Statutory Issue Paper No. 6

Amounts Due From Agents and Brokers

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 6

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Some reporting entities conduct a significant amount of their business through insurance agents and brokers. For purposes of this issue paper the term agent will be used as reference to both entities. In the ordinary course of business, amounts may be due from or payable to agents by a reporting entity. Business reasons for these transactions vary between each type of entity transacting business with the reporting entity. These variations may be the result of formal contractual requirements, the nature of the insurance products being sold or the services being performed. Statutory accounting for amounts due from agents is not addressed in sufficient detail in either the Accounting Practices and Procedures Manuals for Life and Accident and Health or for Property and Casualty Insurance Companies. Additionally, interpretation and application of accounting practices dealing with amounts due from agents are inconsistent among states. This issue paper establishes a framework for the accounting and reporting of amounts due from agents and brokers (collectively referred to as "agents") that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. Amounts due from agents can result from various insurance transactions ranging from premiums collected on behalf of the reporting entity to amounts advanced to the agent by the reporting entity to finance agency operations. Premiums owed by the agent shall be reflected net of commissions, if permitted by the contract. In almost all cases these transactions result in an amount due to the reporting entity that meets the definition of an asset as set forth in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*. First, an evaluation shall be made to determine nonadmitted amounts. Next, 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 there is an impairment. This two-step process is set forth below:

a. The uncollected agent's receivable which is over ninety days due shall be accounted for as a nonadmitted asset regardless of any offsetting amount (e.g., unearned premium).

b. Remaining amounts determined to be uncollectible shall be written off: If, in accordance with Issue Paper No. 5, it is probable the agent's receivable is uncollectible, any uncollectible agent's receivable shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible and is therefore not written off, disclosure requirements outlined in Issue Paper No. 5

IP No. 6

Drafting Notes/Comments

- This issue paper does not address nonadmitted assets for retrospective premiums on direct or assumed business as this issue was addressed and codified by the NAIC in 1993. Current guidance is included in Chapter 22 of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies. This is addressed in a separate issue paper.
- Reinsurance premiums payable, reinsurance commissions receivable, etc., which are currently reported on the same line in the Annual Statement, are addressed in a separate issue paper.
- In preparing this paper, the following issues were identified as future potential issue paper topics:
- Right of Offset - (agent commissions, reinsurance premiums payable and receivable, etc.)
- Aging/nonadmitting of reinsurance premiums due (governed by Chapter 22)
- Premiums sold with recourse (premium finance company)
- Accounting/aging of retrospective premiums currently reported on line 9.2 or line 9.3 is addressed in a separate issue paper.
- Accounting for uncollected premium balances is addressed in *Issue Paper No. 10—Uncollected Premium Balances.*
- Accounting for bills receivable is addressed in *Issue Paper No. 21—Bills Receivable for Premiums.*
- Sale of premium receivables will be addressed in *Issue Paper No. 42—Sale of Premium Receivables*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

10. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 7, *Agents' Balances or Uncollected Premiums*, page 2, paragraph 2, provides the following guidance:

> To satisfy the requirements of the annual statement blank, agents' balances or uncollected premiums over three months due are nonadmitted assets. (See Chapter 9 - Nonadmitted Assets, see excerpt below.)

11. Chapter 9, *Nonadmitted Assets*, page 1, point 3, reinforces Chapter 7 by stating the following:

> Agents' Balances or Uncollected Premiums Over Three Months Due: The statutes of most states require that agents' balances or uncollected premiums over three months due be nonadmitted because of the uncertainty of collection.

12. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies is silent with respect to when the aging of agents' balances and uncollected premiums is to commence, however, the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force (Emerging Accounting Issues Working Group) reached a consensus in the 89-2 session which states the following:

> Aging of Agents' Balances
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> The issues considered were:
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> 1. In computing the non-admitted portion of agents' balances, should an agents' account current be aged from the dates of the account current statement or from the eff006 we

2. How should balances be aged when the account current system is not used?

The balance should be aged from the

b) The amount of loss can be reasonably estimated.

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[3]Paragraphs 23-24 of *APB Opinion No. 9*, "Reporting the Results of Operations," describe the "rare" circumstances in which a prior period adjustment is appropriate. Those paragraphs are not amended by this statement.

[4]Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented.

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15. The FAS 5 criteria above, is used in interpreting information such as historical trending and general information about the stability of the agents\insured in an effort to evaluate the adequacy of a premium receivable allowance. Accounting for contingencies is discussed in more detail in Issue Paper No. 5.

16. GAAP accounting requires the aging of agents' balances or uncollected premiums to begin from the effective date of the policy. Aging for endorsement premiums should begin from the endorsement's effective date and installment premiums should begin from the installment's due date. Although not specifically stated, this guidance can be deduced through review of *FASB Statement of Financial Accounting Concepts No. 5, Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 83, as follows:

> 83. Further guidance for recognition of revenues and gains is intended to provide an acceptable level of assurance of the existence and amounts of revenues and gains before they are recognized. Revenues and gains of an enterprise during a period are generally measured by the exchange values of the assets (goods or services) or liabilities involved, and recognition involves consideration of two factors (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important consideration.
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> a. Realized or realizable. Revenues and gains generally are not recognized until realized or realizable.[50]Revenues and gains are realized when products (goods or services), merchandise, or other assets are exchanged for cash or claims to cash. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Readily convertible assets have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price.
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> b. Earned. Revenues are not recognized until earned. An entity's revenue earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations,[51] and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Gains commonly result from transactions and other events that involve no "earning process," and for recognizing gains, being earned is generally less significant than being realized or realizable.

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[50]The terms realized and realizable are used in the Boards conceptual framework in precise scenes, focusing on conversion or convertibility of noncash assets into cash or claims to cash (Concepts Statement 3, par. 83). Realized has sometimes been used in a different, broader sense: for example, some have used that term to include realizable or to include certain conversions of noncash assets into other assets that are also not cash or claims to cash. APB Statement 4, paragraphs 148-153, used the term realization even more broadly as a synonym for recognition.

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