

Statutory Issue Paper No. 4

Definition of Assets and Nonadmitted Assets

STATUS

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Original SSAP and Current Authoritative Guidance: SSAP No. 4

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. One of the cornerstones of the statutory accounting model is the use of nonadmitted assets. This concept interjects a level of conservatism in the reporting of an insurance enterprise's statutory financial position and is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts). Currently, statutory accounting does not address the general definition of assets as used in the statutory accounting model. Furthermore, statutory accounting is not explicit and is sometimes inconsistent with regard to the guidelines for accounting for nonadmitted assets. Current guidance allows the establishment of an asset. This asset is charged against surplus as a nonadmitted asset, and is also depreciated or amortized against net income as its estimated economic benefit expires. Current guidance also allows in limited circumstances for a nonadmitted asset to be charged through operations when acquired.

The purpose of this issue paper is to provide a definition of an "asset" for use in statutory accounting and establish consistent treatment of nonadmitted assets.

SUMMARY CONCLUSION

2. For purposes of statutory accounting, an asset shall be defined as: probable¹ future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3 below.

¹ FASB Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (CON 6), states:

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies*, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved...

3. As stated in the Statement of Concepts, "*The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party*

interests should not be recognized on the balance sheet”, and are, therefore, considered nonadmitted. For purposes of the Codification, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting and is one which is:

- a. Specifically identified within the Codification as a nonadmitted asset or
- b. Not specifically identified within the Codification as an admitted asset.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Codification. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity’s capitalization policy, immaterial amounts of furniture, fixtures, and equipment, or supplies, can be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of an asset, but are specifically identified within the Codification as not giving rise to assets (e.g., policy acquisition cost), shall also be charged to operations in the period the transactions occur.

DISCUSSION

5. The Accounting Practices and Procedures Manuals for Property and Casualty and for Life and Accident and Health Insurance Companies define the term nonadmitted asset as an asset that has been “*accorded limited or no value in statutory reporting*”. Chapter 9 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies further elaborates by saying, “*Some assets may be nonadmitted because they do not conform to the laws and regulations of the various states and other assets may be nonadmitted because they are not readily convertible to liquid assets.*” Chapter 9 of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies includes a similar discussion.

6. The concept of nonadmitted assets can be traced back to the 1874 Association Blank, thus establishing general acceptance through universal use. Statutory accounting does not specifically address the general definition of an asset. CON 6, which was adopted as part of the framework to be utilized in the Codification, does provide a general definition of assets. This provides an appropriate measure for statutory assets.

7. The adoption of the above accounting principles will be consistent with the recognition concept within the Statement of Concepts (i.e., the ability to meet policyholder obligations as predicated on the existence of readily marketable assets available when both current and future obligations are due).

Drafting Notes/Comments

- Accounting Practices and Procedures manual states that non-admittance of accrued investment income is to be recorded as a reduction of investment income. This is specifically addressed in a separate issue paper.
- Deferred premiums is addressed in a separate issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

8. Statutory accounting in this area is general and somewhat inconsistent. The prefaces to the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies state:

State statutes and accompanying regulations generally define what may be included as assets on a balance sheet, i.e., admitted assets. Because of the conservatism intrinsic to insurance accounting, certain assets may be accorded limited or no value in statutory reporting, i.e., nonadmitted assets. The investments a company is permitted to make and the limitations and methods of valuation for inclusion as admitted assets are usually specified. Also, because of the nature of the calculation of certain liabilities, offsetting of assets is permitted in order to maintain consistency. The discussion of assets in Part One includes certain nonadmitted as well as admitted assets.

9. Chapter 9 of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies discusses the accounting for periodic transactions for nonadmitted assets as follows:

Some assets or portions thereof may be nonadmitted because they do not conform to the laws and regulations of the various states. As a result, certain assets which normally would be accorded value in noninsurance corporations are accorded no value and thus reduce the reported surplus of the insurance company. In addition, state regulations require that certain expenditures which could normally be capitalized by a non-insurance company be charged as an expense.

Changes between years in nonadmitted assets are usually charged directly to surplus. The change between years in nonadmitted investment income due or accrued, though, is reported as a component of investment income in the summary of operations.

Even though a state insurance code may prohibit or limit certain assets, these assets are generally carried in the company's general ledger. Depreciable assets are depreciated in a systematic and rational manner over their estimated useful lives.

10. Chapter 9 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies states:

Because, in many respects, the statutory balance sheet is presented on a conservative basis, certain assets (which may have a recognized value in noninsurance corporations) are accorded no value and thus reduce the reported surplus of the insurance company. Some assets may be nonadmitted because they do not conform to the laws and regulations of the various states and other assets may be nonadmitted because they are not readily convertible to liquid assets. Changes in the amount of nonadmitted assets are charged or credited directly to surplus.

Each chapter in this book relating to investments discusses the limitations in amount and quality of investments that are treated as admitted. In general, authorized investments that are within the limitations of the laws and regulations of the various states are considered to be admitted assets. Investments exceeding the limitations, or those of questionable quality, may be nonadmitted.

11. Chapter 9 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies also provides some general guidance on certain nonadmitted assets. A sample follows:

Electronic Data Processing Equipment: Application systems software may be expensed when purchased or established as a nonadmitted asset and written off over a period of years not to exceed the software's expected useful life.

Equipment, Furniture and Supplies: The company may record furniture and equipment as a ledger asset, depreciate it, and nonadmit it in the exhibit of assets in the statutory financial statements, or the company may expense the furniture and equipment when it is purchased. Supplies are normally expensed when purchased.

Generally Accepted Accounting Principles

12. Asset recognition is governed by *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6), paragraphs 25-34. An asset is defined in paragraph 25 of CON 6 as follows:

Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

13. Paragraph 26 of CON 6, further defines the characteristics of an asset as follows:

An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

RELEVANT LITERATURE**Statutory Accounting**

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, pg. v and Chapter 9
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, pg. v and Chapter 9

Generally Accepted Accounting Principles

- *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements*

State Regulations

- No additional guidance obtained from state statutes or regulations.

Other Sources of Information

- Draft discussion material from previous Property/Casualty codification projects
- Draft discussion material from previous Life codification projects