

Statutory Issue Paper No. 34

Investment Income Due and Accrued

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 34

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory guidance pertaining to accounting for investment income due and accrued is contained in the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies. The purpose of this paper is to establish statutory accounting principles for investment income due and accrued which are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. Investment income due shall be defined as investment income earned and legally due to be paid to the reporting entity (i.e., receivable) as of the reporting date. Investment income accrued shall be defined as investment income earned as of the reporting date but not legally due to be paid to the reporting entity until subsequent to the reporting date.

3. In general, gross investment income shall be recorded as earned and shall include investment income collected during the period, the change in investment income due and accrued, the change in unearned investment income plus any amortization (e.g., discounts or premiums on bonds, origination fees on mortgage loans, etc.). Additional guidance on investment income recognition relative to specific types of investments is provided in issue papers on each specific type of investment.

4. Investment income due and accrued shall be recorded as an asset in accordance with *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4). An evaluation shall be made of such assets in accordance with *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5), to determine whether an impairment exists. Amounts determined to be uncollectible shall be written off through the statement of operations. Then an evaluation shall be made to determine nonadmitted amounts.

This two step process is set forth below.

a) Investment income due and accrued shall be assessed for collectibility. If, in accordance with Issue Paper No. 5, it is probable the investment income due and accrued balance is uncollectible, the amount shall be written off and shall be charged against investment income in the period such determination is made.

b) Any remaining investment income due and accrued (i.e., amounts considered probable of collection) representing either (1) amounts that are over 90 days past due (generated by any invested asset except mortgage loans in default), or (2) amounts designated elsewhere in the codification as nonadmitted shall be considered nonadmitted assets and recognized through a direct charge to surplus in accordance with Issue Paper No. 4. These nonadmitted amounts shall be subject to continuing assessments of collectibility and, if determined to be uncollectible, a

write-off shall be recorded in the period such determination is made in accordance with subparagraph (a) above.

5. Accrued interest on mortgage loans that are in default (as defined in *Issue Paper No. 37—Mortgage Loans*) shall be recorded as Investment Income Due and Accrued when such interest is deemed collectible. Interest can be accrued on mortgage loans in default if deemed collectible; if interest is deemed uncollectible, it shall not be accrued and any previously accrued amounts are to be written off in accordance with the guidelines in paragraph 4.a. above. If a loan in default has interest 180 days past due which has been assessed as collectible, all interest shall be considered a non-admitted asset and recognized through a direct charge to surplus as outlined in paragraph 4.b. above.

6. The following disclosures shall be made for investment income due and accrued in the notes to the financial statements.

- The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued
- Disclose total amount excluded.

DISCUSSION

7. The Statutory Accounting Principles outlined in the conclusion above are consistent with current statutory accounting guidance for investment income due and accrued, except for the following:

- Current statutory accounting states that “*Income due, which is doubtful collectibility, should either not be accrued or should be treated as nonadmitted*”. However, the conclusion above requires that such amounts be accrued as earned and then written off in the period in which the determination is made that the amounts are uncollectible.
- Current statutory guidance states that accrued rent on real estate three months or more be treated as a nonadmitted asset. The conclusion above requires that accrued rent be assessed for collectibility and any uncollectible amounts written off in the period in which the determination is made that the amounts are uncollectible. Any remaining accrued rent past due three months or more (but determined to be collectible) shall be treated as a nonadmitted asset.
- Current statutory guidance states that accrued interest on mortgage loans past due twelve months or more be treated as a nonadmitted asset and accrued interest on loans in default, being voluntarily conveyed, or being foreclosed be added to the carrying value if such amounts are deemed to be recoverable from the ultimate disposition of the property. The conclusion above requires an assessment of the collectibility of the interest to determine if such should be accrued or written off. If the loan in default has interest which is 180 days past due and deemed to be collectible, all interest on the defaulted loan shall be considered a nonadmitted asset.

8. The statutory accounting principle outlined in the conclusion above accounts for investment income due and accrued in a manner consistent with the Statement of Concepts recognition concept which states that “*Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed*”. It recognizes any impairment (i.e., doubtful collection) of the asset in the period in which such a determination occurs in accordance with Issue Paper No. 5.

9. The Statement of Concepts also states:

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 interest should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

10. Based on the above concept, investment income due and accrued should reflect only amounts that are available to meet policyholder obligations. Consistent with the conservatism concept, amounts for which collection is past due by a specified number of months, but for which the ultimate collection is not considered doubtful, should be recognized as nonadmitted assets through a direct charge against surplus in accordance with Issue Paper No. 4.

Drafting Notes/Comments

- Accounting for common and preferred stock holdings of subsidiary, controlled and affiliated entities will be addressed in *Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities*.
- Accounting for joint ventures and partnerships will be addressed in *Issue Paper No. 48—Investments in Joint Ventures, Partnerships and Limited Liability Companies*.
- Accounting for recognition of investment income is addressed in separate issue papers on each type of investment.
- Accounting for investments in surplus notes is addressed in a separate issue paper.
- Accounting for mortgage loans, including valuation, is addressed in *Issue Paper No. 37—Mortgage Loans*.
- Accounting for policy loans is addressed in *Issue Paper No. 49—Policy Loans*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

11. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to unearned investment income and investment income due and accrued. Similar guidance is found in the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies. Pertinent excerpts from the Life and Accident and Health manual are as follows:

CHAPTER 19

INVESTMENT INCOME AND NET REALIZED GAINS

Investment Income Due

Income due represents certain amounts of income which are legally owed to the company as of the statement date but have not yet been received. Income due, which is doubtful collectibility, should either not be accrued or should be treated as nonadmitted. On certain bonds in default, the company should not report interest due because the association value of the bond includes such interest.

Accrued Investment Income

Income accrued represents interest that would be collectible if the obligation were to mature as of the statement date. The amounts that are shown as accrued for preferred stocks and common stocks are dividends on stocks declared to be ex-dividend on or prior to the statement date and payable after that date.

Nonadmitted Investment Income

Nonadmitted income represents any of the above-noted types of investment income reported as due or accrued if it is of doubtful collectibility. The company should not take credit for this as income. This is of particular importance regarding mortgage loans with interest that is past due twelve months or more and real estate with rents past due three months or more. These receivables should be deducted as nonadmitted.

12. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides additional guidance with respect to interest income on bonds and loan-backed and structured securities. Pertinent excerpts are as follows:

CHAPTER 1

Bonds and Loan Backed and Structured Securities Interest income

If interest (including contingent interest) on a bond is recorded when received, an adjustment must be made to recognize due and accrued interest as of the reporting date. Interest income for any period consists of interest collected during the period and the change in the due and accrued interest between the beginning and end of the period, plus the adjustments for the accrual of discount, minus adjustment for the amortization of premium, and minus adjustment for interest paid on acquisition of bonds.

Contingent interest represents bondholder income generated through the occurrence of specific economic events in relation to the issuer. For example, contingent interest may become payable upon the attainment by the issuer of a given level of cash flow or income. In many respects, bonds with contingent interest provisions are similar to income bonds. Due and unpaid contingent interest may be recorded as income. The proper accrual of such income does, however, require an analysis of the applicable provisions in the underlying agreement and the verification that the prerequisite conditions have been met.

13. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies contains similar guidance.

14. The Accounting Practices and Procedures Manual for Life and Accident and Health and Property and Casualty Insurance Companies provides additional guidance with respect to dividends. Pertinent excerpts are as follows:

CHAPTER 2 STOCKS

Dividends

Dividends are usually recorded in the general ledger on a cash basis. Dividends receivable on qualified shares of stock are generally permitted as admitted assets to the extent that the dividend has been excluded from the determination of the market price of the holding (i.e., on stock selling ex-dividend). Dividends receivable are included in "Investment Income Due and Accrued" in the annual statement. The asset is developed by a determination of the dividend status of each stock investment at the balance sheet date. Thus, dividend income on stock for any period consists of dividends collected during the year and the change in the declared but unpaid dividends between the beginning and end of the period.

The Valuation of Securities manual has a complete listing of all stocks that are traded "ex-dividend" at the end of the year. An ex-dividend stock is one in which the issuing company has closed its stock ledger on a certain date and has declared a dividend payable to the stockholder of record, even though the stock may have been sold after the record date but prior to the payment date. The association value of ex-dividend stock includes no value for the dividend

since the unpaid dividend does not transfer with ownership of the stock. The listing of ex-dividend stock contains the declared dividend rate for calculating the declared but unpaid dividends that are allowable for each stock owned by the company on the dividend record date.

15. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to mortgage loan interest income. Pertinent excerpts are as follows:

CHAPTER 3 MORTGAGE LOANS

Interest

Interest income on mortgage loans is recorded when earned during the any reporting period. An “inventory” of due and accrued interest must be determined at the end of each reporting period. Interest income includes adjustments for amortization or the accrual of discount.

A portion of the interest due and accrued on mortgage loans may require treatment as a nonadmitted asset for reporting purposes. In general, amounts over one year past due are nonadmitted. In practice, some companies consider that interest past due for periods of less than one year indicates future uncollectibility, and may make a provision against operations for such amounts to establish an appropriate reserve. Alternatively, some companies may cease accrual of interest on loans that default on any payment. Therefore, the amount of due and accrued interest that is considered to be a nonadmitted asset depends on the policy regarding accrual determination, and whether reserves have been established by charges to operations. In the case of mortgage loans on which foreclosure action is pursued, delinquent interest may be recovered from the amount, if any, by which the proceeds on the eventual sale of the property exceed the unpaid principal balance.

Contingent interest represents income generated through the occurrence of specific economic events in relation to the borrower. For example, contingent interest may become payable upon the attainment of a given level of cash flow or income. Contingent interest may be reported as income when received or accrued. The proper accrual of such income does, however, require an analysis of the applicable provisions in the underlying agreement and the verification that the prerequisite conditions have been met.

Payments

Payments on mortgage loans may be received in advance of due dates. Such payments may produce prepaid interest which is considered unearned and is recorded as a liability in the annual statement.

Companies that use servicing agents for their mortgage loans should report the “Interest Due and Accrued” asset on the balance sheet consistently with the income statement treatment of the charge for servicing costs. If interest income is reported net of servicing costs, which is usual when the servicing agent fee is based on a percentage retention of each interest payment, then the interest receivable in the balance sheet should be net of the related servicing costs. If interest is reported gross, with the servicing costs reported as an expense item, then interest due and accrued should be reflected as an asset at the gross amount, with an appropriate liability to reflect the related servicing cost accrual.

16. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies contains similar guidance.

17. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to real estate investment income. Pertinent excerpts are as follows:

CHAPTER 4
REAL ESTATE

Income Derived from Real Estate

Income on real estate, or on space in buildings owned and occupied by the company, usually is received periodically and in advance and any amount not received at the end of an accounting period should be set up as investment income due and unpaid to the extent that the amount applies to that accounting period. If the collectibility of unpaid rent is in doubt, or if the amount due exceeds a period specified by statute or regulation, most jurisdictions require that the entire amount be nonadmitted. Rental income paid in advance of the accounting period for which it is payable in whole or in part should be included in the liability for unearned investment income to the extent it applies to the succeeding accounting period. If rental income is to be received over a period shorter than the full lease period, the total rent to be received should be accrued periodically as if the rent were received over the total lease period. Interest expense on a mortgage is netted against the rental income for the period.

18. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies contains similar guidance.

19. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to interest income on cash on deposit. Pertinent excerpts are as follows:

CHAPTER 5
CASH AND SHORT-TERM INVESTMENTS

Income from Bank Deposits

Income consists of the interest that is earned on interest-bearing bank deposits and on demand certificates of deposit. Earned interest consists of interest that is collected during the period, plus due or accrued interest at the end of the period, minus any unearned interest, and minus due or accrued interest, plus any unearned interest at the beginning of the period.

The amount allowed as an admitted asset for due or accrued interest is the interest or dividends due and payable, but not credited, on deposits in banks and trust companies or on accounts with savings and loans associations.

The accrued interest on savings accounts is admissible because, if the deposit was withdrawn at the statement date, interest would be paid to the date of withdrawal. Accrued interest on demand CD's may be wholly or partially not admitted in some states, as interest is payable at maturity and, if the certificates are redeemed early, an interest penalty may be assessed. The certificate must be examined to determine the status of accrued interest. If the certificate were to be redeemed before maturity, and the interest would be payable, the accrued interest may be admitted but not in an amount that exceeds that amount receivable if redeemed prior to maturity. The maximum amount of accrued interest that may be admitted on a certificate which provides for an interest penalty for early redemption is based upon a reduced interest rate.

20. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies contains similar guidance.

21. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies provides guidance with respect to interest income on policy loans. Pertinent excerpts are as follows:

CHAPTER 7
POLICY LOANS

Interest

Interest on a policy loan may be payable at either the beginning or end of the policy loan interest period. Where it is payable at the beginning of the period, appropriate balance sheet provision should be established for any unearned policy loan interest. Where it is payable at the end of the period, appropriate provision should be established for any accrued interest. Interest earned is reported as investment income.

The calculation of investment income from a company's policy loans requires a determination of unearned or accrued interest. These are included in their respective accounts in the balance sheet as unearned or accrued investment income and not with the balance of policy loans. The calculation of accrued and unearned interest usually is made on a policy-by-policy basis, or for policies grouped by interest rate and policy anniversary or interest paid-to-date.

Past-due interest normally is capitalized as an addition to the loan balance with the interest recorded as received.

22. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies provides the following in its list of admitted assets in Chapter 8:

(k) Interest, Dividends and Real Estate Income Due and Accrued

1. The rents accrued and owing to the company on real and personal property, directly or beneficially owned
2. Interest or rents accrued on conditional sales agreements, chattel mortgages and real or personal property under lease to other corporations
3. The fixed and required interest due and accrued on bonds and other like evidences of indebtedness, not in default
4. Dividends receivable on shares of stock, provided that the market price taken for valuation purposes does not include the value of the dividend
5. The interest or dividends due and accrued, but not credited, on deposits in banks and trust companies or on accounts with savings and loan associations
6. Interest accrued on tax anticipation warrants
7. Interest accrued on secured loans

23. The Iowa state regulations provide the following guidance:

In estimating the profits, a reserve for unearned premiums as set out in section 515.47, also a reserve for unpaid losses, expenses, and taxes which have been incurred shall be set up; and there shall also be held as nonadmitted assets all sums due the corporation on bonds and mortgages, bonds, stocks, and book accounts, of which no part of the principal or interest thereon has been paid during the year preceding such estimate of profits, and upon which suit for foreclosure or collection has not been commenced, or which, after judgment has been obtained thereon, shall have remained more than two years unsatisfied, and on which interest has not

been paid; and such judgment with the interest due or accrued thereon and remaining unpaid, shall also be so held.

Generally Accepted Accounting Principles

24. There is no specific GAAP guidance that addresses unearned investment income or investment income due and accrued.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 1, *Bonds and Loan Backed and Structured Securities*, Chapter 2, *Stocks*, Chapter 3, *Mortgage Loans*, Chapter 4, *Real Estate*, Chapter 5, *Cash and Short-Term Investments*, Chapter 7, *Policy Loans*, Chapter 19, *Investment Income and Net Realized Gains*
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 1, *Bonds and Loan Backed and Structured Securities*, Chapter 2, *Stocks*, Chapter 3, *Mortgage Loans*, Chapter 4, *Real Estate*, Chapter 5, *Cash and Short-Term Investments*, Chapter 8, *Other Admitted Assets*, Chapter 15, *Investment Income*

Generally Accepted Accounting Principles

- No applicable GAAP guidance

State Regulations

- Iowa Statutes - Insurance Laws, TITLE XIII--COMMERCE, Subtitle 1. Insurance and Related Regulation, Chapter 515 --INSURANCE OTHER THAN LIFE, General Provisions, 515.45 Reserves