

Statutory Issue Paper No. 119

Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

STATUS

Finalized June 10, 2002

Current Authoritative Guidance for Capitalization Policy: SSAP No. 4, SSAP No. 19, SSAP No. 29 and SSAP No. 73

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

Original SSAP from Issue Paper: SSAP No. 87

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. The purpose of this issue paper is to establish a statutory capitalization policy that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

2. This issue paper amends certain conclusions reached in *SSAP No. 4–Assets and Nonadmitted Assets* (SSAP No. 4), *SSAP No. 19–Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements* (SSAP No. 19), *SSAP No. 29–Prepaid Expenses* (SSAP No. 29), *SSAP No. 73–Health Care Delivery Assets - Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities* (SSAP No. 73), *SSAP No. 79–Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16–Electronic Data Processing Equipment and Software* (SSAP No. 79) and *SSAP No. 82– Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs* (SSAP No. 82).

RECOMMENDED CONCLUSION

3. In general, this issue paper amends the phrase “in accordance with the reporting entity's capitalization policy, immaterial amounts ... can be expensed ...” to “in accordance with the reporting entity's capitalization policy, amounts less than a predefined threshold ... shall be expensed ...”. A predefined threshold shall be established, for each asset class identified by SSAP Nos. 19, 29, 73, 79 and 82, by management based upon an analysis of circumstances unique to the entity and shall not be adjusted from period to period except under extenuating circumstances. If an entity demonstrates a pattern of varying its capitalization policy from period to period without sufficient evidence as determined by the reporting entity's domestic regulator, such action would call into question both the entity's ability to accurately establish a predefined threshold and the propriety of expensing or capitalizing certain assets. Accordingly, entities shall expense all immaterial amounts (i.e., entity is no longer allowed to establish its own capitalization policy).

4. This issue paper amends paragraph 3 of SSAP No. 4 to the following:

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 statutory accounting principles, 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 Accounting Practices and Procedures Manual as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.

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 Accounting Practices and Procedures Manual. 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, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

5. This issue paper amends paragraphs 3 and 6 of SSAP No. 19 to the following:

In accordance with the reporting entity's capitalization policy, amounts less than a predefined threshold of such assets shall be expensed when purchased.

6. This issue paper amends paragraph 3 of SSAP No. 29 to the following:

In accordance with the reporting entity's capitalization policy, prepaid expenses less than a predefined threshold shall be expensed when purchased.

7. This issue paper amends paragraph 10 of SSAP No. 73 to the following:

In accordance with the reporting entity's capitalization policy, amounts less than a predefined threshold of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements shall be expensed when purchased.

8. This issue paper amends paragraph 4 of SSAP No. 79 to the following:

In accordance with the reporting entity's capitalization policy, amounts less than a predefined threshold shall be expensed when purchased, otherwise the assets shall be capitalized and depreciated in accordance with this statement.

9. This issue paper amends paragraph 4 of SSAP No. 82 to the following:

In accordance with the reporting entity's capitalization policy, amounts less than a predefined threshold of such costs shall be expensed when incurred.

10. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Disclosures

11. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Effective Date and Transition

12. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of years beginning on or after January 1, 2004.

DISCUSSION

13. This issue paper replaces the subjectivity associated with capitalizing assets based upon materiality with a more quantifiable concept of capitalizing assets above a predefined threshold. This amendment is in harmony with the principle of consistency found in the Statement of Concepts. That is, the concept of materiality used in previous SSAPs was subject to interpretation and manipulation from period to period whereas the predefined threshold model used in this issue paper provides a definitive benchmark that can be quantified and judged from period to period. This issue paper requires entities to disclose their threshold, explain how they reached their threshold and offer support if they modify their capitalization policy. Previous statements, due to the subjective nature of expensing immaterial amounts, did not require this disclosure. The issue paper also includes a penalty for entities that manipulate their capitalization policy from period to period. The NAIC believe this issue paper provides a more consistent and transparent capitalization framework than previous statements.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**Statutory Accounting**

14. SSAP No. 4 paragraph 3:

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 statutory accounting principles, 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 Accounting Practices and Procedures Manual as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.

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 Accounting Practices and Procedures Manual. 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, equipment, or supplies, can be expensed when purchased.

15. SSAP No. 19 paragraphs 3 and 6:

3. In accordance with the reporting entity's capitalization policy, immaterial amounts of such assets can be expensed when purchased.

6. In accordance with the reporting entity's capitalization policy, immaterial amounts of such assets can be expensed when acquired.
16. SSAP No. 29 paragraph 3:
 3. In accordance with the reporting entity's capitalization policy, immaterial prepaid expenses may be expensed when purchased.
17. SSAP No. 73 paragraph 10:
 10. In accordance with the reporting entity's capitalization policy, immaterial amounts of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements may be expensed when purchased.
18. SSAP No. 79 paragraph 4:
 4. In accordance with the reporting entity's capitalization policy, immaterial amounts may be expensed when purchased, otherwise the assets shall be capitalized and depreciated in accordance with this statement.
19. SSAP No. 82 paragraph 4:
 4. In accordance with the reporting entity's capitalization policy, immaterial amounts of such costs can be expensed when incurred.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 4—Assets and Nonadmitted Assets*
- *SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements*
- *SSAP No. 29—Prepaid Expenses*
- *SSAP No. 73—Health Care Delivery Assets - Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities*
- *SSAP No. 79—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software*
- *SSAP No. 82—Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs*

Generally Accepted Accounting Principles

- No guidance obtained from GAAP

EXHIBIT A: Illustration of Marked Changes to Amended SSAPs

The following depicts the amendments made by this issue paper as “marked changes” (new text underlined and deleted text struck-through):

SSAP No. 4 paragraph 3:

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 statutory accounting principles, 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 Accounting Practices and Procedures Manual as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the Accounting Practices and Procedures Manual.

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 Accounting Practices and Procedures Manual. 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 less than a predefined threshold of furniture, fixtures, equipment, or supplies, ~~can shall~~ be expensed when purchased.

SSAP No. 19 paragraphs 3 and 6:

3. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ amounts less than a predefined threshold of such assets ~~can shall~~ be expensed when purchased.

6. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ amounts less than a predefined threshold of such assets ~~can shall~~ be expensed when purchased.

SSAP No. 29 paragraph 3:

3. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ prepaid expenses less than a predefined threshold shall ~~may~~ be expensed when purchased.

SSAP No. 73 paragraph 10:

10. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ amounts less than a predefined threshold of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements ~~may shall~~ be expensed when purchased.

SSAP No. 79 paragraph 4:

4. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ amounts less than a predefined threshold shall ~~may~~ be expensed when purchased, otherwise the assets shall be capitalized and depreciated in accordance with this statement.

SSAP No. 82 paragraph 4:

4. In accordance with the reporting entity's capitalization policy, ~~immaterial~~ amounts less than a predefined threshold of such costs ~~can~~ shall be expensed when incurred.