

NAF Accounting Working Group Workers' Compensation Classification Position Paper #18

Issue

Workers' Compensation has several distinct components, and under certain circumstances can be an asset, expense, liability, and an equity account. The Services have chosen to deal with these components in different ways, with some Services choosing to use Off Balance Sheet financing while others retain all components in the financial statements, albeit in slightly differing locations.

This position paper will address the separate components and recommend standardized treatment of Workers' Compensation in the NAFSGL. The separate components of workers' compensation are as follows:

1. Premium Expense - paid by the employer to an insurer for workers' compensation insurance, required by state law.
2. Claims Expense - paid by the employer in excess of the claims paid by the insurance company.
3. Prepaid Premium Expense - an asset account created when the employer pays the insurance company in advance of premiums being due.
4. Premium Payable - a liability account (likely current) due to workers' compensation premiums not being paid.
5. Workers' Compensation Payable - a liability account that can be current or noncurrent, representing the claims amount due at a future date in excess of the insurance proceeds. This liability is a contingent liability, due to the fact that this liability is not known to have been incurred and for what amount. However, it is reported if the event causing the loss is probable and the value is reasonably estimable. The event causing the loss must be probable to have taken place on or before the balance sheet date. It is not a reserve per FASB 450.20.05.08.
6. Workers' Compensation Equity Reserve- an equity account for use of reserving specific funds to deal with future Workers' compensation claims expenses. This account is not a prepaid asset as there is no clear future economic benefit- the expenses may not ever exceed the insurance proceeds.

Research

Below outlines the current treatment on how each Service complies and what the regulations, accounting guidance and industry standards are for this issue.

Classification and Handling of Workers' Compensation Guidance	Air Force	Army	Navy	Marines
Service Classification of Workers' Compensation	Self-insured Liability & Equity	Self-insured Liability & Equity	Third Party Insured Liability & Equity	Third Party Insured Equity

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	Has one GLAC called "Insurance" that installations use because they are charged a premium each month.	Has a workers' compensation expense (labor GLAC) and a standard insurance premium expense that is recorded.	Carried with payroll.	Records as an operating expense within insurance accounts.
DoDI 1015.15: Silent on treatment	N/A	N/A	N/A	N/A
FMR Chapter 13: Silent on treatment	N/A	N/A	N/A	N/A
<p>GAAP: FASB 450.20.05.10 identifies types of Loss Contingencies The following are examples of loss contingencies that are discussed in this Subtopic: ...</p> <p>c. Actual or possible claims and assessments</p> <p>FASB defines a loss Contingency in [FAS 005, paragraph 1, sequence 30-31]</p> <p>"An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses."</p> <p>GAAP thus indicates that future workers' compensation claims are a contingent liability:</p> <p>According to FASB 450-20-05, self-insured entities should create a liability for probable losses relating to uninsured, or self-insured, risks occurring on or before the balance-sheet date when reasonable loss estimates can be made based on experience and other sources. No accruals shall be established,</p>	Follows Current Guidance- however uses Claims Payable instead of the Workers' Compensation specific account	Off Balance Sheet Treatment	Follows Current Guidance- Uses the Workers' Compensation account	Off Balance Sheet Treatment

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however, for losses that apply to events occurring after the balance-sheet date. "Accrual of a loss related to a contingency does not create or set aside funds to lessen the possible financial impact of a loss."				
FASAB Handbook version 16: Liabilities, Legal Framework 36. The federal government is governed by and operates within a framework of laws. Thus, a federal liability must have its foundation in law. Some federal liabilities result from discrete actions of the government that are authorized by law but are not explicitly required by law. Examples are liabilities that result from contractual arrangements, including amounts borrowed, amounts owed for purchased goods and services, and liabilities for providing goods or services to entities that have paid for them in advance. Other liabilities flow directly from a law and its implementing regulation that specifically require the federal government to provide assets to another entity. Examples include formula grants and subsidies, claims owed under workers' compensation, and amounts owed for environmental clean-up.				
Industry Practice: GAAP	Follows Current Guidance	Unclear- Off Balance Sheet	Follows Current Guidance	Unclear- Off Balance Sheet

Discussion

Workers' Compensation is considered an on-demand pay out that entities have to be prepared to provide on notice. GAAP considers this a probable contingent loss. According to GAAP, a probable liability like Workers' Compensation should only include probable losses relating to uninsured, or self-insured risks occurring on or before the balance-sheet date when reasonable loss estimates can be made based on experience and other sources. No accruals shall be established, however, for losses that apply to events occurring after the balance-sheet date. It is acceptable under GAAP to establish a trust or reserve part of equity to provide funds to cover possible claims since an accrued liability cannot protect against risk.

Recommendation

Given GAAP and industry practice, it is recommended that all Services account for Workers' Compensation relating to uninsured, or self-insured risks occurring on or before the balance-sheet date as a probable loss contingency. The related account "Workers' Compensation Payable" is currently only used by the Navy, but should be used by all Services if a probable loss contingency exists for them. For third-party insured Services, this would not include the full liability as Services that use a third-party insurer do not bear the full risk of loss. The amount that third-party

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insured Services will record is the difference between the probable and estimable contingent liability related to workers' compensation claims and the amount provided by the insurance company. Self-insured Services will record the full amount of the probable and estimable contingent liability related to workers' compensation claims in this account. The amounts included should be probable and estimable by the financial statement date. To align with the accounting principles of comparability and consistency in financial reporting among the Services and to maximize the usefulness of financial information at the OSD level, Off Balance Sheet Financing should not be used to account for Workers' Compensation. Services should not account for any workers' compensation claims on a cash basis.

The other accounts related to Workers' Compensation should have minor alignment issues, using differing OSD GLACs for the same account element. These discrepancies should be resolved in the following manner:

NOTE: The "Standard Prefix" to the GLAC was changed from a 3-digit number to the 4-digit number with the NAFSGL 3.0 update, which was approved/promulgated on October 6, 2020. The GLAC numbers were changed accordingly below (in bold).

- ~~303~~**3060** Workers' Compensation Reserves - Usage of the reserve account in equity for workers' compensation is optional based on the Service's own willingness to set aside funds.
- ~~507~~**5140** Employee Insurance Premium Expense - Insurance premiums for workers' compensation should be included in this account under operating expenses.
- ~~536~~**5600** Claims Expense - Claims expense in excess of the insurance proceeds provided by the worker's compensation insurer.
- ~~442~~**1620** Prepaid Insurance and ~~207~~**2060** Employee **Employer** Insurance Payable - Prepaid insurance and insurance payable accounts should be used when the employer prepays (~~442~~**1620**) or has not paid the premium due (~~207~~**2060**) for workers' compensation insurance coverage as of the Balance Sheet Date.
- ~~224~~**2380** Claims Payable – This account should be used when a claim has been incurred in excess of insurance proceeds, and the employer has not paid the difference between the claim and the proceeds as of the balance sheet date.

Clarifications to the NAFSGL definitions will be required by this recommendation. No change required to the FMR, unless OSD and the Working Group desire an explicit policy prohibition or endorsement of Off-Balance sheet financing.

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Service Concurrence

Service	Concurrence	Reason for Non-concurrence
Air Force	Concurred 12/13/2018.	
Army	Concurred 1/7/2019.	
Marines	Concurred 11/15/2018.	
Navy	Concurred 12/13/2018.	

USD(P&R)/MC&FP Disposition

Changes in recommendation made in NAFSGL 3.0 update, which was approved/promulgated on October 6, 2020.

DFAS Disposition

No further action.

Forward to DoDIG?

No DoDIG equities.
