are provided separately from a defined benefit pension plan and are expected to benefit temporarily disabled employees pending their expected return to service should be accounted for as risk financing activities in conformity with the requirements of Statement 10, as amended.

3.50.2. *Q*—Does Statement 10 apply to supplemental workers' compensation benefits?

A—Yes. Paragraph 1e of Statement 10 designates "job-related illnesses or injuries to employees" as one of the types of risk included within the scope of the Statement. To the extent that an entity has claims, either reported or incurred but not reported, for which risk has not been transferred, it should accrue a liability or disclose a contingency in accordance with paragraphs 53−56 and paragraphs 58−61 of Statement 10, as amended, and paragraph 9 of Statement 30.

3.50.3. *Q*—Does Statement 10 apply to health, dental, or other medical benefits provided to active employees and retirees and their dependents and beneficiaries?

A—Statement 10, as amended, applies to health benefits provided to *active employees* and their dependents and beneficiaries. Health benefits provided to *retirees* and their dependents and beneficiaries are *other postemployment benefits* and should be accounted for in accordance with the requirements of Statement 45, as amended.

3.51 Environmental Liabilities

3.51.1. *Q*—Does the scope of Statement 10 include environmental liabilities?

A—The scope of Statement 10 includes environmental liabilities that are not within the scope of other GASB pronouncements or within the scope of other sources determined to be applicable using the GAAP hierarchy. Governments that retain risk for pollution remediation liability contingencies should apply the provisions of Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* as amended, for recognition of such liabilities. The provisions of Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs,* as amended*,* should be applied to entities covered by the scope of that Statement.

3.52 Stand-Alone Entities

3.52.1. *Q*—May a stand-alone entity that is engaged only in business-type activities use an internal service fund to report its own risk financing activities?

A—No. As amended, footnote 12 of Statement 10 provides that entities that are reported as proprietary funds, trust funds, or discretely presented component units of a primary government may participate in a risk financing internal service fund of that primary government. However, the footnote limits the classification of risk financing activities by stand-alone entities that are not reported as component units. Stand-alone entities that are engaged only in business-type or fiduciary activities and that are not considered to be a part of another financial reporting entity should not use an internal service fund to report their own risk financing activities. Instead, their risk financing activities should be reported as part of the stand-alone entities' activities. Business-type or fiduciary component units should not use an internal service fund of their own to report their risk financing activities. However, those component units may use the risk financing internal service fund of the primary government.

3.53 Recognition and Measurement

3.54 General Fund

3.54.1. *Q*—If the general fund is used for an entity's risk financing, is the government required to allocate its claims expenditures to other funds in the entity?

A—No. An allocation of these expenditures is not required to be made. Paragraph 53 of Statement 10, as amended, provides: ". . . This Statement is not intended to inhibit or restrict the method of allocation of those expenditures/expenses and liabilities among funds of the primary government in the fund financial statements." In addition, paragraph 64, as amended, states: ". . . The entity may use any method it chooses to allocate loss expenditures to the other funds of the entity. . . ." See Question 7.28.1 about allocating direct expenses to the programs/functions reported in the government-wide statement of activities.

3.54.2 [Not used in GASBIG 20XX-1]

3.55 Internal Service Fund

3.55.1. [Not used in GASBIG 20XX-1]

3.55.2. *Q*—A county government operates an internal service fund for the costs of medical care. Every month $500 per employee is accumulated for future claims experience. Claims and costs are deducted from these resources. May net position be reported as *designated* for future claims experience?

A—No. Paragraph 98 of Statement 34, as amended, states that designated net position should not be reported on the face of proprietary fund financial statements. Net position should be displayed in three categories: *net investment in capital assets, restricted,* and *unrestricted.* The restricted classification of net position arises from constraints imposed by creditors, by others outside the government, or by law (Statement 34, paragraph 34, as amended). The resources set aside by the county government do not satisfy the definition of *restricted.*

Statement 10, paragraph 67, as amended, does, however, provide for disclosure of net position designated for future catastrophe losses. (See Question 7.47.21 about the government-wide reporting implications.)

3.56 Revenue

3.56.1. *Q*—Does Statement 10, as amended, provide requirements on how to *finance* rather than how to *report* deficits in risk financing internal service funds?

A—No. Statement 10, as amended, does not require the use of any specific claims financing method. Paragraph 67 of Statement 10, as amended, states that internal service fund deficits resulting from application of paragraphs 66b and 66c do *not* need to be charged back to other funds each year as long as fee or charge adjustments are made over a reasonable period of time. Conversely, paragraph 68, as amended, requires that deficits in an internal service fund should be charged back to other funds if the deficits are not recovered over a reasonable period of time.

The provisions of paragraph 66 are designed to generally permit a level charge to be assessed over a reasonable period of years from the internal service fund to the user funds. In years in which loss experience is unfavorable, a deficit in earnings and perhaps a deficit in net position will be shown in the internal service fund. Paragraph 67, as amended, recognizes this possibility and provides that if the government has a plan to recoup deficits over a reasonable period of time, then no current-period charge should be made in the user funds.

3.56.2. *Q*—What is meant or intended by the term *actuarial method* as introduced in paragraph 66b of Statement 10?

A—Statement 10 defines the term *actuarial method* as follows:

> Any of several techniques that actuaries use to determine the amounts and timing of contributions needed to finance claims liabilities so that the total contributions plus compounded earnings on them will equal the amounts needed to satisfy claims liabilities. It may or may not include a provision for anticipated catastrophe losses.

The purpose of paragraph 66 of Statement 10 is to recognize that an internal service fund is a proprietary activity and that premiums should be able to be determined in a manner similar to insurance enterprises, with the intent of recovering the cost of paying claims. This method may be used for internal service funds. By allowing an actuarial method for determining charges to other funds, the amount recorded in other funds as expenditures/expenses can be level. Therefore, those funds are not affected in any one period because of a catastrophe or a payment of a large court settlement.

3.57 Colleges and Universities

3.57.1. [Not used in GASBIG 20XX-1]

3.58 Liability Measurement

3.58.1. *Q*—Do the liability measurement provisions in paragraphs 53−56 of Statement 10, as amended, and paragraph 9 of Statement 30 apply for liability measurement to all governmental, proprietary, and fiduciary funds?

A—Yes. The liability *measurement* provisions in those paragraphs apply to all governmental, proprietary, and fiduciary funds; the requirements are not limited to just those governments that use a single fund (an internal service fund or a governmental fund) for risk financing. The requirements for liability *recognition* in governmental funds are set forth in paragraph 14 of Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* as amended.

3.59 Contingencies

3.59.1. [Not used in GASBIG 20XX-1]

3.60 Discounting

3.60.1. *Q*—Are all claims liabilities required to be discounted?

A—No. Paragraph 59 of Statement 10 provides that presenting claims liabilities at the discounted present value of estimated future cash payments is neither mandated nor prohibited. However, discounting is required for structured settlements only if they "represent contractual obligations to pay money on fixed or determinable dates." Implicit in these settlements is the time value of money.

Discounting for all claims liabilities is not required because of the "softness" of estimates and all the variables that need to be considered, such as interest rates, settlement dates, and amounts to be paid on future dates. Because payment dates and amounts are fixed or determinable for structured settlements, the time and payout rate variables have been removed, thereby making estimation of a present value more certain.

3.61 IBNR claims

3.61.1. *Q*—What are IBNR claims?

A—According to footnote 5 of Statement 10, IBNR claims include three components:

a. Known loss events that are expected to later be presented as claims—for example, a government that retains risk for workers' compensation claims is aware of an on-the-job injury for which no formal claim has been filed.
b. Unknown loss events that are expected to become claims—for example, a government that retains risk for workers' compensation claims is unaware of an on-the-job injury that has occurred and has not been filed, but based on historical experience has an expectation of claims to be filed.
c. Expected future development on claims already reported—for example, a government that retains risk for property damage is unaware of the full extent of damages from a storm for a claim that has been filed.

IBNR is largely an estimate of loss associated with future likely activity on incurred claims based on historical actual results that establish a reliable pattern.

3.61.2. *Q*—How are IBNR claims to be estimated and recognized?

A—IBNR claims generally are estimable. Initially, it may take time to accumulate a history of the proper data if those data are not currently available. If the historical results of an entity are not representative, supplementary analysis, including use of historical actual results of other entities with similar structure, risk assumptions, and risk exposure, should be considered. Other factors to be considered are changes in operations or operating environment, demographic changes, and statutes and regulations.

Other sources of data may also be used. For example, the AICPA Audit and Accounting Guide, *Health Care Entities,* Chapter 8, provides nonauthoritative guidance on the use of statistical and other data to estimate the amount and probability of medical malpractice IBNR claims for a hospital. The concepts in that guide can be applied to risks other than healthcare. The help of an actuary may be desirable, although it is not required that an actuary's services be used.

Paragraph 53 of Statement 10, as amended, requires recognition of claims and related liabilities if they are both probable and reasonably estimable. However, paragraph 58 requires disclosure of the nature of the contingency and a statement that an estimate cannot be made in situations in which a loss is probable or reasonably possible but has not been accrued because it is not estimable.

3.61.3. *Q*—Can another entity's experience be used to calculate IBNR claims?

A—Statement 30 requires that accruals be made if IBNR claims are both probable and estimable, and it requires that such estimates should be made based on historical experience (paragraph 9). However, some entities may have a low frequency of losses and, therefore, may not be able to derive a reasonable IBNR estimate. If a reasonable estimate can be derived from another entity's experience, it may serve as a basis for making a calculation, but there should be some level of confidence that the other entity's experience is similar in amounts and types of past claims. Furthermore, it may be more appropriate to use aggregate data from several similar entities for the IBNR calculation.

Going forward, however, the entity should retain sufficient records to accumulate a history necessary to make such an estimation. Another entity's experience should not be used on an ongoing basis.

3.61.4. [Not used in GASBIG 20XX-1]

3.62 Use of third-party insurer

3.62.1. *Q*—If risk is transferred to a private insurer or a public entity risk pool, can it be removed from an entity's claim liability?

A—To the extent that the government can reasonably expect that the insurance policy or participation contract will cover the risk in question, risk has been transferred; no liability, other than premiums or required contributions payable, needs to be accrued by the government, in accordance with Statement 10, paragraph 53, as amended. The government should look at such factors as the basis of coverage being provided by the insurer, the periods covered by the policy and when claims are required to be reported to be covered, any deductibles or SIRs on claims that are required to be paid by the government, and the financial capacity and stability of the insurer. If there is a deductible or an SIR, the government should accrue for its portion of unpaid claims, both reported and IBNR. If

there is a possibility that the insurer or pool may not be able to fulfill its obligations or that the risk may fall outside the coverage of the policy due to type or timing of claim or occurrence, risk may not effectively be transferred. The government should evaluate the likelihood that it will be required to pay its own claims. An accrual or disclosure of loss contingencies may be required, applying the provisions of paragraphs 53−56, 58, and 70 of Statement 10, as amended, and paragraph 9 of Statement 30.

Furthermore, for risks transferred to a public entity risk pool, the entity should consider the likelihood that the pool will assess the entity for its share of pool losses if the pool has the right to make these assessments according to the pooling agreement. If an assessment is probable and reasonably estimable, a liability should be accrued, as required by paragraph 69 of Statement 10, as amended. If the assessments are probable but not reasonably estimable or if the assessments are reasonably possible, disclosures about the possible assessments should be made, as required by paragraph 69, as amended. (See Question 3.58.1 about liability measurement and recognition.)

3.63 Claims-made policies

3.63.1. *Q*—Does the requirement in Statement 10, paragraph 72, to account for the estimated costs of unreported claims under a claims-made policy apply only if the policy period ends on or before the statement of net position/balance sheet date?

A—No. The relationship of the policy period ending date to the statement of net position/balance sheet is not relevant. Under a claims-made policy, risk is transferred to the insurer only to the extent that covered claims are reported during the claims reporting period described within the policy. For example, if a policy period ends on June 30, and an insurable incident occurs on June 29 but is not reported until July 1, it is outside the policy coverage. Unless it has purchased tail coverage or the policy has a period beyond the policy year when claims may be reported, the entity would be responsible for payment of the claim and should account for the claim in accordance with paragraphs 53−56 and paragraph 58 of Statement 10, as amended, and paragraph 9 of Statement 30. If the entity had a June 30 year-end, it should account for the claim and include any unpaid portion of the liability on the statement of net position/balance sheet. Likewise, if the entity had a December 31 year-end, it should account for the claim and include any unpaid portion of the liability on the statement of net position/balance sheet. (See Question 3.58.1 about liability measurement and recognition.)

3.64 Claims-paid policies

3.64.1. *Q*—When is risk transferred under an insurance policy with claims-paid provisions?

A—Risk is transferred only to the extent that claims are physically paid during the policy period. Therefore, an entity should evaluate the likelihood that the insurer will cover claims, regardless of when the event leading to the claim or the reporting of the claim occurred. If an entity determines that the insurer may not cover certain claims, an accrual or disclosure of loss contingencies may be required, applying the provisions of paragraphs 53−56 and 58 of Statement 10, as amended, and paragraph 9 of Statement 30.

3.65 Retrospectively rated policies and contracts

3.65.1. *Q*—Under a retrospectively rated policy, when should a liability for premiums be recognized?

A—With this type of policy, final premiums are determined after loss experience is known, and the initial payment under the policy is generally the minimum payment. For example, a government may make an up-front premium payment but may make additional premium payments at a later date

based on loss experience. Under a policy where the entity's premiums are based just on its own loss experience, there should be a minimum amount of known premium liability that should be recognized in accordance with paragraph 73 of Statement 10. Any amounts above the minimum that are probable and reasonably estimable should be accrued. Paragraph 58 requires disclosure of amounts that are reasonably possible or are probable and not reasonably estimable.

Similarly, under a policy where the entity's premiums are based on the loss experience of a group of entities, at least the minimum premium liability should be recognized in accordance with paragraph 74, as amended. Any amount above the minimum premium, however, should be accrued if it is probable and reasonably estimable. Paragraph 58 requires disclosure of other amounts or conditions.

3.65.2. *Q*—A school district experiences above-the-ordinary medical claims. Should a liability and current expenditures/expenses be reported in anticipation of higher insurance premiums?

A—If the district's policy is retrospectively rated, an accrual should be made for anticipated premium increases. On the other hand, if risk has been transferred to the insurer for predetermined premiums, the district's liability is limited to those premiums. This guidance is appropriate even though excess claims experience may be expected to be factored into the determination of premiums for the following period. (See also Question 3.58.1 about liability measurement and recognition.)

3.66 Policyholder or pool dividends

3.67 Deductibles and self-insured retentions

3.67.1. *Q*—Should a liability be accrued for loss deductibles and self-insured retentions (SIRs)?

A—Loss deductibles and SIRs are that portion of a claim for which an entity is responsible and for which risk has effectively not been pooled or transferred. Paragraph 53 of Statement 10, as amended, requires risks that have not been transferred to an unrelated third party to be evaluated for potential recognition as a liability.

For example, an insurance policy (or a participation contract) may stipulate that the policyholder (or participant) is responsible for the first $10,000 of each claim submitted. This portion of the risk has been retained by the policyholder. Thus, the policyholder should accrue a liability for the unpaid portion of claims, both reported and IBNR. In this example, the policyholder determines the following: There are five claims (on an occurrence-based policy) of $150,000 each for incidents that have occurred before the end of the fiscal year, whether reported or not reported; all the claims qualify for coverage under the insurance policy; and there is no uncertainty about the insurer's ability to pay the claims. Based on this information, the policyholder should accrue a liability for $50,000 (5 × $10,000) for the loss deductibles or SIRs for which it will be responsible.

3.68 Costs related to claims

3.68.1. *Q*—Should the claims liabilities calculated in accordance with paragraphs 53−56 of Statement 10, as amended, and paragraph 9 of Statement 30 include costs related to the claims?

A—Yes. Paragraph 9 of Statement 30 requires that claims liabilities include specific, incremental claim adjustment expenses, reduced by estimated recoveries on unsettled claims. Incremental costs are incurred only because of a claim, such as adjustment fees for outside counsel engaged to settle a particular claim. Other allocated or unallocated claim adjustment expenditures/expenses, such as salaries, supplies, and utilities for the claims department, may be included, and, if so, this fact should be disclosed.

3.68.2. [Not used in GASBIG 20XX-1]

3.69 Annuity contracts

3.69.1. *Q*—When can a claim liability be removed from the statement of net position/balance sheet?

A—Paragraph 61 of Statement 10, as amended, provides that if an annuity contract is purchased in the claimant's name to satisfy a claim liability and the likelihood that the government will be required to make future payments (for example, because an insurance company or institution may not fulfill its obligations on the annuity) is remote, then the government should remove the annuity contract and the covered liability from the statement of net position/balance sheet. A government usually pays a lump sum for an annuity contract. That lump sum plus the earnings on it are used to make periodic payments, fixed or variable in amount, to the claimant under the terms of a settlement with the claimant. However, the government is not completely relieved of responsibility. It should evaluate whether the insurance company or institution from which the annuity contract was purchased can fulfill its obligations to pay out the required annuities.

Unless the claimant provides the entity with a signed agreement releasing the government from any further obligation, the government should include the liability in the disclosure of aggregate outstanding liabilities removed from the statement of net position/balance sheet, as required by paragraph 77d(3), as amended. The requirement for this off−financial statement settlement of claims liabilities is provided because the substance of these transactions is similar in nature to transactions involving in-substance defeasance of debt.

3.69.2. *Q*—Do annuity contracts that are held by the government but that designate the claimant as the annuitant (payee) qualify as being "in the claimant's name"?

A—Yes, provided that the government cannot unilaterally change that designation. The intent of "in the claimant's name" is to distinguish the contracts from those that are held for general investment or hedging purposes. When contracts are purchased only in the name of the government or in a name that can unilaterally be changed by the government, there is nothing that would distinguish the contracts from any other investment. It would be inappropriate to treat these types of investments as having defeased a specific claim liability, in accordance with paragraph 61 of Statement 10, as amended.

3.70 Investments

See Chapter 6.

3.71 Participation in Pool without Transfer of Risk

3.71.1. *Q*—Should payments to public entity risk pools without transfer of risk be reported as deposits or as reductions of claims liabilities?

A—Paragraph 71 of Statement 10 provides guidance for entities participating in public entity risk pools in which transfer of risk is not part of the relationship. To the extent that cumulative payments to the pool are less than cumulative paid and unpaid claims, payments should be treated as reductions of claims liabilities. The portion of cumulative payments to the pool that exceeds cumulative paid and unpaid claims should be reported as a deposit. (See the example in nonauthoritative Appendix 3-6.)

3.72 Participation in Risk-Sharing Pool

3.72.1. *Q*—Does a participant's share of the surplus of a risk-sharing pool need to be disclosed?

A—No. Statement 10 contains no provisions for an entity participating in a pool to disclose that the pool has a surplus—that is, that the pool has taken in revenues sufficient to cover current and future claims. However, an entity may include a disclosure on pool surplus if the disclosure would meet the parameters of NCGA Interpretation 6, *Notes to the Financial Statements Disclosure,* paragraph 6:

> The suggested areas to be considered for notes to the financial statements disclosures, as listed [in paragraph 5, as amended], are neither all-inclusive nor intended to replace professional judgment in determining disclosure necessary for fair presentation in the circumstances. The notes to financial statements should not be cluttered with unnecessary and immaterial disclosures. Attendant circumstances and materiality must be considered in assessing the propriety of the notes to the financial statements disclosures. Notes to the financial statements provide necessary disclosure of material items, the omission of which would cause the financial statements to be misleading.

Furthermore, paragraph 74 of Statement 10, as amended, provides that an entity insured under a retrospectively rated policy or contract with premiums or required contributions based primarily on the experience of a group of entities should accrue any refunds on the basis of the group's experience to date. In determining if a refund should be recorded, the entity should consider the ultimate cost of reported and unreported claims as of the date of the financial statements.

3.72.2. *Q*—How should an entity account for a policyholder dividend from a pool or commercial insurer?

A—The entity should record a receivable (or a prepaid asset, if the dividend will be retained by the pool or insurer as payment of the entity's premiums) and a reduction in premium expenditures/expenses at the time the dividend declaration is made. This treatment is in accordance with paragraph 75 of Statement 10. (See the example in nonauthoritative Appendix 3-7.)

3.72.3. *Q*—What is a participant's responsibility for payment of claims that cannot be covered by a risk-sharing pool?

A—A participant's responsibility depends on the pooling agreement. Pooling agreements usually specify whether any assessments other than premiums will be required of a participant to cover claims and related expenses if the pool experiences losses in excess of premiums. However, even if a pool has no recourse against a participant to make additional assessments for a higher than expected loss experience, the participant should still evaluate the pool's ability to continue as a going concern. If the pool's financial capacity or stability is in doubt, a participant may need to accrue or disclose loss contingencies for its own claims that the pool may not be able to cover.

3.73 Disclosures

3.74 Level of Disclosure

3.75 Liability Reconciliation

3.75.1. *Q*—Should the disclosure of the reconciliation of unpaid claims liabilities required in paragraph 77d(4) of Statement 10 include IBNR claims as well as claims that have already been reported?

A—Yes. If IBNR claims are probable and reasonably estimable, they are required to be included in the total unpaid claims accrual. Therefore, they should be included in the reconciliation of unpaid claims liabilities. In addition, the expected future development on existing claims, which is another component of IBNR, should be included in the total unpaid claims accrual and, accordingly, in the reconciliation of unpaid claims liabilities. If, however, IBNR claims are disclosed only, in accordance with paragraph 58, because of an inability to estimate the amount or because claims are only reasonably possible and, thus, are not included as liabilities on the statement of net position/balance sheet, this reconciliation would not include them either. However, *IBNR claims generally are estimable.*

3.75.2. *Q*—How is the removal of a liability because of an annuity contract reported in the reconciliation of the changes in aggregate liabilities?

A—The removal should be reported as an "other" item (paragraph 77d(4)(d) of Statement 10) with an explanation. It is not appropriate to report the removal as a payment, because the amount of the annuity contract will not necessarily correlate with the claim liability being removed.

3.76 Component Units

3.76.1. *Q*—A component unit participates in the risk financing internal service fund of its primary government. How should it report those activities in its separately issued financial statements?

A—Under the provisions of Statement 10, paragraph 79, as amended, the component unit should disclose its participation in the fund, the nature of that participation, and the rights and responsibilities of the component unit and the primary government. In addition, the disclosures should address the types of risk to which the component unit is exposed, how these are handled in the internal service fund, any reductions in the amount of risk covered by or through the internal service fund, and whether the amount of any settlements for the past three fiscal years exceeded coverage provided by or through the internal service fund.

The purpose of these disclosures is to clearly identify the extent to which risk has or has not been transferred to the primary government's internal service fund or through the internal service fund to a third-party insurer so that a reader can identify the component unit's potential exposure to risk.

3.76.2. *Q*—A component unit handles its risk financing separately from the rest of the financial reporting entity. What disclosures should it make in its separately issued financial statements?

A—Component units should apply all of the provisions of paragraphs 77−80 of Statement 10, as amended, and paragraph 10 of Statement 30 to their separately issued financial statements as if they were primary governments.

3.77 Loss Contingencies

3.78 Subsequent Events

3.78.1. *Q*—When disclosing significant subsequent events, is pro forma financial information required?

A—No. Paragraph 80 of Statement 10, as amended, requires disclosure about events that occur after the statement of net position/balance sheet date where there is a reasonable possibility that an asset has been impaired or a liability incurred and where the financial statements may be misleading without this information. The required disclosures are (a) indications of the nature of the loss or loss contingency and an estimate of the amount or range of loss or possible loss or (b) a statement that

an estimate cannot be made. Paragraph 80 only suggests that pro forma information may be the best way to make these disclosures, but it does not mandate that information.

3.79 Effective Date and Transition

3.79.1. [Not used in GASBIG 20XX-1]

3.79.2. [Not used in GASBIG 20XX-1]

3.79.3. [Not used in GASBIG 20XX-1]

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Appendix 3-1

GLOSSARY

This glossary defines certain terms used in this chapter and in Statement 10, as amended. Items marked with an asterisk (*) have not been defined in Statement 10. Items marked with a dagger (†) appear in Statement 10 but are not used in the questions and answers of this chapter. (Certain definitions from Statement 10 have been modified.)

Account pool*

A public entity risk pool in which separate accounts are used to manage the risk financing activities of each pool member and from which the losses of only that member are paid. (The term *claims-servicing pool* is also used.)

Acquisition costs

Costs incurred in the acquisition of new and renewal insurance or pool participation contracts. Acquisition costs include those costs that vary with and are primarily related to the acquisition of contracts (for example, certain underwriting and policy issue costs, and inspection fees).

Act of God†

An event beyond human origin or control—a natural disaster. Lightning, windstorms, and earthquakes are examples.

Actuarial method

Any of several techniques that actuaries use to determine the amounts and timing of contributions needed to finance claims liabilities so that the total contributions plus compounded earnings on them will equal the amounts needed to satisfy claims liabilities. It may or may not include a provision for anticipated catastrophe losses.

Annuity contract

A contract that provides fixed or variable periodic payments made from a stated or contingent date and continues for a specified period, such as for a number of years or for life.

Banking pool*

A public entity risk pool through which resources are made available, on a loan basis, for pool members in the event of loss.

Catastrophe

A conflagration, earthquake, windstorm, explosion, environmental pollution or damage, or similar event resulting in substantial losses, *or* an unusually large number of unrelated and unexpected losses occurring in a single period.

Cede†

To transfer all or part of an insurance risk to another enterprise through reinsurance.

Claim

A demand for payment of damages or a policy benefit (for insured risks) because of the occurrences of an event, such as the destruction or damage of property and related deaths or injuries.

Claim adjustment expenses

Expenses incurred in the course of investigating and settling claims. Allocated claim adjustment expenses include costs associated directly with specific claims paid or in the process of settlement, such as legal and adjusters' fees. Unallocated claim adjustment expenses include other costs that cannot be associated with specific claims but are related to claims paid or in the process of settlement, such as salaries and other internal costs of the pool's claims department.

Claims-made policy or contract

A type of policy or participation contract that covers losses from claims asserted (reported or filed) against the policyholder during the policy period, regardless of whether the liability-imposing events occurred during the current or any previous period in which the policyholder was insured under the claims-made contract or other specified period before the policy period (the policy retroactive date).

Claims-paid policy or contract*

A type of policy or participation contract in which the obligation of the pool to pay the claim is not fixed until the pool has physically paid the claim. A claim that has not physically been paid—regardless of the date of the occurrence or event giving rise to the claim, the time at which the claim was reported, and the legal status of the claim—is not covered. The policy may impose additional requirements, such as time periods when the event giving rise to the claim is required to occur or be reported in order to be covered.

Claims-servicing pool*

A public entity risk pool in which separate accounts are used to manage the risk financing activities of each pool member and from which the losses of only that member are paid. (The term *account pool* is also used.)

Cost recovery method

Under the cost recovery method, premiums are recognized as revenue in an amount equal to estimated claims costs as insured events occur until the ultimate premium is reasonably estimable. At that time, the rest of the premiums are recognized as revenue.

Deductible*

An amount on each claim or aggregation of claims for which risk is not transferred to a pool or insurer, as provided in a policy or participation contract. The pool or insurer generally assumes the responsibility for claim adjustment on the amount.

Deposit

Money placed with a banking or other institution or with a person, sometimes for a specified purpose.

Deposit method

Under the deposit method, premiums are not recognized as revenue and claims costs are not charged to expense until the ultimate premium is reasonably estimable; recognition of revenue is postponed until that time.

Discounting

A method used to determine the present value of a future cash payment or series of payments that takes into consideration the time value of money.

Excess insurance (insurer)

The transfer of risk of loss from one party (the insured) to another (the excess insurer) in which the excess insurer provides insurance (as defined in this glossary) in excess of a certain—typically, large—amount. For example, a public entity risk pool may purchase excess insurance to transfer risk of aggregate losses above $5 million by its pool participants.

Excess pooling arrangement*

An arrangement by which individual pools or insurers obligate themselves to share in each other's losses, as opposed to a transfer of loss from a pool or insurer to an excess insurer or reinsurer through the purchase of an excess insurance or reinsurance policy.

Experience refund*

Payments made or credits extended to the participant by a public entity risk pool that result in reducing the participant's net participation contribution. These returns may be paid in cash to the participant or applied by the pool to reduce participation contributions due for the next participation contract year. Experience refunds are determined based on the actual experience of an individual pool participant.

Future development*

Changes in expected loss and claim adjustment expenses associated with a claim (reported or unreported) between a point in time (for example, the statement of net position/balance sheet date) and the ultimate disposition of the claim. (In many situations, the term *case reserve development* is used in the commercial insurance industry.)

Incurred but not reported (IBNR) claims

Claims for insured events that have occurred but have not yet been reported to the governmental entity, public entity risk pool, insurer, or reinsurer as of the date of the financial statements. IBNR claims include (a) known loss events that are expected to later be presented as claims, (b) unknown loss events that are expected to become claims, and (c) expected future development on claims already reported.

Incurred claims

Claims (losses) paid or unpaid for which the entity has become liable.

Insurance

The transfer of risk of loss from one party (the insured) to another party (the insurer) in which the insurer promises (usually specified in a written contract) to pay the insured (or others on the insured's behalf) an amount of money (or services, or both) for economic losses sustained from an unexpected (accidental) event that occurs or is reported during a period of time for which the insured makes a premium payment to the insurer.

Insurance-purchasing pool*

A public entity risk pool in which governments combine resources to purchase commercial insurance products. (The term *risk-purchasing group* is also used.)

Liability for claim adjustment expenses†

The amount needed to provide for the estimated ultimate cost required to investigate and settle claims for insured events that have occurred on or before a particular date (ordinarily, the statement of net position/balance sheet date), whether or not reported to the governmental entity, public entity risk pool, or insurer at that date.

Liability for unpaid claims costs

The amount needed to provide for the estimated ultimate cost of settling claims for events that have occurred on or before a particular date (ordinarily, the statement of net position/balance sheet date). The estimated liability includes the amount of money that will be needed for future payments on both (a) claims that have been reported and (b) incurred but not reported (IBNR) claims.

Maintenance costs

Costs associated with maintaining records relating to insurance contracts and with the processing of premium collections and commissions.

Occurrence-based policy or contract*

A type of policy or participation contract that covers losses that happen during the policy period, regardless of when the claims are asserted, reported, or paid.

Participation contract

A formal written contract between a public entity risk pool and a pool participant describing, among other things, the period, the amount of risk coverage the pool will provide for the participating governmental entity, and the required contribution the participant is required to pay for that coverage. (The term *policy* is used in the commercial insurance industry.)

Policy

A formal written contract of insurance between an insurer and an insured describing, among other things, the period and amount of risk coverage the insurer agrees to provide to the insured. (The term *participation contract* is also used in the public risk financing field.)

Policyholder

The party to whom an insurance policy is issued and who pays a premium to an insurer for the insurer's promise to provide insurance protection.

Policyholder dividends

Payments made or credits extended to the insured by the insurer, usually at the end of a policy year, that result in reducing net insurance cost to the policyholder. These dividends may be paid in cash to the insured or applied by the insured to reduce premiums due for the next policy year. (The term *return of contribution* is also used in the public risk financing field.)

Policy-year basis

For disclosure purposes as used in Statements 10 and 30, a method that assigns incurred losses and claim adjustment expenses to the year in which the event that triggered coverage under the pool insurance policy or participation contract occurred.

Premium

The consideration paid for an insurance contract. (The term *required contributions* is also used in the public risk financing field.)

Premium deficiency

The amount by which expected claims costs (including IBNR) and all expected claim adjustment expenses, expected dividends to policyholders or pool participants, and incurred policy maintenance costs exceed related unearned premium revenue.

Probable

Used in the context of assessing estimated losses from claims, the likelihood of a future event or events confirming the fact that a loss has occurred.

Property and liability (insurance)

Insurance contracts that provide protection against (a) damage to, or loss of, property caused by various perils, such as fire and theft, or (b) legal liability, resulting from injuries to other persons or damage to their property. Property and liability insurance companies also may issue accident and health insurance contracts.

There is a broad insurance distinction between companies writing life and health insurance and those writing the property insurance or "nonlife" lines of fire, marine, casualty, and surety. Although no one definition has been fully established, some use the generic title "property and casualty" insurance, whereas others use "property and liability" insurance.

Public entity risk pool

A cooperative group of governmental entities joining together to finance an exposure, liability, or risk. Risk may include property and liability, workers' compensation, or employee healthcare. A pool may be a stand-alone entity or be included as part of a larger governmental entity that acts as the pool's sponsor.

Reasonably possible

Used in the context of assessing estimated losses from claims, there is a more than remote but less than probable chance that a future event (or events) will occur.

Reinsurance (reinsurer)

A transaction in which an assuming enterprise (reinsurer), for a consideration (premium), assumes all or part of a risk undertaken originally by another insurer (ceding enterprise). However, the legal rights of the insured are not affected by the reinsurance transaction, and the ceding enterprise issuing the original insurance contract remains liable to the insured for payment of policy benefits.

Remote

Used in the context of assessing estimated losses from claims, there is a slight chance that a future event (or events) will occur.

Reporting-form contract (policy)

A contract or policy in which the policyholder is required to report the value of insured property (or some other relevant value) to the insurer at certain intervals. The final premium on the contract is determined by applying the contract rate to the average of the values reported.

Required contributions

The consideration a pool participant pays a public entity risk pool for a participation contract. (The term *premium* is used in the commercial insurance industry.)

Retrospective (experience) rating (retrospectively rated policies)

A method of determining the final amount of an insurance premium by which the initial premium is adjusted based on actual experience during the period of coverage (sometimes subject to maximum and minimum limits).

Return of contribution

Payments made or credits extended to the participant by a public entity risk pool, usually at the end of a participation contract year, that result in reducing the participant's net participation contribution. These returns may be paid in cash to the participant or be applied by the pool to reduce participation contributions due for the next participation contract year. (The term *dividend* is used in the commercial insurance industry.) Returns of contributions are determined based on the experience of the pool as a whole or of a class of participants.

Risk

Defined variously as uncertainty of loss, chance of loss, or the variance of actual from expected results. Also, the subject matter of an insurance contract (for example, the insured property or liability exposure).

Risk management

The process of managing an organization's activities to minimize the adverse effects of certain types of losses. The main elements of risk management are risk control (to minimize the losses that strike an organization) and risk financing (to obtain finances to restore the economic damages of these losses).

Risk-purchasing group*

A public entity risk pool in which governments combine resources to purchase commercial insurance products. (The term *insurance-purchasing pool* is also used.)

Risk-sharing pool*

A public entity risk pool in which governments combine risks and resources and share in the cost of losses.

Salvage†

The amount received by a public entity risk pool from the sale of property (usually damaged) on which the pool has paid a total claim to the insured and has obtained title to the property.

Self-insurance†

A term often used to describe an entity's retention of risk of loss arising out of the ownership of property or from some other cause, rather than transferring that risk to an independent third party through the purchase of an insurance policy. It is sometimes accompanied by the setting aside of assets to fund any related losses. Because no insurance is involved, the term *self-insurance* is a misnomer.

Self-insured retention (SIR)*

An amount on each claim or aggregation of claims for which risk is not transferred to a pool or insurer, as provided in a policy or participation contract. The insured generally assumes the responsibility for claim adjustment on the amount.

Settlement rate†

The rate at which a monetary liability with uncertain terms can be settled or a monetary asset (receivable) with uncertain terms can be sold.

Structured settlement

A means of satisfying a claim liability, consisting of an initial cash payment to meet specific present financial needs combined with a stream of future payments designed to meet future financial needs, generally funded by annuity contracts.

Subrogation

The right of an insurer to pursue any course of recovery of damages, in its name or in the name of the policyholder, against a third party who is liable for costs of an insured event that have been paid by the insurer.

Tail†

The length of time between the occurrence of an event giving rise to a claim and the actual reporting and eventual settlement of that claim.

Tail coverage

A type of insurance policy designed to cover claims incurred before, but reported after, cancellation or expiration of a claims-made policy. (The term *extended discovery coverage* is used in the commercial insurance industry.)

Tort

A wrongful act, injury, or damage (not involving a breach of contract) for which a civil action can be brought.

Type of contract

Classification of policies or participation contracts based on the nature of the coverages provided that distinguishes them as an identifiable class of contract. For example, types of contracts may include general liability, property, automobile liability, automobile physical damage, multiperil, and workers' compensation.

Underwriting

The process of selecting, classifying, evaluating, rating, and assuming risks.

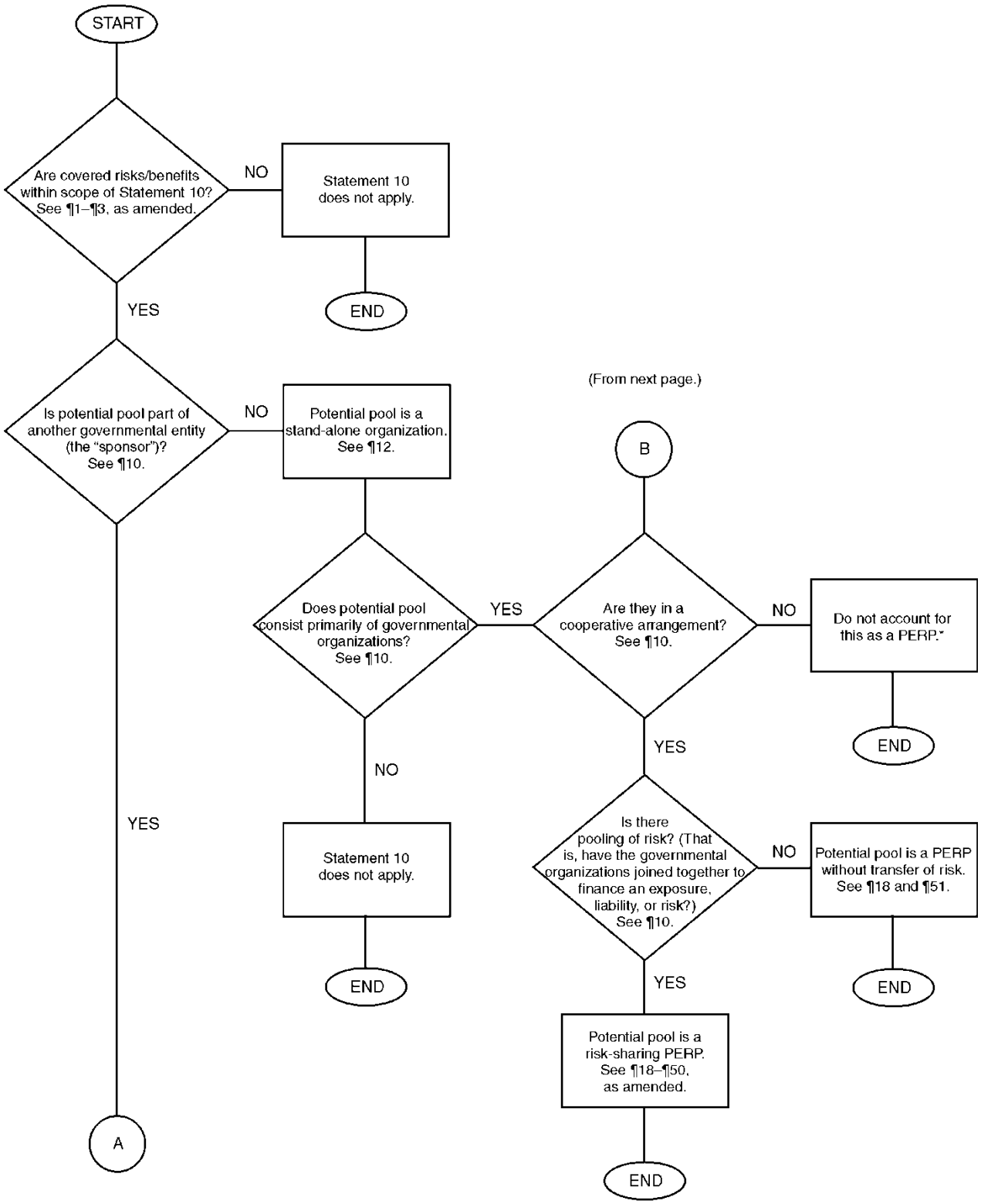
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Appendix 3-2

DETERMINING WHAT IS A PUBLIC ENTITY RISK POOL

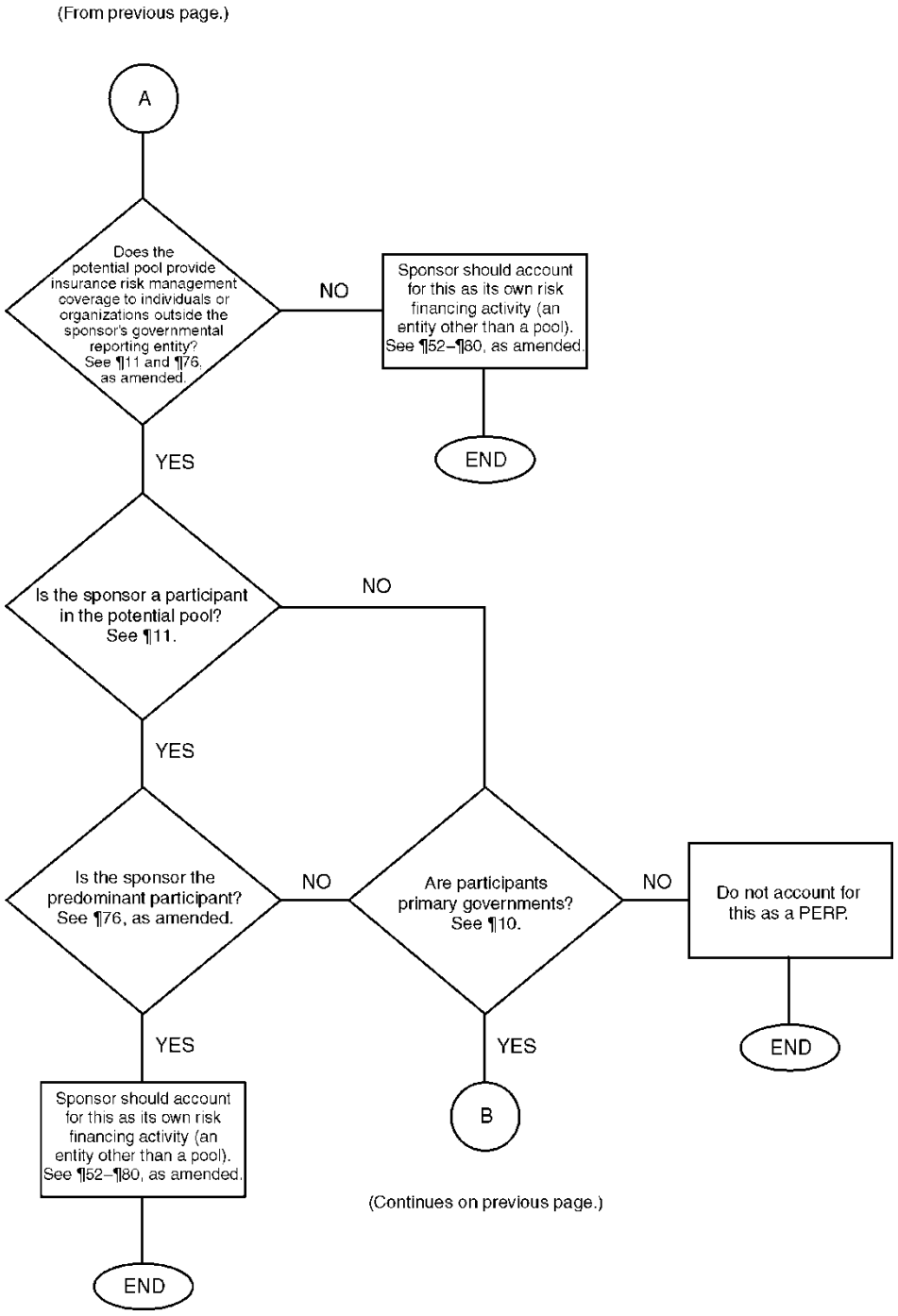
This nonauthoritative appendix contains a decision diagram and nonauthoritative examples that can be used to assist in determining whether an entity is a public entity risk pool and how to report it. The diagram is intended only to guide the user through the process of determining whether an entity is a public entity risk pool. In making that determination, the user should consider all factors together.

What Is a Public Entity Risk Pool?



(Continues on next page.)

*PERP = public entity risk pool.


(From previous page.)
A
Does the potential pool provide insurance risk management coverage to individuals or organizations outside the sponsor's governmental reporting entity? See ¶11 and ¶76, as amended.
NO
Sponsor should account for this as its own risk financing activity (an entity other than a pool). See ¶52–¶80, as amended.
END
YES
Is the sponsor a participant in the potential pool? See ¶11.
NO
YES
Is the sponsor the predominant participant? See ¶76, as amended.
NO
Are participants primary governments? See ¶10.
NO
Do not account for this as a PERP.
END
YES
YES
Sponsor should account for this as its own risk financing activity (an entity other than a pool). See ¶52–¶80, as amended.
B
END
(Continues on previous page.)

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Illustrative Examples

The following nonauthoritative examples illustrate the determination of whether an organization is a public entity risk pool.

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Example 1: State-Sponsored Healthcare Coverage for Local Government Employees

Facts: A state has a fund through which it offers healthcare coverage for active employees of local governments that elect to participate. Employees are eligible to receive benefits only for covered illnesses and events that occur during active employment. Required annual contributions to the fund are actuarially determined. Participants (the governments) pay a pro rata share of the required annual contributions based on total payroll costs for the prior year. Claims are paid from the fund up to an aggregate limit. Excess insurance is purchased for the remainder of claims. The state is not a participant in the fund. It uses a separate fund to account for the healthcare costs of its active employees.

Determination: This activity meets the definition of a public entity risk pool (where there is transfer or pooling of risk) for purposes of applying Statement 10: The participants are local governments, there is a cooperative effort, and there is transfer of risk.

Example 2: A Pension System Accumulates Assets for Retiree Healthcare Benefits

Facts: A statewide pension system has a fund through which it accumulates assets contributed by the state and participating local governments for future retiree healthcare benefits.

Determination: This does not meet the definition of a public entity risk pool: Other postemployment benefits (OPEB) are being provided through this fund. OPEB is specifically excluded from the scope of Statement 10 in paragraph 2, as amended.

Example 3: County-Sponsored Workers' Compensation Coverage for Local Schools; County Does Not Participate

Facts: A county has a fund through which it offers workers' compensation coverage to local schools, both public and private (nongovernmental not-for-profit), that elect to participate. Required annual contributions to the fund are actuarially determined. Participants pay a pro rata share of the required annual contributions based on total payroll costs for the prior year. Eighty percent of covered payroll costs are attributable to public schools; the remainder is attributable to private schools. The county does not participate in this fund for its own workers' compensation costs.

Determination: This meets the definition of a risk-sharing public entity risk pool: The participants are primarily local governmental units, there is a cooperative effort, and there is transfer of risk.

Example 4: County-Sponsored Workers' Compensation Coverage for Local Governments; County Participates

Facts: A county has a fund through which it offers workers' compensation coverage to all local governments and not-for-profit organizations within the county's geographic boundaries that elect to participate. Required annual contributions to the fund are actuarially determined. Participants pay a pro rata share of the required annual contributions based on total payroll costs for the prior year. The county participates in this fund for its own workers' compensation costs. It has 30 percent of the covered payroll; the local governments have 65 percent of the covered payroll, and not-for-profit organizations have 5 percent of the covered payroll.

Determination: This meets the definition of a risk-sharing public entity risk pool: The participants are primarily local governmental units, the sponsor (the county) is not the predominant participant, there is a cooperative effort, and there is transfer of risk.

Example 5: County-Sponsored Workers' Compensation Coverage for Local Governments; County Is Predominant Participant

Facts: A county has a fund through which it offers workers' compensation coverage to all local governments and not-for-profit organizations within the county's geographic boundaries that elect to participate. Required annual contributions to the fund are actuarially determined. Participants pay a pro rata share of the required annual contributions based on total payroll costs for the prior year. The county participates in this fund for its own workers' compensation costs. It has 60 percent of the covered payroll; the local governments have 25 percent of the covered payroll, and not-for-profit organizations have 15 percent of the covered payroll.

Determination: This activity should be accounted for as the county's own risk management activity (in an internal service fund or in the county's general fund) because it is the predominant participant. If at any time the county is no longer the predominant participant, then it should report the activity as a risk-sharing public entity risk pool.

Example 6: County-Sponsored Workers' Compensation Coverage for Local Governments; No Transfer of Risk

Facts: A county has a fund through which it offers workers' compensation claims processing to all local governments and not-for-profit organizations within the county's geographic boundaries that elect to participate. Required deposits to the fund are calculated by applying a flat rate to each participant's payroll costs. An account is maintained for each participant and only claims against that participant are paid from its account. If the account has insufficient funds to pay a claim, the participant is required to deposit additional money. The county participates in this fund for its own workers' compensation costs. It has 30 percent of the covered payroll; the local governments have 65 percent of the covered payroll, and not-for-profit organizations have 5 percent of the covered payroll.

Determination: This meets the definition of a public entity risk pool without transfer of risk: The participants are primarily local governmental units, the sponsor (the county) is not the predominant participant, and there is a cooperative effort but no transfer of risk.

Example 7: Municipal League−Sponsored Workers' Compensation Pool; Transfer of Risk

Facts: A municipal league administers a program that provides workers' compensation coverage to all member local governments that elect to participate. Required annual contributions to the program are actuarially determined. Participants pay a pro rata share of the required annual contributions based on total payroll costs for the prior year.

Determination: The program, which is an entity separate from the municipal league, meets the definition of a risk-sharing public entity risk pool: The participants are local governmental units, there is a cooperative effort, and there is transfer of risk.

Example 8: Workers' Compensation; Majority of Participants Are from Private Sector

Facts: A state has a monopoly on workers' compensation insurance. All employers in the state, including private entities, can purchase workers' compensation insurance only from the state. Over 95 percent of the coverage is provided to private-sector employers.

Determination: The participants in this program are primarily nongovernmental. Therefore, the workers' compensation fund is not a public entity risk pool and should be reported as an insurance enterprise.

Example 9: State-Sponsored Disability Fund; Majority of Participants Are from Private Sector; No Transfer of Risk

Facts: A state fund is designed to promote hiring of the disabled and the seriously ill. It provides that an employer that hires a disabled worker will not, in the event such worker suffers a subsequent injury on the job, be held liable for a disability that had actually occurred before this employment. That is, it ensures that the employer pays only the benefits that are due for the second injury. Other than an initial contribution to the fund, the state is not responsible for the fund's financing, which consists of assessments to all workers' compensation insurance carriers and self-insured employers. These are primarily nongovernmental employers. Assessments are based on a percentage of prior-year claims paid.

Determination: The fund is more in the nature of a state benefit program than a pool: Participants are primarily nongovernmental, and there is no transfer of risk. In this example, the state is not liable for the fund's financing after an initial contribution. If the state were liable, however, Statement 10, as amended, should be applied to the

recognition and measurement of claims liabilities that are required to be paid by the state from resources other than the assessments. Those requirements begin with paragraph 52 of Statement 10, amended, for entities other than pools.

Example 10: Insurance Tax Used to Regulate Insurers

Facts: The state has a Department of Insurance, funded primarily through premium taxes assessed against insurers. A percentage of the insurer premium taxes are used for regulation of the insurance industry in the state. The remainder of those premium taxes are primarily used to cover claims costs for insolvent insurers.

Determination: This activity does not meet the definition of a public entity risk pool: There is no cooperative effort, and there is no pooling of risk. Nevertheless, Statement 10, as amended, should be applied to the recognition and measurement of claims liabilities. Those requirements begin with paragraph 52 of Statement 10 for entities other than pools.

Example 11: Fees Collected for Environmental Remediation of Private Property

Facts: The state has a program in which it collects a fee from underground storage tank owners throughout the state to provide financial assurances for the owners in the event of a leak. The owners generally are not governments. Owners that pay the fee receive coverage that makes a limited dollar amount available for the cost of cleanup. The coverage is renewable annually by paying a fee. Although fees are not required to be actuarially determined, a statute requires the state to set a fee that "maintains the financial condition of the fund."

Determination: The program is not a public entity risk pool, because participants generally are not governments. It should be reported as an insurance enterprise.

Example 12: State-Sponsored, Voluntary Commodity Fund for Nongovernmental Participants

Facts: The state has an indemnity fund to protect and compensate commodity producers in the event of financial failure of commodity dealers or warehouse operators. Participation in the fund is optional. Participants are independent farmers and private-sector corporations. Fees are assessed on grains sold until the fund revenues reach a specific limit. If revenues are insufficient to pay claims, a limited amount may, with approval, be borrowed from the state. The loans are interest-bearing. In addition, the assets may be obtained for the fund from failed dealers or operators to pay claims for these failures. If fund revenues are insufficient and loan requests are denied by the state, all or parts of claims may not be paid.

Determination: To the extent that the fund has resources to cover claims, there is transfer of risk from participants to the fund. However, the participants are nongovernmental. Therefore, the fund is not a public entity risk pool and should be reported as an insurance enterprise.

Example 13: Auto Liability Cooperative; No Transfer of Risk

Facts: A group of governments formed a pool to handle losses related to automobiles. Each participant is required to maintain a minimum deposit from which claims against that government are paid. The money deposited by a participant cannot be used to pay claims against another participant. In addition, each participant is required to pay an annual fee to the pool for investment and claims-processing services.

Determination: This meets the definition of a public entity risk pool without transfer of risk. The participants are only state and local governments; there is a cooperative effort but no transfer of risk.

Appendix 3-3

CALCULATION OF POOL PREMIUM DEFICIENCIES

Paragraphs 34−36 of Statement 10, as amended, require premium deficiencies to be calculated and reported for pools. Those paragraphs provide details on the types of costs that are required to be considered in this nonauthoritative calculation.

Example

Assume the following facts:

- For the premium deficiency calculation, policies are grouped consistent with the manner of acquiring, servicing, and measuring revenue and expense elements of the policies in the pool.
- Policyholder dividends are based on the experience of the entire pool, not on groups of policies. Therefore, if the overall pool experience is favorable, it is possible that dividends may be paid to policyholders with policies in a group in which a premium deficiency exists.
- The pool considers anticipated investment income in its determination of a premium deficiency.
- All amounts are in thousands.

Following is a summary of significant amounts, determined as of the statement of net position date. All accrued amounts would be reported in the financial statements before the effect of the premium deficiency is recorded. (References are to paragraphs in Statement 10 that define these amounts.) Expected or anticipated amounts are related to events that are expected to occur (for example, claims filed against a claims-made policy or claims incurred against an occurrence-based policy) after the statement of net position date and through the expiration of policy terms.

Component of Calculation	Statement 10 Reference	Accrued Amount	Expected or Anticipated Amount
Unearned premium	¶19, as amended	$100	$ —
Unpaid claims costs (including IBNR claims costs)	¶22	110	105
Claim adjustment expenses	¶23	7	5
Policyholder dividends	¶32	0	5
Investment income	¶35, fn6	4	5

The calculation should be as follows:

Unearned premiums		$ 100
Less:		
Expected claims costs	$105	
Expected claim adjustment expenses	5	
Expected policyholder dividends	5	
Anticipated investment income	(5)	
Total costs		(110)
Deficiency		$ (10)

A premium deficiency liability of $10 and a corresponding premium deficiency expense should be recognized.

In addition, if (a) the premium deficiency is reasonably estimable, (b) the pool has a legal and enforceable right to assess policyholders for the deficiency, and (c) the collectibility of assessments is probable and reasonably estimable, revenue and receivables for the assessments should be reported by the pool.

Appendix 3-4

ACCOUNTING FOR RECOVERED AMOUNTS, LOSS DEDUCTIBLES, AND SELF-INSURED RETENTIONS

This nonauthoritative appendix illustrates the accounting treatment for public entity risk pools. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 10, as amended, or Statement 30, as amended, or to indicate the GASB's endorsement of the policies or practices shown. Application of the provisions of Statement 10, as amended, may require accounting treatments other than those illustrated here.

Illustration 1: Accounting Treatment of Recovered Amounts (Right of Subrogation)

Illustration 2: Accounting Treatment of Loss Deductibles and Self-Insured Retentions

Illustration 1: Accounting Treatment of Recovered Amounts (Right of Subrogation)

Example A

Assume the following facts:

- A liability for an unpaid claim of $100 is recorded on the pool's statement of net position as of December 31, 20X3.
- The claim is actually paid on May 1, 20X4.
- The proceeds from the subrogated assets of $30 are received June 5, 20X4.

If the original estimated claim was reduced for the amount expected to be received from subrogation, the entries would be:

12/31/X3	Subrogation receivable	$ 30	
	Claims expense	70	
	Claims liability		$ 100
	(To record claim and estimated subrogation)		
5/1/X4	Claims liability	100	
	Cash		100
	(To report claims payment)		
6/5/X4	Cash	30	
	Subrogation receivable		30
	(To report receipt of subrogated assets)		

Based on the entries above and assuming no other claims, the liability for unpaid claims on the statement of net position as of December 31, 20X3, would be $70—the $100 claims liability less the $30 subrogation receivable.

Example B

Assume the same facts as in the previous example, except the value of subrogation was uncertain and accordingly was not reported initially, but its receipt was considered probable at some point before the claim was settled.

The entries would be:

12/31/X3	Claims expense	$ 100	
	Claims liability		$ 100
	(To record claim)		
4/12/X4	Subrogation receivable	30	
	Claim expense		30
	(To accrue probable subrogation on paid claims)		
5/1/X4	Claims liability	100	
	Cash		100
	(To report claims payment)		
6/5/X4	Cash	30	
	Subrogation receivable		30
	(To report receipt of subrogated assets)		

Based on the entries above and assuming no other claims, the liability for unpaid claims on the statement of net position as of December 31, 20X3, would be $100.

Example C

Assume the same facts as in Example A, except the value of subrogation was uncertain and accordingly was not reported until receipt.

The entries would be:

12/31/X3	Claims expense	$ 100	
	Claims liability		$ 100
	(To record claim)		
5/1/X4	Claims liability	100	
	Cash		100
	(To report claims payment)		
6/5/X4	Cash	30	
	Claims expense		30
	(To report receipt of subrogated assets)		

Based on the entries above and assuming no other claims, the liability for unpaid claims on the statement of net position as of December 31, 20X3, would be $100.

Illustration 2: Accounting Treatment of Loss Deductibles and Self-Insured Retentions

Assume the following facts:

- Pool B estimates that it is probable that 10 claims of $1 million each have been incurred by participants.
- It is probable that the claims will be paid.

If the participants are required to pay $100,000 self-insured retentions (SIRs) on each claim, the pool would accrue a claim liability of $9 million [(10 × $1 million) – (10 × $100,000)]. The entries would be:

Claims expense	$ 9,000,000	
Claims liability		$ 9,000,000
(To record claims, net of SIRs to be paid by participants)		

Assuming that the claims had not yet been paid and that there are no other claims, the liability for unpaid claims on the statement of net position would be $9 million.

When the claims are paid (in aggregate), the entries would be:

Claims liability	$ 9,000,000	
Cash		$ 9,000,000
(To record payment of claims, net of SIRs)		

If the SIR amounts of $1 million had been on deposit with the pool, the initial liability entry above would remain the same. Assuming that the claims had not yet been paid and that there are no other claims, the liability for unpaid claims on the statement of net position would be $9 million, and the liability for participant deposits on the statement of net position would be $1 million.

The entry for the payment of the claim would be different from the above, as follows:

Claims liability	$ 9,000,000	
Participant SIR deposits	1,000,000	
Cash		$ 10,000,000
(To record payment of claims, including SIRs from participants)		

If Pool B pays the entire claim and is reimbursed for deductibles, it would record the same liability as above. The entries would be:

Deductibles receivable	$ 1,000,000	
Claims expense	9,000,000	
Claims liability		$ 10,000,000
(To record claims and deductibles to be paid by participants)		

For financial reporting purposes, the pool would treat these deductibles as estimated recoveries and would reduce the liability—that is, report a net liability—on the statement of net position (paragraph 22). That is, assuming that the claims had not yet been paid and that there are no other claims, the liability for unpaid claims on the statement of net position would be $9 million.

When the claims are paid, the entries (in aggregate) would be:

Claims liability	$ 10,000,000	
Cash		$ 10,000,000
(To record payment of claims)		

In effect, only $9 million in risk has been pooled. The remainder of the risk has been retained by participants. Those participants should accrue a liability for their share of these claims, in accordance with paragraphs 69 and 70, as amended.

In any event, the pool still should consider whether it has a liability for claims costs or for claim adjustment expenses. It should consider the collectibility of deductible amounts from participants, and it should consider whether it needs to incur claim adjustment expenses related to amounts covered by an SIR—for example, to ensure that a claim is defended—if participants are not adequately handling the servicing of their portion of claims.

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Appendix 3-5

ACCOUNTING FOR RISK FINANCING IN THE GENERAL FUND AND INTERNAL SERVICE FUNDS

This nonauthoritative appendix illustrates risk financing activities in both the general fund and internal service funds. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 10, as amended, or Statement 30, as amended, or to indicate the GASB's endorsement of the policies or practices shown. Application of the provisions of Statement 10, as amended, may require accounting treatments other than those illustrated here.

Illustration 1: Risk Financing—General Fund

Illustration 2: Risk Financing—Internal Service Fund

Illustration 1: Risk Financing—General Fund

Assume the following facts:

- At fiscal year-end, a city calculates a $1 million liability for claims, both reported and incurred but not reported (IBNR).
- All amounts are expected to be paid with expendable, available financial resources; thus, the entire $1 million is reported as a liability and as claims expenditures in the general fund.
- All other claims incurred and paid during the fiscal year have been charged to the appropriate funds or programs.

Example A

Charges for claims expenditures are allocated as follows: $500,000 to water utility (enterprise fund), $300,000 to liquor commission (special revenue fund), and $200,000 to the public safety department (general fund). The entries in each fund would be:

Water Utility (enterprise fund)		
Claims expense	$ 500,000	
Cash		$ 500,000
(To record amounts paid to general fund for incurred claims)		
Liquor Commission (special revenue fund)		
Claims expenditures	300,000	
Cash		300,000
(To record amounts paid to general fund for incurred claims)		
General Fund		
Claims expenditures	1,000,000	
Claims liability		1,000,000
(To record liability for incurred claims)		
Cash	800,000	
Claims expenditures		800,000
(To record allocation of liability for incurred claims to other funds)		

Example B

Assume the same facts as in the previous example, except that charges for claims expenditures are allocated as follows: $600,000 to water utility (enterprise fund), $400,000 to liquor commission (special revenue fund), and $200,000 to the public safety department (general fund).

In this case, the total of the charges ($1,200,000) exceeds the total expenditures. Because the general fund can be “reimbursed” only for actual claims expenditures, the $200,000 should be reported as transfers in from the enterprise fund and special revenue fund to comply with paragraph 64 of Statement 10, as amended. Statement 10, as amended, does not specify how the government should determine what portion of the transfers is from each fund. For purposes of this example, the amount has been allocated to the two funds after deducting actual claims costs related to those funds. For example, the $600,000 allocation to the water utility less $500,000 in actual claims expense results in a transfer out of $100,000. The entries in each fund would be:

Water Utility (enterprise fund)		
Claims expense	$ 500,000	
Transfers out	100,000	
Cash		$ 600,000
(To record amounts paid to general fund for incurred claims and additional amounts)		
Liquor Commission (special revenue fund)		
Claims expenses	300,000	
Transfers out	100,000	
Cash		400,000
(To record amounts paid to general fund for incurred claims and additional amounts)		
General Fund		
Claims expenditures	1,000,000	
Claims liability		1,000,000
(To record liability for incurred claims)		
Cash	1,000,000	
Claims expenditures		800,000
Tranfers in		200,000
(To record allocation of liability for incurred claims and additional amounts to other funds)		

Illustration 2: Risk Financing—Internal Service Fund

Assume the following facts about an internal service fund that is used to account for risks associated with the use of a government's automobiles:

- The charges from the internal service fund to other funds are based on an actuarial method.
- The actuarially determined charge to the general fund for the current year is $50,000.
- It has been determined that there is no need to accumulate resources in the internal service fund for future catastrophe losses.
- The charges to the general fund are sufficient to cover claims costs over time.

If charges to the general fund from the internal service fund are $50,000, the entries in each fund would be:

Internal Service Fund		
Due from other funds	$ 50,000	
Automobile risk revenue		$ 50,000
(To record charges to general fund for automobile coverage)		
General Fund		
Insurance expenditures	50,000	
Due to other funds		50,000
(To record amounts due to internal service fund for automobile coverage)		

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Appendix 3-6

ACCOUNTING FOR PAYMENTS TO PUBLIC ENTITY RISK POOLS WITHOUT TRANSFER OF RISK

This nonauthoritative appendix illustrates accounting for the payments to public entity risk pools without transfer or pooling of risk. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 10, as amended, or Statement 30, as amended, or to indicate the GASB's endorsement of the policies or practices shown. Application of the provisions of Statement 10, as amended, may require accounting treatments other than those illustrated here.

Example A

Assume the following facts:

- A city uses an internal service fund for risk financing and begins its participation in a claims-servicing pool on July 1, 20X3, the first day of its fiscal year.
- The city deposits $10 million to initialize its account in the pool.
- During the year, the pool pays $8 million in claims related to the city.
- The city and the pool determine that, at June 30, 20X4, there is an additional $3 million in unpaid claims, both reported and incurred but not reported (IBNR).

For fiscal year 20X4, the city would have claims expenses of $11 million for the fiscal year and a year-end liability of $1 million in the internal service fund. On the city's statement of net position, when an internal service fund is used, the $3 million in unpaid claims would be reported as a liability of either governmental or business-type activities, as appropriate. The $2 million difference between the fund liability and the $3 million in unpaid claims is developed when the internal service fund is eliminated, and it should be included in the reconciliations between fund financial statements and the statements of net position and activities. An example of the conversion of internal service fund balances in the statement of net position and results in the statement of activities can be found in nonauthoritative Appendix 7-3, Exercise 4, of Chapter 7.

On July 1, 20X4, the city contributes another $10 million to its account in the pool. During the fiscal year, the pool pays $7 million in claims for the city (including the $3 million unpaid claims accrued as of June 30, 20X4). At June 30, 20X5, the city and pool determine that there is an additional $1 million in unpaid claims, both reported and IBNR. At that date, the city would report in the internal service fund claims expenses of $5 million and a deposit of $4 million. The following illustrates how the liability and deposit amounts in the internal service fund were determined:

City's account in pool:	
Deposit 7/1/X3	$10,000,000
Claims paid in fiscal 20X4	(8,000,000)
Balance in pool account 6/30/X4	2,000,000
Accrued unpaid claims	(3,000,000)
Liability 6/30/X4	$ (1,000,000)
Balance in pool account 6/30/X4	$ 2,000,000
Deposit 7/1/X4	10,000,000
Claims paid in fiscal 20X5	(7,000,000)
Balance in pool account 6/30/X5	5,000,000
Accrued unpaid claims	(1,000,000)
Deposit 6/30/X5	$ 4,000,000

Example B

Assume the same facts as in the previous example, except that the city uses the general fund for risk financing. If the general fund is used, governments should adapt this to a modified accrual basis of accounting. Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* provides that a governmental fund liability and expenditure should be recognized to the extent liabilities mature (come due for payment) each period (paragraph 14). If the $3 million in unpaid claims meets the definition of a governmental fund liability, the general fund should report the entire $11 million expenditure and $1 million liability in the fund. If the general fund reported the claims servicing, there would be a reconciliation to the government-wide statement of net position to the extent that there are differences between the liability recognized in the general fund and the liability recognized for governmental activities in the statement of net position.

Appendix 3-7

ACCOUNTING FOR POLICYHOLDER DIVIDENDS FROM A POOL OR COMMERCIAL INSURER

This nonauthoritative appendix illustrates accounting for policyholder dividends from a pool or commercial insurer. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 10, as amended, or Statement 30, as amended, or to indicate the GASB's endorsement of the policies or practices shown. Application of the provisions of Statement 10, as amended, may require accounting treatments other than those illustrated here. Assume the following facts:

- A county, which reports its risk financing in an internal service fund, has an insurance policy for which a dividend is declared.
- The dividend will be allocated to all policyholders on a pro rata basis.
- The county's share is $25,000.

If the dividend is to be used to reduce future premiums, the entry would be:

Internal Service Fund		
Prepaid insurance	$ 25,000	
Insurance expense		$ 25,000
(To record policyholder dividend declared by insurer)		

If the county is to receive a cash distribution for the dividend, the entry would be:

Internal Service Fund		
Dividend receivable	$ 25,000	
Insurance expense		$ 25,000
(To record policyholder dividend declared by insurer)		

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Appendix 3-8

ILLUSTRATIVE NOTE DISCLOSURES AND REQUIRED SUPPLEMENTARY INFORMATION

This nonauthoritative appendix illustrates disclosures required by Statement 10 (and only those required by Statement 10), as amended. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 10 or 30, as amended, or to indicate the GASB's endorsement of the policies or practices shown. Application of the provisions of Statement 10, as amended, may require disclosures and formats other than those illustrated here.

Illustration 1a: Risk-Sharing Public Entity Risk Pool (with multiple types of contracts)

Illustration 1b: Risk-Sharing Public Entity Risk Pool (with single type of contract)

Illustration 1a: Risk-Sharing Public Entity Risk Pool (with multiple types of contracts)

Public Insurance Fund
Notes to Financial Statements
Year Ended December 31, 20X8

Description of the Fund

The Public Insurance Fund (Fund) was organized in October 20W7 to provide a program of property and casualty and employee health and accident coverage for its member organizations. In accordance with Local Law XX-123(a)[k], all political subdivisions in the State of A are eligible to participate. The program's general objectives are to formulate, develop, and administer, on behalf of the member political subdivisions, a program of insurance; to obtain lower costs for that coverage; and to develop a comprehensive loss control program. Political subdivisions joining the Fund must remain members for a minimum of three years; a member may withdraw from the Fund after that time by giving six months' notice. Subdivisions applying for membership in the Fund may do so on approval of a two-thirds vote of the board of the Fund. Fund underwriting and rate-setting policies have been established after consultation with actuaries. Fund members are not subject to a supplemental assessment in the event of deficiencies. Annual premium increases are limited to 20 percent of the prior year's premium. If the assets of the Fund were to be exhausted, members would not be responsible for the Fund's liabilities. Fund members currently include nine cities with populations ranging from 60,000 to 140,000 and four counties with populations ranging from 90,000 to 120,000.

A. Summary of Significant Accounting Policies

1. *Basis of accounting* [not illustrated].
2. *Valuation of investments* [not illustrated].
3. *Unpaid claims liabilities.* The Fund establishes claims liabilities based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The length of time for which such costs must be estimated varies depending on the coverage involved. Estimated amounts of salvage and subrogation and reinsurance recoverable on unpaid claims are deducted from the liability for unpaid claims. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liability, and damage awards, the process used in computing claims liabilities does not necessarily result in an exact amount, particularly for coverages such as general liability. Claims liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. A provision for inflation in the calculation of estimated future claims costs is implicit in the calculation because reliance is placed both on historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made.
4. *Reinsurance.* The Fund uses reinsurance agreements to reduce its exposure to large losses on all types of insured events. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Fund as direct insurer of the risks reinsured. The Fund does not report reinsured risks as liabilities unless it is probable that those risks will not be covered by reinsurers. Premiums ceded to reinsurers during 20X8 were $1,004,000, and the amount deducted from claims liabilities as of December 31, 20X8, for reinsurance was $377,000.

B. Unpaid Claims Liabilities

As discussed in Note A, the Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses, both allocated and

unallocated. The following represents changes in those aggregate liabilities for the Fund during the past two years (in thousands):

	20X8	20X7
Unpaid claims and claim adjustment expenses at beginning of year	$1,421	$1,189
Incurred claims and claim adjustment expenses:		
Provision for insured events of current year	1,282	900
Increases in provision for insured events of prior years	649	540
Total incurred claims and claim adjustment expenses	1,931	1,440
Payments:		
Claims and claim adjustment expenses attributable to insured events of current year	641	450
Claims and claim adjustment expenses attributable to insured events of prior years	904	758
Total payments	1,545	1,208
Total unpaid claims and claim adjustment expenses at end of year	$1,807	$1,421

At year-end 20X8, $718,000 of unpaid claims and claim adjustment expenses are presented at their net present value of $576,000. These claims are discounted at annual rates ranging from 8.5 to 11 percent. Unpaid claims expenses of $249,000 are not reported in the 20X8 year-end balances because the Fund has purchased annuities in claimants' names to settle those claims.

Note: The tables that follow should be presented immediately after the Fund's notes to financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

Reconciliation of Claims Liabilities by Type of Contract

The schedule below presents the changes in claims liabilities for the past two years for the Fund's two types of contracts: property and casualty and employee health and accident benefits. (Amounts presented in thousands.)

	Property and Casualty		Employee Health and Accident	
	20X8	20X7	20X8	20X7
Unpaid claims and claim adjustment expenses at beginning of fiscal year	$762	$713	$ 659	$476
Incurred claims and claim adjustment expenses:				
Provision for insured events of current fiscal year	513	360	769	540
Increases in provision for insured events of prior fiscal years	389	324	260	216
Total incurred claims and claim adjustment expenses	902	684	1,029	756
Payments:				
Claims and claim adjustment expenses attributable to insured events of current fiscal year	256	180	385	270
Claims and claim adjustment expenses attributable to insured events of prior fiscal years	542	455	362	303
Total payments	798	635	747	573
Total unpaid claims and claim adjustment expenses at end of fiscal year	$866	$762	$ 941	$659

Ten-Year Claims Development Information

The following table illustrates how the Fund's earned revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Fund as of the end of each of the past 10 years. The rows of the table are defined as follows:

(1) This line shows the total of each fiscal year's gross earned contribution revenue and investment revenue, contribution revenue ceded to reinsurers, and net earned contribution revenue and reported investment revenue.
(2) This line shows each fiscal year's other operating costs of the Fund including overhead and claims expense not allocable to individual claims.
(3) This line shows the Fund's gross incurred claims and allocated claim adjustment expenses, claims assumed by reinsurers, and net incurred claims and allocated adjustment expenses (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (called *policy year*).
(4) This section of 10 rows shows the cumulative net amounts paid as of the end of successive years for each policy year.
(5) This line shows the latest reestimated amount of claims assumed by reinsurers as of the end of the current year for each accident year.
(6) This section of 10 rows shows how each policy year's net incurred claims increased or decreased as of the end of successive years. (This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, and emergence of new claims not previously known.)
(7) This line compares the latest reestimated net incurred claims amount to the amount originally established (line 3) and shows whether this latest estimate of net claims cost is greater or less than originally thought. As data for individual policy years mature, the correlation between original estimates and reestimated amounts commonly is used to evaluate the accuracy of net incurred claims currently recognized in less mature policy years. The columns of the table show data for successive policy years.

	Fiscal and Policy Year Ended (in Thousands of Dollars)									
	20W9	**20X0**	**20X1**	**20X2**	**20X3**	**20X4**	**20X5**	**20X6**	**20X7**	**20X8**
1. Required contribution and investment revenue:										
Earned	$908	$957	$1,357	$1,493	$1,479	$1,595	$1,811	$1,993	$2,192	$2,411
Ceded	366	387	559	615	624	686	754	830	913	1,004
Net earned	542	570	798	878	855	909	1,057	1,163	1,279	1,407
2. Unallocated expenses	64	68	81	91	70	81	92	110	123	131
3. Estimated claims and expenses, end of policy year:										
Incurred	287	303	453	503	569	651	780	909	1,092	1,512
Ceded	52	54	96	111	129	148	168	186	210	251
Net incurred	235	249	357	392	440	503	612	723	882	1,261
4. Net paid (cumulative) as of:										
End of policy year	118	124	179	196	220	251	306	361	450	641
One year later	177	186	268	294	330	377	459	542	675	
Two years later	254	268	385	422	474	542	660	779		
Three years later	304	321	461	506	568	649	790			
Four years later	359	379	545	597	671	766				
Five years later	404	427	614	673	756					
Six years later	445	469	674	740						
Seven years later	473	499	717							
Eight years later	473	499								
Nine years later	473									
5. Reestimated ceded claims and expenses	104	109	160	174	184	195	211	217	234	251
6. Reestimated net incurred claims and expenses:										
End of policy year	235	249	357	392	440	503	612	723	882	1,261
One year later	294	311	447	490	550	628	765	898	1,102	
Two years later	338	357	513	563	632	722	874	1,028		
Three years later	380	401	577	632	710	811	982			
Four years later	422	446	641	703	789	902				
Five years later	449	474	682	748	840					
Six years later	468	494	710	779						
Seven years later	473	499	717							
Eight years later	473	499								
Nine years later	473									
7. Increase in estimated net incurred claims and expenses from end of policy year	238	250	360	387	400	399	370	305	220	0

Illustration 1b: Risk-Sharing Public Entity Risk Pool (with single type of contract)

Note: The following example uses these assumptions:

- The pool reports no liabilities at net present value.
- The pool provides only one type of coverage and has only one class of participants.

Association of Municipalities Workers' Compensation Program
Notes to Financial Statements
Years Ended December 31, 20X3 and 20X2

A. Summary of Significant Accounting Policies

1. *Description of the program.* The Association of Municipalities Workers' Compensation Program (the Program) provides workers' compensation coverage to member cities pursuant to RS 9-K of the state statutes. The Program is fully funded by its member cities. Members include 545 cities with populations of 113 to 73,000. The Program is governed by a Board of Directors that is elected from, and by representatives of, member cities. Any member may withdraw from the Program by giving twelve months' written notice to the Board of Directors. Cities may be admitted by a vote of the Board of Directors. Rate-setting policies are established by the Board of Directors in consultation with independent actuaries. Member cities are subject to a supplemental assessment in the event of deficiencies. The Board of Directors may distribute returns of contributions to member cities in the event of a surplus.
2. *Cash equivalents* [not illustrated].
3. *Investments* [not illustrated].
4. *Premiums.* Premiums are recognized on a pro rata basis over the term of the policy. Premiums applicable to the unexpired terms of the policies in force are reported as unearned at the statement of net position date.
5. *Losses and loss adjustment expenses.* The provision for losses and loss adjustment expenses includes paid and unpaid claims and expenses associated with settling claims, including legal fees. The liability for unpaid losses and loss adjustment expenses is based on claims adjusters' evaluations of individual claims and management's evaluation and an actuarial review of experience with respect to the probable number and nature of claims arising from losses that have been incurred but have not yet been reported. The liability represents the estimated ultimate cost of settling the claims, including the effects of inflation and other societal and economic factors. Any adjustments resulting from the settlement of losses will be reflected in earnings at the time the adjustments are determined.

B. Reinsurance Ceded

In the ordinary course of business, the Program reinsures certain risks with commercial insurers through contractual agreements, commonly referred to as reinsurance ceded. These agreements serve to limit the Program's potential losses for large aggregate and individual losses. A contingent liability exists with respect to reinsurance ceded to the extent that any reinsurer is unable to meet its obligation assumed under the reinsurance agreements.

The following reinsurance balances were deducted from unearned premiums and unpaid claims liabilities, respectively, in the Program's financial statements (in thousands):

	20X3	20X2
Reinsurance premiums ceded	$1,100	$1,050
Losses recoverable from reinsurers	3,950	4,400

C. Annuities

In the current and prior fiscal years, the Program has purchased several annuities in claimants' names to fund future payments to these claimants. The Program believes there is no material contingent liability related to these annuities. Accordingly, the amounts of $1,425,000 and $650,000 have not been reported as an asset or as a liability on the statement of net position as of December 31, 20X3, and December 31, 20X2, respectively.

D. Unpaid Loss Liabilities

As discussed in Note A, the Program establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related loss adjustment expenses. The following represents changes in those aggregate liabilities for the Program during the past two years (in thousands):

	20X3	**20X2**
Unpaid losses and loss adjustment expenses at beginning of fiscal year	$43,780	$36,090
Incurred losses and loss adjustment expenses:		
Provision for insured events of current year	20,125	15,490
Increases (decreases) in provision for insured events of prior fiscal years	(225)	685
Total incurred losses and loss adjustment expenses	19,900	16,175
Payments:		
Losses and loss adjustment expenses attributable to insured events of current fiscal year	3,315	2,700
Losses and loss adjustment expenses attributable to insured events of prior fiscal years	7,110	5,785
Total payments	10,425	8,485
Losses satisfied with annuity contracts in claimants' names	(835)	0
Unpaid losses and loss adjustment expenses at end of fiscal year	$52,420	$43,780

Note: The table that follows should be presented in a separate section immediately after the Program's notes to financial statements. A reconciliation of claims liabilities by type of contract is not required because there is only one type of contract. Only the reconciliation in Note D is necessary.

REQUIRED SUPPLEMENTARY INFORMATION

Ten-Year Loss Development Information

The following table illustrates how the Program's earned revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Program as of the end of each of the previous ten years. The rows of the table are defined as follows:

(1) This line shows the total of each fiscal year's gross earned premiums and reported investment revenue, amounts of premiums ceded, and reported premiums (net of reinsurance) and reported investment revenue.
(2) This line shows each fiscal year's other operating costs of the Program including overhead and loss adjustment expenses not allocable to individual claims.
(3) This line shows the Program's gross incurred losses and allocated loss adjustment expense, losses assumed by reinsurers, and net incurred losses and loss adjustment expense (both paid and accrued) as originally reported at the end of the year in which the event that triggered coverage occurred (called *accident year*).
(4) This section of 10 rows shows the cumulative net amounts paid as of the end of successive years for each accident year.
(5) This line shows the latest reestimated amount of losses assumed by reinsurers for each accident year.
(6) This section of 10 rows shows how each accident year's net incurred losses increased or decreased as of the end of successive years. (This annual reestimation results from new information received on known losses, reevaluation of existing information on known losses, and emergence of new losses not previously known.)
(7) This line compares the latest reestimated net incurred losses amount to the amount originally established (line 3) and shows whether this latest estimate of losses is greater or less than originally thought. As data for individual accident years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of net incurred losses currently recognized in less mature accident years. The columns of the table show data for successive accident years.

	Fiscal and Accident Year Ended (in Thousands of Dollars)									
	20W4	**20W5**	**20W6**	**20W7**	**20W8**	**20W9**	**20X0**	**20X1**	**20X2**	**20X3**
1. Premium and investment revenue:										
Earned	$ 3,880	$ 3,221	$ 3,680	$ 6,377	$ 15,285	$ 16,784	$ 17,567	$ 20,421	$ 25,411	$ 31,110
Ceded	360	376	405	688	1,426	1,700	1,750	2,198	2,423	3,011
Net earned	3,520	2,845	3,275	5,689	13,859	15,084	15,817	18,223	22,988	28,099
2. Unallocated expenses	235	253	322	522	1,089	1,203	1,148	1,295	1,557	1,783
3. Estimated losses and expenses, end of accident year:										
Incurred	1,436	1,863	2,266	3,067	7,183	11,787	12,604	15,566	18,297	23,260
Ceded	130	175	204	267	639	1,088	1,201	1,366	1,708	2,258
Net incurred	1,306	1,688	2,062	2,800	6,544	10,699	11,403	14,200	16,589	21,002
4. Net paid (cumulative) as of:										
End of accident year	310	846	388	724	1,355	1,987	2,179	2,177	2,599	3,201
One year later	799	1,205	1,055	1,326	3,020	3,802	4,503	4,639	5,998	
Two years later	943	1,655	1,422	1,839	3,954	5,088	6,074	6,091		
Three years later	1,222	2,341	1,615	2,174	4,386	5,802	7,225			
Four years later	1,401	2,777	1,777	2,444	5,140	6,420				
Five years later	1,588	2,843	1,870	2,687	5,411					
Six years later	1,623	3,011	1,993	2,711						
Seven years later	1,706	3,125	2,065							
Eight years later	1,789	3,189								
Nine years later	1,795									
5. Reestimated ceded losses and expenses	219	368	300	379	812	996	1,372	1,354	1,708	2,258
6. Reestimated net incurred losses and expenses:										
End of accident year	1,306	1,688	2,062	2,800	6,544	10,699	11,403	14,200	16,589	21,002
One year later	1,356	2,231	2,522	4,521	8,501	11,295	13,388	13,568	16,759	
Two years later	1,488	2,602	3,521	4,066	8,668	11,148	12,703	13,342		
Three years later	1,785	4,534	2,830	4,189	8,014	10,423	13,254			
Four years later	2,421	3,349	2,965	3,903	7,862	10,178				
Five years later	2,039	3,827	2,918	3,799	7,923					
Six years later	2,001	3,988	2,965	3,625						
Seven years later	2,204	3,916	2,988							
Eight years later	2,276	3,754								
Nine years later	2,183									
7. Increase (decrease) in estimated net incurred losses and expenses from end of accident year	877	2,066	926	825	1,379	(521)	1,851	(858)	170	0