Statutory Issue Paper No. 1

Consolidation of Majority-Owned Subsidiaries

STATUS
Finalized March 16, 1998

Current Authoritative Guidance for Consolidation of Majority-Owned Subsidiaries: SSAP No. 3 and SSAP No. 97

This issue paper may not be directly related to the current authoritative statement.

Original SSAP from Issue Paper: SSAP No. 3

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Currently, statutory reporting entities do not consolidate the financial statements of a majority-owned subsidiary in their annual statement filing. Investments in majority-owned subsidiaries are reported in Schedule D of the Annual Statement as other investments of a similar type (e.g., common stock and preferred stock) and are valued in accordance with the procedures outlined in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office* (SVO Purposes and Procedures). Current GAAP guidance is not consistent with this position and requires consolidation of majority-owned subsidiaries.

SUMMARY CONCLUSION

2. The policy of not consolidating majority owned subsidiaries for individual entity statutory reporting is consistent with the recognition concept included in the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts), therefore formal codification of such practice is recommended. The current statutory practice for recording the investment in majority-owned subsidiaries is also an accepted statutory accounting practice by all states.

3. Certain reporting entities who are members of an affiliated group may be required to prepare and issue consolidated or combined annual statements as supplemental information. These statements shall be prepared in accordance with NAIC guidelines.

DISCUSSION

4. The policy of not consolidating majority-owned subsidiaries is consistent with the *Recognition* concept included in the Statement of Concepts. This concept states that one objective of statutory reporting is to reflect an entity’s ability to meet its policyholder obligations with the existence of readily marketable assets available when both current and future obligations are due. With an investment in subsidiaries, the cash flow generated by the investee may not be available to satisfy policyholder obligations. Therefore the asset that is readily marketable is the shares of ownership (e.g., common or preferred stock).

5. Other issue papers address specific statutory accounting principles which will be used in recording a reporting entity’s investment in insurance and non-insurance affiliates.

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Drafting Notes/Comments

- Valuation of the investment in subsidiaries and the reporting of the related income or loss as described in Chapter 6 of the Life APP and Chapter 5b in the SVO Purposes and Procedures is addressed in another issues paper.
- Subsidiary is defined in *Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

6. Statutory accounting guidance defines a subsidiary, controlled, or affiliated ("SCA") entity in terms of controlling ownership in an entity's voting capital stock. Ownership of more than 50% provides "undisputed control" and when 50% or less of the outstanding stock is owned, "control is dependent upon the influence that the owner of that block of stock may have on the other holders of outstanding capital stock." Relevant guidance states that *"Investments in SCA companies include debt security loans and preferred and common stock. In general, the accounting for each type of investment is the same as it would be for any other bond, preferred stock, or common stock investment except that there are some special valuation considerations.*" This precludes consolidation of subsidiaries for individual entity statutory reporting purposes.

Generally Accepted Accounting Principles

7. FAS 94 paragraph 13 (amending ARB 51 paragraphs 2 and 3), states:

> 2. The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. A majority-owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner (as, for instance, if the subsidiary is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmental imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary).
>
> 3. All majority-owned subsidiaries--all companies in which a parent has a controlling financial interest through direct or indirect ownership of a majority voting interest--shall be consolidated except those described in the last sentence of paragraph 2.

RELEVANT LITERATURE

Statutory Accounting

– Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies and Property/Casualty Insurance Companies - Chapter 6 Investments in Subsidiary, Controlled or Affiliated Companies
– *Purposes and Procedures Manual of the NAIC Securities Valuation Office* - Chapter 5b Common Stocks of Subsidiary, Controlled or Affiliated Companies

Generally Accepted Accounting Principles

– *FASB Statement No. 94 (FAS 94), Consolidation of All Majority-Owned Subsidiaries*
– *Accounting Research Bulletin No. 51 (as amended by FAS 94), Consolidated Financial Statements*

State Regulations

No accounting guidance was noted in the state regulations.

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