



Accounting for Actuaries

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Food for Thought...

- Have you read your Company's GAAP financial statements?
- Can you trace the components of your GAAP net income back to their economic drivers?
- Are you familiar with the accounting policies that affect your products? Is there any controversy or differing of opinion?



Discussion Agenda

- Part 1 – Refresh the Basics
- Part 2 – Accounting Mechanics
- Part 3 – Case Study



Part 1 – Financial Statements

- Typical financial statements important to insurance companies are the income statement, balance sheet and statement of cash flows.
- Balance sheet gives a view of the current carrying value of the assets and liabilities.
- The income statement provides a view of the components that comprise the company's earnings.
- The cash flow statement provides a view of the sources and uses of cash and is made up of changes in balance sheet accounts



Detailed Income Statement

- For a plain vanilla FAS 97 annuity

GAAP Income Statement

- + Annuity Charges and Fees
- + GAAP Net Investment Income

- GAAP Tabular Interest
- GAAP Mortality Gain/Loss
- Annuity Payments
- GAAP Net Change in UPR

- + Deferral of Acquisition Expenses
- Amortization of Acquisition Expenses
- Nondeferrable Acquisition Expenses
- Maintenance Expenses

- = Pre-Tax GAAP Operating Income**
- GAAP Taxes

- = After-Tax GAAP Operating Income**
- + GAAP Realized Capital Gains/Losses
- GAAP Taxes on RCG/L

- = After-Tax GAAP Net Income**

Statutory Income Statement

- + Annuity Premium
- + Statutory Net Investment Income

- Statutory Tabular Interest
- Statutory Mortality Gain/Loss
- Annuity Payments
- Change in Interest Maintenance Reserve

- Commissions

- General Insurance Expenses

- = Pre-Tax Statutory Operating Income**
- Statutory Taxes

- = After-Tax Statutory Operating Income**
- + Statutory Realized Capital Gains/Losses
- Statutory Taxes on RCG/L
- + Change in Asset Valuation Reserve

- = After-Tax Statutory Net Income**



I/S Differences by Product

- For a FAS 60 product, premium is considered revenue and benefits are considered expenses
- For a FAS 97 product, premium are considered deposits and benefit payments are considered return of deposits – no income statement impact
 - Income earned is fee income
- Many other product-specific differences depending on product design and applicable accounting guidance.



How Change in B/S Affects Income

- For products accounted for on fair value, changes in fair value directly impact net income
- For products not accounted for on fair value, changes in reserves directly impact net income
- For investments classified as “trading”, changes in fair value directly impact net income
- For investments classified as “available for sale”, changes in fair value are recorded within equity



GAAP and Statutory Accounting Concepts

GAAP

- Better measure of earnings (matching income and expense)
- Going concern assumption
- Net realizable value of assets
- Reserves based on more realistic assumptions, and consider adverse deviation

Statutory

- Conservative
- Primary emphasis on solvency
- Balance sheet focus – not designed to feature results of operations
- Admitted asset concept



GAAP and Statutory Reporting Standards

GAAP

- FASB
 - SFAS No. 60, 97, 113, 120
 - EITF
 - Technical Bulletins
- AICPA
 - Industry audit guides
 - Statements of Position
- SEC
 - Regulations S-K, S-X
 - Staff Accounting Bulletins

Statutory

- Domicile State
 - State laws, rules and regulations
 - Permitted/Prescribed practices
- NAIC
 - Accounting practices and procedures manual
 - Emerging accounting issues working group
 - Annual statement instructions
- EITF
- Statement of Concepts



GAAP to Statutory Differences

- Acquisition costs
- Sales Inducements
- Deferred taxes
- Asset admission
- Revenue recognition
- Reserves
- Investments
- Asset valuation reserve
- Interest maintenance reserve
- Post-retirement benefit plans



Acquisition Costs

GAAP

- Acquisition costs that vary with and are primarily related to new and renewal business (for FAS 60 products) are deferred and amortized over the policy period

Statutory

- Costs of acquiring policies are charges to expense when incurred; generally at the beginning of the accounting period



Part 2 – Accounting Mechanics

- Account ownership and ledger queries.
 - An accountant books a 'journal entry' to update most accounts on the balance sheet on a monthly, quarterly or annual basis.
 - Example
 - Debit Commissions \$50,000
 - Credit Cash \$50,000
 - Ledger entries are often 'tagged' with identifiers for which legal entity, business line, product lines are involved, whether a transaction is GAAP-only, STAT-only or both, and other information such as state codes and operator IDs.



Ledger Queries and Transactions

- Your ledger system tracks all entries booked to a specific account, who books them, when, and in what amounts.
- A typical internal control structure would assign each account an owner who is responsible for that account reconciliation and signoff. That person can provide answers on the balance and can help analyze entries.
- A user can query the general ledger to isolate transactions that contribute to a balance, see who booked what entries, etc.



Consolidation Hierarchy

- To create an income statement or balance sheet, the ledger is queried for change in accounts during the period.
- A set of instructions is developed to pull accounts into line items or to assign them into an A, L, E hierarchy.
- A consolidation structure is defined to combine across business units or legal entities.



Elimination & Reversing Entries

- Used to ensure that the ultimate financial statements present transactions with ultimate impact to the consolidated company.
- Ensures intercompany profits, investment balances, reserves, etc. that are separate for parent-child relationships are not duplicated.
- Entries can be set up automatically or in advance.
- Problems can occur when the elimination entry is incorrect or when the underlying entries are incorrect.



Part 3 – Case Study

- Slight product differences can impact the accounting for a policy
 - SFAS 133 vs. SFAS 97
- Seemingly innocuous restriction can trigger significant accounting implications
 - SOP 05-1



Successful Interactions

- As part of product development
- To reduce earnings volatility
- Perception issues at senior management and board level
- Consistency with peers – auditors typically see same issues at different companies
- Emerging accounting issues – forthcoming guidance changes



Appendix



Traditional FAS 60 Reserves

GAAP

- Assumptions are reasonable and realistic at issuance
- Assumptions are locked-in
- Net level method
- No deferred premium

Statutory

- Conservative interest and mortality assumptions prescribed by authorities
- No consideration of lapses and surrenders
- Net level or modified method
- Deferred premiums are established to offset portion of reserve



FAS 97 Products Reserves

GAAP

- Investment contracts
 - Premiums and considerations reported as liabilities
 - GAAP reserve reported net of front-end loads
- Limited payment contracts
 - Reserves calculated in accordance with SFAS No. 60
- Universal life-type contracts
 - Retrospective deposit method
 - Reserve equals policyholder account balance

Statutory

- Investment contracts without any life contingencies recorded as deposit-type contracts
 - Consideration received and disbursements to policyholder impact reserve balance
 - Reserve calculated on a gross basis (don't consider front-end loads)
- Limited payment contracts and universal life contracts are considered life contracts
 - Deferred premiums are recorded as an admitted asset



Revenue Recognition Summary

	SAP	GAAP
Traditional Life (whole, term)	X	X
Fixed Annuities	X	O
Universal Life	X	O
Variable Annuities	X	O
Period Certain Annuities	O	O
Supp Contracts/Immediate Annuities:		
w/ Life Contingencies	X	X
w/o Life Contingencies	O	O

Key:

X – Premium recognized in I/S

O – Premium (Deposits) recognized as Liability



Revenue Recognition - GAAP

SFAS 60:

- Short duration and long duration policies
- Gross premiums are recognized in revenue when due

SFAS 97:

- Universal Life products (and other account balance products)
- Limited pay long duration contracts
- Gross premiums are recorded as deposits
(i.e., not all of the cash received is recognized in operations)
- Revenues consist of:
 - Policy maintenance fees
 - Cost of insurance (COI) charges
 - Surrender charges

SFAS 120:

- Mutual Life insurance companies
- Participating policies
- Premiums recognized when due