Statewide Accounting Policy & Procedure

Accounting Manual Reference:		**Effective Date:** 07/01/2015
Section:	Claims, Judgments, and Accounting for Contingencies	**Revision Date:** 07/01/2015
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Index:

Authority:

- GASB Statement No. 62 – *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (Contingencies section, paragraphs 96-113)
- GASB Statement No. 56 – *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*
- GASB Statement No. 30 – *Risk Financing Omnibus an amendment of GASB Statement No. 10*
- GASB Statement No. 10 – *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*
- GASB Statement No. 7 – *Advance Refundings Resulting in Defeasance of Debt*
- GASB Codification Section 1500, *Reporting Liabilities* (paragraph 125)
- GASB Codification Section 1600, *Basis of Accounting* (paragraphs 122 and 129)
- GASB Codification Section C50, *Claims and Judgments*

Applicability:

This accounting policy applies to all organizations included in the State of Georgia reporting entity. Refer to the *Management Responsibilities* policy for a summary of general financial reporting responsibilities.

Policy Summary:

The State is subject to many types of risks of loss. These losses include claims and judgments arising from employment, contractual actions, actions of government personnel, etc. Although the State has the privilege of sovereign immunity, there are circumstances when the Georgia Constitution allows for the waiver of that immunity. The General Assembly is authorized to provide by law for procedures for the making, handling, and disposing of actions (judgments) or claims against the State and its departments, agencies, officers, and employees.

The financial impact of these risks of loss may be known or may require estimation.

Certain risks of loss (such as general liability, property/casualty losses, and workers' or unemployment compensation issues) are handled through the State's risk management process via self-insurance or external insurance programs.

Some risks of loss arise from conditions that exist at fiscal year-end, but involve uncertainties which will be resolved in the future when one or more events occur or fail to occur (i.e., some claims are contingent). Depending on the likelihood of the future event or transaction, GAAP may require the recognition of liabilities and expenditures/expenses or certain disclosures for these risks of loss, even if a specific event or transaction has not occurred at the end of a reporting period.

This policy provides guidance on the types of risks of loss to which the State may be exposed and the accounting for liabilities, expenditures/expenses, related transactions (including contingencies), disclosures and the use of estimates for these risks of loss.

Policy Requirements:

Organizations included in the State reporting entity are required to comply with the recognition, measurement, and disclosure provisions of GASB Codification Section C50, *Claims and Judgments*. This section provides comprehensive guidance for risk financing and insurance-related activities other than public entity risk pools, as well as for accounting and reporting disclosures for related contingencies. Accounting for termination/postemployment benefits and for Medicaid insurance plans are specifically excluded from claims and judgments accounting, therefore the guidance in this policy does not apply to those topics.

Risk Financing and Insurance-related Activities (other than public entity risk pools)

The GASB includes risk of loss from the following types of events within the scope of risk financing and insurance-related issues reporting:

- Torts
- Theft of, damage to, or destruction of assets
- Business interruption
- Errors or omissions
- Job-related illnesses or injuries to employees (see recognition and measurement of incurred but not reported below)
- Acts of God
- Losses that result from the provision of accident and health, dental, and other medical benefits to employees and their dependents and beneficiaries, based on covered events that have already occurred (see recognition and measurement of incurred but not reported below)

If the above events involve a contingent situation, then the contingency rules described below must be followed. If applicable, apply the provisions of GASB Codification Section C50.126 through C50.131 when charging or allocating expenditures to other funds of the reporting entity.

Other Types of Risks of Loss

GASB also specifically includes risks of loss from the following types of events as being within the scope of contingency reporting:

- Collectibility of receivables (refer to the SAO policy titled *Uncollectible Accounts/Write-offs*)
- Guarantees of indebtedness of others in an exchange or exchange-like transaction (including indirect guarantees)

- Agreements to repurchase receivables (or to repurchase the related property) that have been sold
- Contractual actions, such as claims for delays or inadequate specifications on contracts
- Property tax appeals
- Unemployment compensation

Public Entity Risk Pools

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

Treatment of public entity risk pool transactions requires special evaluation. The GASB addresses public entity risk pools in its Codification section on stand-alone reporting for specialized units and activities. Refer to and apply the provisions of GASB Codification Section Po20, *Public Entity Risk Pools*, when accounting for and reporting such activity.

Entities that participate in a pool that share risks should report their premiums or required contributions in their modified accrual and accrual basis financial statements as insurance expenditures or expenses. The State reports the activities of the State Health Benefit Plan (SHBP) for employee healthcare as a public entity risk pool.

Recognition and Measurement

Liabilities and expenditures/expenses for claims, judgments and other risks of loss follow basic recognition and measurement criteria (for each relevant basis of accounting) when a transaction has been adjudicated and settled. Recognition and measurement of any contingent portion of these transactions depend on the topics documented below. Treatment specific to each basis of accounting is discussed in the following section of this policy.

Assessment of Contingencies

Contingencies must be assessed as to the likelihood of loss to determine whether accrual or disclosure is required. The assessment is based on the following guidance.

1. *Loss Contingencies*

   Both GASB Codification Sections C50.112 and C50.155 state: “When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote.” Three degrees of likelihood are defined within this range:

   a) Probable - The future event or events are likely to occur.
   b) Reasonably Possible - The chance of the future event or events occurring is more than remote but less than likely.
   c) Remote - The chance of the future event or events occurring is slight.

   A loss contingency is accrued as of the date of the statement of financial position when information is available prior to issuance of the financial statements that the contingency is both (i.) probable, as described above and (ii.) reasonably estimable (see below),

   The accrual of a loss contingency is not dependent on an actual claim existing as of the date of the statement of financial position. All that is needed is the occurrence of an event on or before that statement’s date which may lead to a loss contingency. If the governmental unit becomes aware of the claim after that date but before the issuance of the financial statements, the claim must be evaluated for possible accrual or inclusion in financial statements.

Contingent liabilities are not required to be accrued if
- A loss contingency is either not probable but is reasonably possible, or
- A loss contingency is probable but is not subject to reasonable estimation.

Disclosure in the notes to the financial statements is required when it is reasonably possible that a loss may have been incurred (Refer to the Disclosure Requirements section).

2. *Gain Contingencies*
Gain contingencies should not be recorded. Additionally, special care is required when disclosing gain contingencies to avoid potentially misleading assessments about the likelihood of realization.

Estimates

Estimates are used throughout accounting records and are considered reliable if they are verifiable, free from bias, faithfully represented, and comprehensive. The amount of loss is considered to be reasonably estimable even if the estimate is a range of amounts. If some amount within the range appears to be a better estimate than other amounts, then that amount should be accrued. If no amount within the range seems better, then the minimum amount in the range should be accrued.

Estimates for claims liabilities, including incurred but not reported (IBNR, see below) should be based on the ultimate expected costs of settling the claims, reduced by any estimated recoveries (such as through salvage, external insurance, or other reimbursements).

Incurred but Not Reported (IBNR)

GASB Codification Section C50.113 states that there are situations in which incidents occur before the date of the statement of financial position but claims are not reported or asserted when the financial statements are prepared. If an IBNR loss can be reasonably estimated and it is probable that a successful claim will be asserted, then the related expenditure/expense and liability should be recorded.

IBNR is essentially a loss estimate. It involves projecting future likely claims activity based on historical actual results that establish a reliable pattern. The GASB provides the following example: after reviewing historical claims experience, an entity determines that only 40 percent of all claims are normally reported during the year of occurrence, an additional 50 percent the next year, and the remainder in the third year. This pattern is used to estimate IBNR amounts and the timing of those amounts for financial reporting purposes.

State organizations that are responsible for funds dedicated to settling claims activity for healthcare, workers' compensation, unemployment compensation, or miscellaneous insurable activities, etc. may need actuarial studies or other estimates and experience studies to support a liability for IBNR.

Discounting

Presenting claims liabilities at the discounted present value of estimated future payments is neither mandated nor prohibited by GASB guidelines. Discounting, however, is required for structured settlements if they represent contractual obligations to pay specific amounts on fixed or determinable dates. The time value of money is implicit in these settlements.

Basis of Accounting

Organizations included in the State reporting entity are required to maintain their accounting records in a manner that provides for the preparation of both GAAP financial statements and budgetary statements.

Day-to-day operations may be accounted for using a budgetary/statutory basis of accounting, which is also used for preparing the year-end BCR. The primary statements in the year-end CAFR, however, are prepared using different bases of accounting, the GAAP bases: modified accrual and accrual.

Statutory Basis
For statutory accounting purposes organizations included in the Appropriations Act should accrue only claims and judgments which have been adjudicated or settled. If an uninsured claim has been made and it is probable that the outcome will be unfavorable and if the amount can be reasonably estimated, a reserve may be established dependent upon available fund balance and the approval of the Office of Planning and Budget. Additionally, although insured or self-insured IBNR claims are not accrued under the statutory basis of accounting, reserves may be approved to cover probable and estimable claims for the SHBP or other predictable risk management claims or obligations.

GAAP Modified Accrual Basis
For the fund financial statements, governmental fund claim expenditures and liabilities should be recognized to the extent that the amounts are payable with expendable available financial resources (i.e., to the extent the liabilities are ***normally expected*** to be liquidated with expendable available financial resources). In general, the determination of modified accrual recognition is based on when the liabilities mature (come due for payment) each period, independent of the method and timing of resource accumulation. For example, if a personal injury occurred on government property before the statement of financial position date and a claim with a probable chance of success has been asserted through litigation, and the litigation is settled before the financial statements are issued, then the liability is mature given the subsequent event, and the expenditure should be recorded. The current portion of the liability is reflected in the governmental funds while the remainder of the liability is reported in the governmental activities column of the government-wide statements.

Accrual Basis
In the government-wide financial statements and proprietary and fiduciary funds, an estimated loss from a claim or contingency is reported as an expense and a liability using the economic resources measurement focus and accrual basis of accounting. Estimated losses from claims or contingencies meeting the recognition criteria above are accrued, separating the current portion from the long-term portion.

General Accounting Procedures:

The following procedures are used by organizations in the State of Georgia reporting entity to meet the requirements for statutory and GAAP reporting purposes.

Identifying Transactions

Some activities may result in claims against the State. The Georgia Constitution Article I, Section II, Paragraph IX provides information about waivers of the State's sovereign immunity and the authority of the General Assembly to provide by law for procedures for the making, handling, and disposing of actions or claims against the State and its departments, agencies, officers, and employees. In addition, OCGA 50-21-33 includes provisions for liability insurance, self-insurance, or a combination of both to provide for payment of judgments and claims against the State.

Claims against the State may include those arising out of (a) employment, such as workers' compensation and unemployment claims; (b) contractual actions, such as claims for delays or inadequate specifications; (c) actions of government personnel, such as claims for medical malpractice, damage to privately owned vehicles by government-owned vehicles, and improper police arrest; and (d) incidents involving governmental properties, such as claims relating to personal injuries and property damage.

Each organization in the State reporting entity must maintain internal controls to ensure that any claims, judgments or related contingencies affecting the organization are identified in a timely manner and assessed to determine whether recognition, measurement, or disclosure is required under each of the bases of accounting that apply to the organization. Relevant information should be provided to SAO through the provision of audited financial statements or through the year–end accounting and reporting procedures described below.

Accounting Transactions and Journal Entries

The journal entries provided in this section are for example purposes only and are not all inclusive. The entries are based on accounts listed in the State Chart of Accounts (SCOA) which is posted on the reporting structure page of the SAO website. The link to the SCOA is SAO.Georgia.gov > Reporting > Reporting Structure and Chart of Accounts. This webpage also includes a complete listing of available chartfields. Although, only the account chartfield is used in these examples, State organizations should use any other required chartfields applicable to their specific transactions. Guidance describing the various chartfields is available in the *Chart of Accounts – Structure Overview* policy.

Statutory Basis Journal Entry

To record payment for a claim or judgment that was settled during the reporting period:

Debit	$5,000	Expenditure (700xxx)
Credit	$5,000	Cash (10xxxx) or Accounts Payable (200xxx) as appropriate

Modified Accrual Basis Journal Entry

To accrue a litigated claim that was settled before the financial statements were issued and is currently due for payment:

Debit	$10,000	Claims and Judgments Expenditures (700xxx)
Credit	$10,000	Claims and Judgments – Current Liability (207xxx)

Accrual Basis Journal Entry

To accrue an estimate for a contingency when it is probable that a liability has been incurred and the loss amount is estimable, but the liability is not yet due for payment – The current portion of the liability must be recorded separately from the noncurrent portion (e.g., to accrue an estimate for a litigation issue that has not been settled as of the financial statements date):

Debit	$ 100,000	Claims and Judgments Expense (700xxx*)
Credit	$ 20,000	Claims and Judgments – Current Liability (207xxx*)
Credit	$ 80,000	Claims and Judgments – Noncurrent Liability (281xxx)

* For organizations using the statewide financial system, account 207002 is specifically available for IBNR current liabilities. Additionally, account 700200 is specifically available to DOAS for IBNR expense estimates.

Year-End Accounting Procedures

State organizations must coordinate with the SAO Statewide Accounting and Reporting (SWAR) group to ensure that the appropriate journal entries are recorded to properly report claims, judgments and contingencies under the modified accrual and accrual bases of accounting at year-end. All required information must be provided to SAO in accordance with the annual year-end reporting calendar.

Organizations may provide their information either by completing the "Year-end Questionnaire" (link is shown below) or by providing independently audited financial statements that include the required accruals and disclosures which are in compliance with this policy. Additionally, organizations responsible for managing various risk pools or funds (such as for active employee healthcare benefits; workers' compensation, unemployment compensation; general, property, or casualty liability claims; etc.) may be required to provide certain additional information as specifically requested by SWAR each year (e.g., actuarial reports, IBNR estimates, or other supporting documentation).

The Year-end Questionnaire includes questions about activities that may be known to only higher levels of management at the organization. Accounting personnel must ensure that the Agency Head, Commissioner, or other appropriate management representative has reviewed the questionnaire and provided the necessary input. The questionnaire, with detailed instructions, is available for download from the Reporting Forms page of the SAO website (SAO.Georgia.gov > Reporting > Year-End Reporting > Reporting Forms). A form to collect information about the allowance for doubtful accounts, related to uncollectible accounts receivable, is also available from this webpage.

Funds that operate on a statutory basis must convert their accounting activity to the modified accrual and/or accrual bases of accounting for the CAFR. Proprietary and fiduciary funds that do not operate on a statutory basis use the accrual basis of accounting throughout the year.

Statutory Basis for Budgetary Compliance Reporting – There are no specific journal entries required to be posted at fiscal year-end related to claims and judgments.

Converting to GAAP Modified Accrual Basis for CAFR Reporting – Unsettled amounts which are mature and due for payment, but could not be recorded under the statutory basis, are accrued.

Converting to Accrual Basis for CAFR Reporting – Adjustments from the modified accrual basis are required if an obligation was incurred as of year-end but was not yet due for payment. For example, a contingent tort claim still subject to a judicial decision would not be due for payment until the court case is settled, so it would not have been accrued for modified accrual purposes. However, if the claim meets the contingency recognition criteria, then it would be accrued under the accrual basis of accounting. Additionally, under the accrual basis, the current portion of such a liability is reported separately from the long-term portion.

Accrual Basis for Funds Not Reporting on a Statutory Basis – No conversion entries are required at year-end for proprietary and fiduciary funds and component units that report their activities using the accrual basis throughout the year.

Disclosure Requirements

General Guidance

As mentioned above, contingent liabilities not requiring accrual should be disclosed in the notes to the financial statements when it is reasonably possible that a loss may have been incurred. Therefore, disclosure is required when:

- A loss contingency is either not probable but is reasonably possible, or
- A loss contingency is probable but is not subject to reasonable estimation.

The disclosure should describe the nature of the loss contingency and provide an estimate of the possible loss or range of loss. If an estimate cannot be made based on the available information, the disclosure should state that no estimate can be made. If the low end of an estimated range was accrued for a probable loss contingency, but it is reasonably possible that any amount within the range could ultimately be paid, then the portion of the range that was not accrued should be disclosed.

Disclosure is not required for a loss contingency involving an unreported claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. For example, if not accrued, IBNR should be disclosed under these conditions.

Contingent Liabilities for Debt

If a government is secondarily liable for the debt of a proprietary or fiduciary fund, then the government should disclose that obligation as a contingent liability, including significant facts about defaults that have occurred or appear imminent. Disclosure is also required for any refunded debt outstanding that was defeased in substance.

Certain Remote Contingencies

Certain loss contingencies should be disclosed even if the possibility of loss is remote. Frequently, these contingencies are guarantees with a right to proceed against an outside party if the guarantor has to satisfy the guarantee. Examples include guarantees of indebtedness of others in an exchange or exchange-like transaction (including indirect guarantees) and guarantees to repurchase receivables (or the related property) that have been sold or assigned. These loss contingencies and others with the same characteristics should be disclosed. The disclosure should include the nature and amount of the guarantee. Also consider disclosing, if estimable, the value of any anticipated recovery, such as from a right to proceed against an outside party.

Gain Contingencies

Disclosure may be required for a significant gain contingency, but management should be careful to avoid misleading implications about the likelihood of realization.

Subsequent Events

Subsequent events relate to information that becomes available after the date of the financial statements but before they are issued. If such information relates to a claim or loss contingency that existed at the date of the statement of financial position, then any resulting affect on liability estimates should be recognized by adjusting the financial statements. For example, subsequent settlement of litigation for a different amount than the recorded liability would require adjustment of the financial statements if the litigated event, such as a personal injury occurring on government property, took place prior to the statement of financial position date.

However, if the loss contingency did not exist at the statement date and the subsequent information indicates that either (1) an asset was impaired or a liability was incurred after that date or (2) there is at least a reasonable possibility that an asset was impaired or a liability was incurred after that date, then disclosure may be required to keep the financial statements from being misleading. An example of a subsequent event that might require disclosure is one related to claims arising from storm, earthquake or flood damage that occurred after the date of the financial statements.

When management decides that disclosure is necessary, the following information should be provided:

- The nature of the loss or loss contingency, and
- An estimate of the amount of the loss or possible loss, an estimated range for the loss, or a statement that an estimate cannot be made.

It also may be necessary to include a discussion of subsequent events in Management's Discussion and Analysis, depending on the facts and circumstances.

Long-term Liabilities

Any long-term liabilities for claims, judgments, or contingencies are subject to the same disclosure requirements as other long-term liabilities. Changes in long-term liabilities are presented in the notes to the financial statements, with governmental activities shown separately from business-type activities. A tabular format showing beginning balance, additions, deductions, ending balance, and amounts due within one year are presented. Additionally, disclosure is made of the governmental funds that typically are used to liquidate the amounts.

Definitions:

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

Contingency – An existing condition, situation, or set of circumstances involving uncertainty as to possible gain (referred to as a gain contingency) or loss (referred to as a loss contingency) to a government that will ultimately be resolved when one or more future events occur or fail to occur.

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.

Incurred but Not Reported (IBNR) – 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.

Judgment **–** A legal decision or opinion given by a judge, etc.

Probable – Used in the context of assessing estimated losses from claims, the future event or events confirming the fact that a loss has occurred are likely to occur.

Reasonably Possible – Used in the context of assessing estimated losses from claims, the chance of the future event or events occurring is more than remote but less than probable.

Remote – Used in the context of assessing estimated losses from claims, the chance of the future event or events occurring is slight.

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 those losses).

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.

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.

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