Statutory Issue Paper No. 96

Other Liabilities

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 67

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance for the other liabilities is provided in Chapter 17, Other Liabilities, of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies and Chapter 13, Other Liabilities, of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies.

2. The purpose of this issue paper is to establish statutory accounting principles for other liabilities, including self-insurance reserves, which are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. For purposes of identifying other liabilities, the discussion, definition and accounting treatment outlined in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5) must be considered. This paper is not an all-inclusive list of other liabilities. Certain other liabilities are covered in other issue papers. All other liabilities, whether or not specifically identified in this issue paper shall be recorded and disclosed in accordance with Issue Paper No. 5, which states that "a liability shall be recorded on a reporting entity's financial statements when incurred".

4. Specific accounting treatment and where appropriate, a definition of certain other liabilities, is discussed below.

Self-Insurance

5. Self-insurance occurs when an entity retains insurance risks associated with the entity's day-to-day operations that are commonly transferred to an insurer through an insurance contract. Self-insurance can also be described as a decision not to insure or non-insurance. To the extent that an event occurs, obligating the entity in accordance with the definition of a liability or impairment of an asset in Issue Paper No. 5, for which insurance coverage has not been obtained, the entity shall record either the appropriate write-down of the assets, if applicable, or reserves shall be established using the same estimation methodology an insurance company uses when an insurance contract is issued for the type of insurance risk which is self-insured. *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* describes the specific reserving guidance which should be followed.

6. The related costs should be treated similarly to comparable expenses and allocated appropriately (see *Issue Paper No. 94—Allocation of Expenses*). As a result of this treatment, the costs are accounted for based on the nature of the underlying expenses.

7. The mere fact that a decision is made not to insure against losses that can reasonably be expected some time in the future does not necessitate accrual by the entity if it is not probable that an asset has been impaired or a liability incurred at the date of the financial statements.

© 1999-2015 National Association of Insurance Commissioners

Amounts Withheld or Retained by Company as Agent or Trustee

8. A reporting entity may, in the normal course of its business, withhold funds as an agent or trustee which will ultimately be paid to others. Amounts withheld or retained by an entity as trustee or agent shall be recorded as a liability when the salaries or other compensation are expensed (8(a and b)) or the funds are received (8(c, d and e)). Examples of such occurrences are:

a. As an employer, the reporting entity deducts and withholds federal and state income taxes, social security taxes, charitable contributions, savings plan deductions, garnishments, employee contributions to pension plans, employee share of group life and health insurance premiums, and other employee salary withholdings or deductions.

b. Amounts due under deferred compensation arrangements shall be accrued in accordance with the provisions of *Issue Paper No. 14—Employers' Accounting for Postretirement Benefits Other Than Pensions*. Segregated funds (i.e., Rabbi trusts and similar arrangements) shall not be netted against the accrued liability unless the requirements of *Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities* are met.

c. Many reporting entities invest in commercial and residential mortgages. The entity may require the mortgagor to prepay real estate taxes and property insurance premiums which the entity will hold in escrow and pay when due.

d. Deposits held by a reporting entity in connection with leases of investment property.

e. Any other funds the reporting entity may receive and hold in a fiduciary capacity.

Remittances and Items Not Allocated

9. Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. Such liability accounts are generally referred to as suspense accounts. Examples of such receipts include:

a. Premium payments received with the application for policies which have not yet been issued;

b. Premium payments in an amount different than the amount billed by the reporting entity;

c. Unidentified cash receipts.

Interest Payable

10. Interest payable includes interest on borrowed money as well as interest on real estate and approved interest on surplus notes. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. The amount to be reported is the amount which has accrued and is unpaid at the balance sheet date. The Property and Casualty Annual Statement includes a specific line to record accrued interest. Accrued interest for Life and Accident and Health Companies shall be recorded with the liability.

Payable to Parent, Subsidiaries and Affiliates

11. A liability shall be established for expenditures incurred on behalf of the reporting entity by a parent, affiliates, or subsidiaries or for amounts owed through other intercompany transactions. Examples of such expenses are executive salaries, workers' compensation insurance premiums, pension contributions, etc. The liability shall be identified as an intercompany balance.

© 1999-2015 National Association of Insurance Commissioners

12. Reinsurance transactions are not considered liabilities of this nature and are covered in *Issue Paper No. 74—Life, Deposit-Type and Accident and Health Reinsurance* and *Issue Paper No. 75—Property and Casualty Reinsurance.*

DISCUSSION

13. This issue paper adopts *FASB Statement No. 116, Accounting for Contributions Received and Contributions made* and *AICPA Statement of Position 96*-1, *Environmental Remediation Liabilities*.

14. The principles established are consistent with current statutory accounting principles and with Issue Paper No. 5. The requirement that liabilities be recorded when they are incurred is also consistent with the recognition principle described in the Statement of Concepts.

15. The liabilities addressed above are not specifically discussed in GAAP, however, they are considered liabilities and therefore are treated consistently with the GAAP guidance referenced in Issue Paper No. 5. The "Scope of the Statement" section of *FASB Statement No. 5*, *Accounting for Contingencies*, includes a reference to the fact that self-insurance is covered under the scope of the statement.

Drafting Notes/Comments

- Interest payable on surplus notes is addressed in *Issue Paper No. 41—Surplus Notes*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

16. Chapter 17, Other Liabilities, of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies discusses accounting for other liabilities as follows:

> <u>Amounts Withheld or Retained by Company as Agent or Trustee</u>
>
> The life insurance company may, in the normal course of its business, withhold funds as an agent or trustee which will ultimately be paid to others. Funds held must be identified as to whom they are held for, as well as the amount, so that the liability can be confirmed by subsequent payments or confirmation by the payee. Examples of such occurrences are:
>
> 1. As an employer, the life insurance company deducts and withholds federal and state income taxes, social security taxes, employee contributions to pension plans, and employees' share of group life and health insurance premiums. Such funds are recorded as a liability of the company at the time gross salaries are expensed and the liability is subsequently cleared by payment.
>
> 2. Many life insurance companies invest in commercial and residential mortgages. The company may require the mortgagor to prepay real estate taxes and property insurance premiums which the company will hold in escrow and pay when due.
>
> 3. Any other funds the company may receive and hold in a fiduciary capacity.
>
> <u>Remittances and Items Not Allocated</u>
>
> Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. It is undesirable, costly, and imprudent for a company to delay depositing such receipts until the payment can be identified. Cash receipts should be deposited intact when received for good accounting control and to be available for investment by the company. It is customary for life insurance companies to maintain one or more liability accounts to record cash receipts which cannot be specifically allocated. Such liability accounts are generally referred to as suspense accounts. Examples of such receipts include:

© 1999-2015 National Association of Insurance Commissioners

1. Premium payments received with the application for policies which have not yet been issued;

2. Premium payments of amount different than the amount billed by the company;

3. Unidentified cash receipts.

Special attention should be given to the verification and clearance of suspense accounts. The outstanding suspense items should be aged. Any suspense item that has not been cleared after a specified time should be investigated. If premium payments are allowed to remain in suspense for a long period of time, it is possible that a policy might be improperly lapsed for nonpayment of premium or have nonforfeiture options or automatic premium loan options applied.

Payable to Parent, Subsidiaries and Affiliates

A liability should be established for amounts payable to a parent, subsidiary or affiliate for intercompany disbursements. Examples of such expenses are executive salaries, workers' compensation insurance premiums, pension contributions, etc. The purpose of separating this liability from other accounts is to identify intercompany balances.

17. Chapter 13 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Other Liabilities, discusses accounting for other liabilities as follows:

Other liabilities are those liabilities not specifically covered by other chapters. Included in this category are the following annual statement captions:

Borrowed Money
Interest Payable
Stockholder Dividends Declared and Unpaid
Policyholder Dividends Declared and Unpaid
Amounts Withheld or Retained by Company for Account of Others
Provision for Reinsurance
Excess of Statutory Reserves over Statement Reserves
Net Adjustments in Assets and Liabilities Due to Foreign Exchange Rates
Liability for Amounts Held Under Uninsured Accident and Health Plans
Drafts Outstanding
Payable to Affiliates
Payable for Securities
Debt Obligations of Employee Stock Ownership Plans
Postretirement Benefits Other Than Pensions

Interest Payable

Interest payable includes interest on "Borrowed Money" as well as interest on real estate and surplus loans. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. Further treatment of funds held by a ceding company may be found in Chapter 22, Reinsurance.

The interest on "Borrowed Money" is also shown parenthetically as part of the caption of this liability item in the annual statement.

Amounts Withheld or Retained by Company for Account of Others

Items to be included under this classification are:

1. Amounts withheld from employee payrolls and unpaid at the balance sheet date. These include federal, state and city taxes and social security taxes, savings bonds deductions, charitable contributions, savings plan deductions, employee retirement plan

© 1999-2015 National Association of Insurance Commissioners

contributions, garnishments, group life and health insurance premiums, and other employee salary withholdings or deductions.

2. Deposits held by the company in connection with leases of investment property.

3. Escrow balances required of mortgagors for property taxes and insurance on real estate pledged for mortgages held by the company.

4. Any other funds the company holds in a fiduciary capacity for the account of others. This excludes reinsurance funds held, which are reported elsewhere and covered in Chapter 22-Reinsurance.

Payable to Affiliates

Amounts shown under this caption include unreimbursed expenditures on behalf of the company by a parent, affiliates, or subsidiaries or amounts owing through other intercompany transactions.

Reinsurance transactions are not normally reported on this line. For further information, see Chapter 22-Reinsurance.

Generally Accepted Accounting Principles

18. *FASB Statement No. 5*, *Accounting for Contingencies*

SCOPE OF THIS STATEMENT

56. Some respondents to the Exposure Draft proposed that the Statement not deal with accrual and disclosure of loss contingencies in general but, rather, only with the following three specific matters: “self-insurance,” risk of losses from catastrophes assumed by property and casualty insurance companies including reinsurance companies, and threat of expropriation.

57. The Board has concluded, however, that the broad issue of accrual and disclosure of loss contingencies should be dealt with in a single Statement, just as the Discussion Memorandum encompasses “the broad issue of accounting for future losses.” As the Discussion Memorandum stated, “future losses of all types presently known to affect enterprises and new types of future losses that may arise are conceptually included in the scope of this project.”

RISK OF FUTURE LOSS OR DAMAGE OF ENTERPRISE PROPERTY, INJURY TO OTHERS, DAMAGE TO THE PROPERTY OF OTHERS, AND BUSINESS INTERRUPTION

85. Some persons contend that the decision not to purchase insurance against losses that can be reasonably expected sometime in the future (such as risk of loss or damage of enterprise property, injury to others, damage to the property of others, and business interruption) justifies periodic accrual for those losses without regard to whether it is probable that an asset has been impaired or a liability incurred at the date of the financial statements. As a basis for their position, they frequently cite the following factors: matching of revenue and expense, spreading the burden of irregularly occurring costs to successive generations of customers, and conservatism. They also believe that accrual of estimated losses from those types of risks improves the comparability of the financial statements of enterprises that purchase insurance. Some contend that a prohibition against periodic accrual for uninsured losses will force enterprises to purchase insurance coverage that would not otherwise be purchased.

86. In the Board’s judgment, however, the mere existence of risk, at the date of an enterprise’s financial statements, does not mean that a loss should be accrued. Anticipation of asset impairments or liabilities or losses from business interruption that do not relate to the current or a prior period is not justified by the matching concept.

87. The Board’s view regarding the contention that periodic accrual for uninsured losses is a way of providing protection against loss and improving comparability among enterprises that do

© 1999-2015 National Association of Insurance Commissioners

not purchase insurance, and the contention that prohibition of accrual will force enterprises to purchase insurance are discussed in paragraphs 61-66. The Board's position regarding periodic accrual for uninsured risks and other loss contingencies on the grounds of spreading the burden of irregularly occurring costs to successive generations of customers or on the grounds of conservatism is discussed in paragraphs 81-84.

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, Chapter 17
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 13
- *Issue Paper No. 14—Employers' Accounting for Postretirement Benefits Other Than Pensions*
- *Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities*
- *Issue Paper No. 74—Life, Deposit-Type and Accident and Health Reinsurance*
- *Issue Paper No. 75—Property and Casualty Reinsurance*

Generally Accepted Accounting Principles

- *FASB Statement No. 5, Accounting for Contingencies*
- *FASB Statement No. 116, Accounting for Contributions Received and Contributions Made*
- *AICPA Statement of Position 96-1, Environmental Remediation Liabilities*

State Regulations

- No additional guidance obtained from state statutes or regulations.

© 1999-2015 National Association of Insurance Commissioners