Statutory Issue Paper No. 9

Subsequent Events

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 9

Type of Issue:
Common Area

SUMMARY OF ISSUE

5. Information that becomes available prior to the issuance of the financial statements relating to a material Type II subsequent event shall not be recorded in the financial statements, but shall be disclosed in the notes to the financial statements. If an event is of such a nature that pro forma disclosures are necessary to keep the financial statements from being misleading, disclosure of supplemental pro forma financial data shall be made including the impact on net income, surplus, total assets and total liabilities giving effect to the event as if it had occurred on the date of the balance sheet.

6. The conclusions in this issue paper, including the disclosures in paragraph 5, shall also apply to quarterly statement filings.

DISCUSSION

7. The above conclusion expands and clarifies the guidance provided in the NAIC *Financial Condition Examiners Handbook* and the Annual Statement Instructions by requiring that Type I subsequent events be recorded in the financial statements.

8. The Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts) states that *"the cornerstone of solvency measurement is financial reporting. Therefore, the regulator's ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders."* The recording of Type I subsequent events provides the regulator relevant information to evaluate the financial condition of an entity. However, in some circumstances, the recording of Type I subsequent events is specifically prohibited within Codification (e.g., subsequent collection of agents balances over 90 days due when determining nonadmitted agents balances).

9. Identifying events that require adjustment of the financial statements under the criteria stated in the conclusion calls for the management of the entity to exercise judgment and accumulate knowledge of the facts and circumstances surrounding the event. For example, a loss on an uncollectible agent's balance as a result of an agent's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of conditions existing at the balance sheet date, thereby requiring the recording of such event to the financial statements before their issuance. On the other hand, a similar loss resulting from an agent's major casualty loss such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing at the balance sheet date and recording of the event to the financial statements would not be appropriate. However, this is a Type II subsequent event which would require disclosure in the notes to the financial statements as described in paragraph 5 above.

10. Additionally, the Statement of Concepts states that *"Because these basic financial statements cannot be expected to provide all of the information necessary to evaluate an entity's short-term and long-term stability, management must supplement the financial statements with sufficient disclosures (e.g., notes to the financial statements, management's discussion and analysis, and supplementary schedules and exhibits) to assist financial statement users in evaluating the information provided."* Disclosure of Type II subsequent events meets this objective. Examples of Type II events that require disclosure to the financial statements (but should not result in adjustment) are: i) sale of a bond or capital stock issue, ii) purchase of a business, iii) settlement of litigation when the event giving rise to the claim took place subsequent to the balance sheet date and iv) casualty losses resulting from a hurricane or earthquake subsequent to the balance sheet date.

Drafting Notes/Comments
None

1. Scan cash receipts records for evidence of proceeds of loans, significant sales of productive assets or other unusual items.

   Amounts over $ ____________Date through _______________

2. Scan cash disbursements records for unusual payments and payment of liabilities not recorded as of balance-sheet date.

   Amounts over $ ___________Date through _______________

3. Review general journal entries for entries that would have a material effect upon the financial statement as of balance sheet date.

   Amounts over $ ___________ Date through ________________

4. Read minutes of meetings to directors, stockholders and important committees up to the report date. If minutes have not been prepared, obtain a written representation from the secretary about matters dealt with at such meetings. Review draft (if any) or proxy statement to be issued to shareholders for matters that may affect the financial statements.

5. Read latest available interim financial statements. Compare them with the financial statements being reported on and obtain explanations for any unusual items noted as a result of the comparison.

   Amounts over $ _____________ Date through ______________

6. Inquire of officers and other executives having responsibility for financial and accounting matters as to whether the interim statements have been prepared on the same basis as that used for the statements under examination. (Indicate identity of statements and periods covered.)

   Amounts over $ _____________ Date through ____________

7. Inquire of officers and other executives having responsibility for financial and accounting matters (limited where appropriate to major locations) as to: (NOTE: Indicate persons with whom discussions were held and date and attach memoranda or comments regarding significant matters discussed. Corporate office inquiries should extend to the report date.)

   a. Whether any substantial contingent liabilities or commitments existed at the balance-sheet date or at the date of inquiry.

   b. Whether there was any significant change in the capital stock or debt to the date of inquiry.

   c. The current status of items in the financial statements being reported on that were accounted for on the basis of tentative, preliminary, or inconclusive data.

   d. Whether any other matters had occurred that would materially affect the financial statements or operations of the company. This includes appropriate inquiries as to subsequent events of material affiliates accounted for by the equity method.

      Amounts over $ __________________ Date through ____________

8. If the above procedures produce responses that significantly affect the financial statements, they should be confirmed in writing. This may be done in the letter of representations.

   Amounts over $ __________________ Date through _____________

Generally Accepted Accounting Principles

15. The primary source of GAAP authoritative guidance for the treatment of subsequent events is *AICPA Statement on Auditing Standards No. 1, Section 560, Subsequent Events*, which states the following:

> .01 An independent auditor's report ordinarily is issued in connection with historical financial statements that purport to present financial position at a stated date and results of operations and cash flows for a period ended on that date. However, events or transactions sometimes occur subsequent to the balance sheet date, but prior to the issuance of the financial statements and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements. These occurrences hereinafter are referred to as "subsequent events."
>
> .02 Two types of subsequent events require consideration by management and evaluation by the independent auditor.
>
> .03 The first type consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.
>
> .04 Identifying events that require adjustment of the financial statements under the criteria stated above calls for the exercise of judgment and knowledge of the facts and circumstances. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy subsequent to the balance-sheet date would be indicative of conditions existing at the balance-sheet date, thereby calling for adjustment of the financial statements before their issuance. On the other hand, a similar loss resulting from a customer's major casualty such as a fire or flood subsequent to the balance-sheet date would not be indicative of conditions existing at the balance-sheet date and adjustment of the financial statements would not be appropriate. The settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the financial statements if the events, such as personal injury or patent infringement, that gave rise to the litigation had taken place prior to the balance-sheet date.
>
> .05 The second type consists of those events that provide evidence with respect to conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date. These events should not result in adjustment of the financial statements.[1] Some of these events, however, may be of such a nature that disclosure of them is required to keep the financial statements from being misleading. Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical financial statements with pro forma financial data giving effect to the event as if it had occurred on the date of the balance sheet. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.
>
> ---
>
> [1] This paragraph is not intended to preclude giving effect in the balance sheet, with appropriate disclosure, to stock dividends or stock splits or reverse splits consummated after the balance-sheet date but before issuance of the financial statements.

.06 Examples of events of the second type that require disclosure to the financial statements (but should not result in adjustment) are:

a. Sale of a bond or capital stock issue.

b. Purchase of a business.

c. Settlement of litigation when the event giving rise to the claim took place subsequent to the balance-sheet date.

d. Loss of plant or inventories as a result of fire or flood.

e. Losses on receivables resulting from conditions (such as a customer's major casualty) arising subsequent to the balance-sheet date.

.07 Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities ordinarily will require adjustment of the financial statements (see paragraph .03) because such events typically represent the culmination of conditions that existed over a relatively long period of time. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements (see paragraph .05) because such changes typically reflect a concurrent evaluation of new conditions.

.08 When financial statements are reissued, for example, in reports filed with the Securities and Exchange Commission or other regulatory agencies, events that require disclosure in the reissued financial statements to keep them from being misleading may have occurred subsequent to the original issuance of the financial statements. Events occurring between the time of original issuance and reissuance of financial statements should not result in adjustment of the financial statements[2] unless the adjustment meets the criteria for the correction of an error or the criteria for prior period adjustments set forth in Opinions of the Accounting Principles Board.* Similarly, financial statements reissued in comparative form with financial statements of subsequent periods should not be adjusted for events occurring subsequent to the original issuance unless the adjustment meets the criteria stated above.

---

[2] However, see paragraph .05 as to the desirability of presenting pro forma financial statements to supplement the historical financial statements in certain circumstances.

* See also Statement of Financial Accounting Standards No. 16, Prior Period Adjustments (AC section A35).

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- NAIC *Annual Statement Instructions for Life and Accident and Health Insurance Companies*
- NAIC *Annual Statement Instructions for Property and Casualty Insurance Companies*
- NAIC *Financial Condition Examiners Handbook*
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 6—Amounts Due from Agents and Brokers*

Generally Accepted Accounting Principles

- *AICPA Statement on Auditing Standards No. 1, Section 560, Subsequent Events*

State Regulations

- No additional guidance obtained from state statutes or regulations.

