Statutory Issue Paper No. 34

Investment Income Due and Accrued

STATUS
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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

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*.

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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 Loaned 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

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
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> Income Derived from Real Estate
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> 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
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> Income from Bank Deposits
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> 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.
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> 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.
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> 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
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> Interest
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> 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.
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> 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
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> 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 Loaned 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