

# Statutory Issue Paper No. 168

## Updates to the Definition of a Liability

### STATUS

Finalized August 13, 2023

Original and Current Authoritative Guidance: SSAP No. 5R

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. This issue paper documents the SAP clarification revisions to *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. The intent of the revisions is to align current statutory accounting guidance, specifically the definition of a “liability,” with the term utilized by the Financial Accounting Standards Board (FASB).

### SUMMARY CONCLUSION

2. The statutory accounting principle clarifications to SSAP No. 5R (illustrated in Exhibit A), reflect that for the purposes of statutory accounting, a liability shall be defined as: a present obligation of an entity to transfer an economic benefit. A liability has two essential characteristics: (1) it is a present obligation, and (2) the obligation requires an entity to transfer or otherwise provide economic benefit to others. For the purposes of these characteristics, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

3. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies. (The definition and recognition requirements of loss contingencies under SSAP No. 5R are not proposed to be revised and will continue as statutory accounting guidance.)

### DISCUSSION

4. In December 2021, FASB issued *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which introduced updated definitions of certain key elements used in financial reporting – most notably updating the fundamental definition of a liability. Through the FASB’s adoption of Concept Statement No. 8, the original Concept Statement No. 6 has been superseded. As statutory accounting currently reflects FASB’s historical definition, this issue paper is to review the prior concept definition (currently utilized by statutory accounting) and compare it to FASB’s updated concept definition and assess whether the revised concept definition shall be reflected in statutory accounting.

5. FASB concept statements do not reflect authoritative U.S. GAAP guidance. Rather concept statements are intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance. The term “liability” is not captured or defined in the FASB Accounting Standards Codification (which is the source of authoritative U.S. GAAP.) Furthermore, although the concept statement is intended to be used as a guide in establishing authoritative



12. When reviewing the substance of the revisions, the FASB concluded that the updated definition resulted in a clearer and more precise definition. Furthermore, while it did not fundamentally change the historical concept of a liability, the revised definition potentially expands the population of liabilities to include certain obligations to issue or potentially issue an entity's own shares rather than settle an obligation exclusively with assets. In essence, clarifying that instruments with characteristics of both liabilities and equity may in fact be classified as liabilities in certain situations.

13. In general, the FASB did not anticipate that the liability definition revisions would result in any material changes in instrument reclassification (e.g., items now being classified as a liability when previously they were not considered liabilities). Again, FASB Concept Statements are not authoritative and thus the guidance in any specific standard will still be utilized for instrument measurement and classification. For statutory accounting purposes, the updated definition should be viewed similarly, that is it does not change fundamental concepts, change current practices, or introduce a new, original or a modified accounting principle. The revisions to the definition of a liability clarify the definitional language and do not modify the original intent of SSAP No. 5R and thus the changes are deemed to be a statutory accounting principle clarification.

14. The remaining concepts and guidance articulated in SSAP No. 5R (e.g., contingencies, impairments, guarantees, etc.) were not proposed for revision and thus are not further discussed in this issue paper.

#### **Actions of the Statutory Accounting Principles (E) Working Group**

15. During the 2022 Spring National Meeting, the Working Group exposed this issue paper for public comment.

16. During the 2022 Summer National Meeting, the Working Group re-exposed this issue paper for public comment.

17. At the 2022 Fall National Meeting, the Working Group re-exposed this issue paper related to the definition change of a liability in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*. This exposure intends to provide additional time for industry to review the changes in accordance with statutory accounting statements. NAIC staff were directed to collaborate with interested parties on proposed clarifying language.

18. At the 2023 Spring National Meeting, the Working Group exposed this issue paper with revisions to: 1) add an additional footnote to the definition of a liability in SSAP No. 5R which defers to more topic specific contradictory guidance and 2) revise the relevant literature section of SSAP No. 5R to note the modification. These clarifications were because of the authoritative treatment that statutory accounting provides to the definition of an asset and a liability in SSAP No. 4 and SSAP No. 5R. For U.S. GAAP, the FASB Conceptual statements definitions are not authoritative, but rather are concepts to consider when developing and applying guidance. The FASB basis for conclusions noted that some existing authoritative FASB literature regarding liabilities is inconsistent with the updates to Concepts Statement No. 8. Therefore, a modification regarding topic specific liabilities guidance was incorporated to address variations from the definition of a liability. Examples of existing SAP variations from the definition of a liability include but are not limited to:

- a. *SSAP No. 7—Asset Valuation Reserves and Interest Maintenance Reserves – AVR and IMR* establish liabilities for regulatory objectives.
- b. *SSAP No. 62R—Property and Casualty Reinsurance* – contains the provision for reinsurance liability guidance which results in a liability that is a regulatory valuation allowance for overdue and slow paying reinsurance and also enforces credit for reinsurance (*Credit for Reinsurance Model Law (#785)*) collateral requirements.

- c. *SSAP No. 92—Post Retirement Benefits Other than Pensions*, provides liability recognition, which adopts several U.S. GAAP standards with modifications.

19. At the 2023 Summer National Meeting, the Working Group adopted the exposed revisions to SSAP No. 5R as documented in this issue paper and adopted this issue paper.

## **RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**

### **Statutory Accounting**

20. Relevant excerpts of SSAP No. 5R, paragraphs 2-3 regarding the definition of a liability accounting are as follows:

2. A liability is defined as certain or probable<sup>1</sup> future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable<sup>1</sup> future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

and selling products with a warranty or guarantee obligates an entity to either pay cash or repair or replace any products that prove defective. Often, obligations incurred in exchange transactions are contractual based on written or oral agreements to pay cash or to provide goods or services to specified or determinable entities on demand at specified or determinable dates or on the occurrence of specified events.

Present obligation

E41. A liability requires that an entity be obligated to perform or act in a certain manner. In most cases it is apparent that liabilities are legally enforceable. Legally enforceable obligations include those arising from binding contracts, agreements, rules, statutes, or other requirements that would be upheld by a judicial system or government. Judicial systems vary in type and form, and the term judicial systems includes any such system that would enforce laws, statutes, and regulations. In the context most relevant to financial reporting, an obligation is any condition that binds an entity to some performance or action. In a financial reporting context, something is binding on an entity if it requires performance. Performance is what the entity is required to do to satisfy the obligation.

E42. Many obligations that qualify as liabilities stem from contracts and other agreements that are enforceable by courts or from governmental actions that have the force of law. Agreements, contracts, or statutory requirements often will specify or imply how an obligation was incurred and when and how the obligation is to be settled. For example, borrowing and lease agreements specify the amount of charges and the dates when the payments are due. The absence of a specified maturity date or event to require settlement may cast doubt that an obligation exists.

E43. Liabilities necessarily involve other parties, society, or law. The identity of the other party or recipient need not be known to the obligated entity before the time of settlement. An obligation of an entity to itself cannot be a liability. For example, in the absence of external requirements an entity is not obligated to repair the roof of its building or maintain its plant and equipment. Although those actions may be wise business moves, the entity may forgo or defer such activities because there is no present obligation to perform the activity.

E44. Certain obligations require nonreciprocal transfers from an entity to one or more other entities.

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risk that it will be unable to attract sufficient skilled staff to sustain its operating activities. Those risks are not liabilities.

E49. To be presently obligated, an entity must be bound, either legally or in some other way, to perform or act in a certain way. Most liabilities are legally enforceable, including those arising from contracts, agreements, rules, and statutes. An entity also can be

23. The other significant change to the definition of a liability included changing *future sacrifices* to a *present obligation*. Rationale for these changes were documented in *Chapter 4, Elements of Financial Statements* commentary as follows:

BC4.25. The term present obligation is included in the definition of a liability, both in this chapter and in Concepts Statement 6. Because the application of the liability definition under Concepts Statement 6 did not give sufficient emphasis to the term present obligation, the definition in this chapter more appropriately emphasizes that term. Assessing whether a present obligation exists is the primary criterion in the definition of a liability in this chapter. The primacy of the term present obligation is made more evident through the removal of many of the problematic terms in the

**EXHIBIT A – SAP Clarification Revisions to SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets** the other paragraphs of SSAP No. 5R are unchanged.

## **Statement of Statutory Accounting Principles No. 5 – Revised**

### **Liabilities, Contingencies and Impairments of Assets**

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#### **SCOPE OF STATEMENT**

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

#### **SUMMARY CONCLUSION**

##### **Liabilities**

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FNI future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability<sup>1</sup> has ~~three~~ two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FNI future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and~~ (c) ~~the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited



of FASB Statement No. 5 (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification ASU 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38, with modification reflected in this statement regarding topic-specific guidance.](#)

## REFERENCES

### Relevant Issue Papers

*Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*

*Issue Paper No. 20—Gain Contingencies*

*Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*

[\*Issue Paper No. 168—Updates to the Definition of a Liability\*](#)

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