

Statutory Issue Paper No. 29

Prepaid Expenses (excluding deferred policy acquisition costs and other underwriting expenses, income taxes and guaranty fund assessments)

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 29

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Current statutory accounting guidance requires prepaid expenses to be recorded as nonadmitted assets. This conflicts with the GAAP treatment which states that prepaid expenses are to be recorded as assets and expensed over the period that the benefits are received from the payment.
2. The purpose of this paper is to establish statutory accounting principles for the accounting for prepaid expenses that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. Prepaid expenses generally meet the definition of an asset in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4). Such expenditures also meet the criteria defining nonadmitted assets as specified in Issue Paper No. 4 (i.e. the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus). They shall be amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's capitalization policy, immaterial prepaid expenses may be expensed when purchased.

DISCUSSION

4. The conclusion above is consistent with the definition of nonadmitted assets as noted in Issue Paper No. 4, which defines an asset as "*probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.*" Issue Paper No. 4 further states that an asset that is not readily available to satisfy policyholder obligations shall be reported as a nonadmitted asset. Prepaid expenses meet the definition of a assets as they represent future economic benefits obtained as a result of past transactions. Additionally, prepaid expenses meet the definition of nonadmitted assets because they are not readily available to satisfy policyholder obligations.

Drafting Notes/Comments

- Guaranty fund assessments are addressed in *Issue Paper No. 35—Accounting for Guaranty Fund and Other Assessments*.
- Accounting for income taxes is addressed in *Issue Paper No. 83—Accounting for Income Taxes*.
- Deferred policy acquisition costs and other underwriting expenses are addressed in *Issue Paper No. 71—Policy Acquisition Costs and Commissions*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

5. Chapter 9, *Nonadmitted Assets*, in the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies includes “other prepaid expenses” in its list of “Common Examples” of nonadmitted assets. Chapter 9, *Nonadmitted Assets*, in the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies contains similar wording.

6. Many states also include prepaid expenses as nonadmitted assets. An example is the Regulations of the Alabama Insurance Department, Regulation No. 18, *Admissibility of Assets*, which states “*Admitted assets, for example, will not include such items as furniture and fixtures, automobiles, supplies, prepaid expenses...*”.

7. Some states nonadmit most prepaid expenses but allow particular prepaid expenses to be recorded as admitted assets. An example is the Virginia Insurance Laws, Title 38.2 - Insurance, Chapter 13, *Reports, Reserves and Examination, Insurance Holding Companies*, Article 2. Valuation and Admissibility of Assets which nonadmits “*prepaid and deferred expenses except prepaid property taxes.*”

Generally Accepted Accounting Principles

8. *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 3, Working Capital*, states:

4. For accounting purposes, the term current assets is used to designate cash and other assets or resources commonly identified as those which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. Thus the term comprehends in general such resources as...(g) prepaid expenses such as insurance, interest, rents, taxes, unused royalties, current paid advertising service not yet received, and operating supplies.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 9, *Nonadmitted Assets*
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 9, *Nonadmitted Assets*

Generally Accepted Accounting Principles

- *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 3, Working Capital*
- *AICPA Practice Bulletin No. 13, Direct-Response Advertising and Probable Future Benefits*
- *AICPA Statement of Position 93-7, Reporting on Advertising Costs*
- *FASB Emerging Issues Task Force No. 88-23, Lump-Sum Payments under Union Contracts*

State Regulations

- Virginia Insurance Laws, Title 38.2 - Insurance, Chapter 13, *Reports, Reserves and Examination, Insurance Holding Companies*, Article 2. Valuation and Admissibility of Assets
- Regulations of the Alabama Insurance Department, Regulation No. 18, *Admissibility of Assets*