1. Current statutory accounting guidance and GAAP differ in accounting for business combinations. Current statutory guidance requires that an investment in a subsidiary, controlled or affiliated entity (SCA) be recorded at historical net asset value of the entity acquired (statutory book value for acquired entities). The difference between the value of the consideration given and the statutory net asset value is considered to be goodwill and under current statutory guidance may be recorded as an admitted asset, subject to certain limitations. Amortization of goodwill is limited to 10 years. However, individual state insurance laws and regulations vary with respect to requirements for the treatment of goodwill. Currently some states allow the admission of goodwill within the limits imposed by the *Purposes and Procedures*

10. The statutory merger method of accounting is defined as accounting for a business combination in which the original investors in the investee receive equity of the reporting entity for their interest in the

accountant audited financial statement prepared in accordance with generally accepted accounting principles; or

(If the common stock of a subsidiary, controlled, or affiliated company is valued on the basis of generally accepted accounting principles in accordance with the provisions of this section the adjustment "to reflect subsequent operating results" shall include net changes in all the capital and surplus accounts on a statutory basis with respect to the shares of any underlying insurance company subsidiaries); or

(v) the market value of the common stock of the company, if the stock is listed on a national securities exchange or entered in the NASDAQ System (other securities traded over-the-counter will not be considered under this section); The share price will be discounted for legal restrictions requiring a registration before any sale may be made and the size and depth of the trading activity in relation to the publicly traded shares outstanding; or

(vi) See Section 3 (C) (2) for valuation of preferred stocks of wholly-owned subsidiaries of insurance companies.

(vii) In applying the provisions of this section to insurers organized in foreign countries, the provisions of Subsection (i) of this section will be applied (based on financial statements for the most recent fiscal year as prepared by an independent certified public accountant), except where special considerations indicate other treatment would be appropriate; or

(viii) any other value that the insurer can substantiate to the satisfaction of the SVO staff as being a reasonable value.

(b) (i) The provisions of Section 5 (B) shall in all cases be subject to the procedures prescribed by state insurance department practices or laws concerning the use of acquisition cost or any other basis for the valuation of common stocks of subsidiary, controlled or affiliated companies.

(ii) Not later than April 1 of each year, every insurer shall file with the SVO staff, on the appropriate form prescribed by the Valuation of Securities Task Force, (Task Force), relevant information identifying, supporting and justifying the value of, and the basis of valuation used in accordance with the provisions of Section 5(B)(a) for each of its subsidiary, controlled or affiliated companies reported upon in the Annual Statement for the preceding year.

(iii) Within thirty (30) days after the acquisition or formation of a subsidiary, controlled or affiliated company, every insurer shall file with the SVO staff, on the appropriated form prescribed by the Task Force, relevant information identifying, supporting and justifying the value of, and the basis of valuation used in accordance with the provisions of Section 5(B)(a) for such company.

(iv) A valuation basis used for a subsidiary, controlled or affiliated company shall thereafter be consistently applied unless a change is substantiated as reasonable and on that basis is approved in writing by the SVO staff.

(v) If a subsidiary, controlled or affiliated company is valued on the basis of Section 5 (B) (a) (ii) and its books are not audited at the time the valuation is included in the insurer's annual statement, the insurer shall thereafter report to the SVO staff and explain the difference, if any, between the value of such company as reported in the annual statement and the value as determined by audit. Such report and explanation shall be made as soon as possible following such audit.

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(vi) If the common stock of any subsidiary, controlled or affiliated company is valued other than on the basis of market value as defined in Section 5 (B) (a) (v), there shall be deducted from the otherwise determined value a sum equal to the value claimed for any of its assets that would not constitute admitted assets for the insurer if held directly by the insurer, if such assets

(1) are held by the company but used, under a lease arrangement or otherwise, significantly in the conduct of the insurer's business; or

(2) were acquired from or purchased for the benefit or use of the insurer by the company under circumstances that, in the opinion of the SVO staff, support a finding that the primary purpose of such acquisition was the evasion or avoidance of state laws or regulations pertaining to non-admitted assets.

(vii) The SVO staff may require filings to be by the use of such forms as it prescribes and may requests such supplemental information as it deems desirable. The SVO staff shall utilize the information in such filings and supplemental information to make its determination as to the reasonableness and appropriateness of the valuation basis and the resultant value and shall notify the insurer and its state of domicile of such determination.

(viii) In making its determination as to the reasonableness and appropriateness of the valuation basis and the resultant value for each subsidiary, controlled or affiliated company, the SVO staff shall, among other relevant factors, take into account the following:

(1) the effect of subsidiary valuation on the solvency of the insurer (it being the intent hereof that doubt as to reasonableness shall be resolved by selection of a conservative valuation standard in those circumstances where the higher valuation would make an otherwise insolvent insurer appear solvent);

(2) if the valuation involves acquisition cost, the degree of affiliation between the insurer and the party from whom such company was acquired, the form of the consideration (cash, property, or the exchange of stock), evidence of ability to recover cost, and whether the acquisition price represented the result of arms-length dealing between economic equals; and,

(3) whether revaluation of assets is involved, and the reasonableness thereof.

(ix) With respect to values determined under Sections 5 (B) (a) (ii) and 5 (B) (a) (iv), amounts attributable to goodwill, as defined in (a) hereunder, and other intangibles shall not, except as provided in (b), hereunder, in the aggregate (of all direct and indirect subsidiaries), exceed, (either initially upon the acquisition of a subsidiary, or thereafter), 10% of the capital and surplus of an insurer, as reported in its next preceding Annual Statement. Such amounts shall, except as provided in (c) and (d), hereunder, be written off over a period not in excess of 10 years, commencing in all cases with the accounting period ending asset value of the properties acquired on the books of the predecessor company. With respect to insurance company subsidiaries "net asset value" shall mean statutory or annual statement book value. In addition any asset account representing the present value of future contractual or estimated revenue streams will also be deemed goodwill and subject to the limitations of this section.

(b) The limitation with respect to the permissible amount of goodwill shall not apply in the cases of subsidiaries acquired or under contract to be acquired on or prior to June 14, 1972.

(c) The write-off period for goodwill in the cases of subsidiaries described in (b), above, may, upon application to and approval by the Securities Valuation Office, be extended to not in excess of 20 years.

(d) Where warranted in exceptional cases, the Securities Valuation Office may require a more rapid write-off of goodwill than is otherwise provided in this section.

(e) In the cases of subsidiaries acquired or under contract to be acquired on or prior to June 14, 1972, an insurer may charge the write-off of goodwill to the common stock component of the Asset Valuation Reserve, where such a reserve exists.

(f) In the cases of subsidiaries acquired after June 14, 1972, amounts of goodwill in excess of 10% of an insurer's capital and surplus shall be written off immediately by a direct charge to surplus.

23. NAIC Annual Statement Instructions provide the following guidance on the restatement of prior year financial information presented after a merger occurs:

Except in situations where a merger has occurred, amounts reported for assets, liabilities, surplus, revenues, and expenses for prior years in the current year's annual statement shall be identical to the amounts that were reported in the annual statement of the prior year. However, amounts reported in prior years may need to be adjusted in the current year as a result of the following:

Changes in accounting principles or practices or changes in the methods of applying accounting principles or practices.

Changes in accounting estimates as a result of new events or new information.

Corrections of errors in previously filed information.

A merger.

If changes are required for amounts reported in prior years, such changes should be included in the amounts reported for the current year and the effects of such changes should be reported as follows, unless these instructions or the NAIC Accounting Practices and Procedures manual for Life and Health specifically provide for a different treatment:

(1) The cumulative effect of a change in accounting principles or practices or a change in the method of applying accounting principles or practices should be reported with an appropriate identifying title as a write-in item for gains and losses in surplus (Page 4, Line 46). The cumulative effect of changing to a new accounting principle is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods. An example of a

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FASB Statement 111; FASB Statement 121; FASB Interpretation 4;
FASB Interpretation 9; FASB Technical Bulletin 85-5

B50 Summary

A business combination occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into one accounting entity. The single entity carries on the activities of the previously separate, independent enterprises. The purchase method and the pooling-of-interests method are both acceptable in accounting for business combinations, although not as alternatives in accounting for the same business combination. This section provides that a business combination shall be accounted for as a pooling of interests if it meets certain specified criteria. Business combinations that do not meet all of the specified criteria shall be accounted for as purchases.

The criteria for the pooling method relate to the attributes of the combining enterprises before the combination, the manner of combining the enterprises, and the absence of certain planned transactions after the combination. The pooling-of-interests method accounts for a business combination as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interests continue and the former bases of accounting shall be retained. The recorded assets and liabilities of the constituents shall be carried forward to the combined corporation at their recorded amounts. Income of the combined corporation shall include income of the constituents for the entire fiscal period in which the combination occurs. The reported income of the constituents for prior periods shall be combined and restated as income of the combined corporation.

The purchase method accounts for a business combination as the acquisition of one enterprise by another. The acquiring corporation shall record at its cost the acquired assets less liabilities assumed. A difference between the cost of an acquired enterprise and the sum of the fair values of tangible and identifiable intangible assets less liabilities assumed shall be recorded as goodwill. The reported income of an acquiring corporation shall include the operations of the acquired enterprise after acquisition, based on the cost to the acquiring corporation.

27. *Accounting Principles Board Opinion No. 17, Intangible Assets* (APB 17), addresses goodwill and amortization of intangible assets. APB 17 specifies that the amortization period should not exceed 40 years and the straight line method is appropriate unless a company demonstrates that another method is more appropriate. APB 17 also requires companies to perform a subsequent review of amortization to determine if changes should be made in the amortization period:

SUMMARY

1. An enterprise may acquire intangible assets from others or may develop them itself. Many kinds of intangible assets may be identified and given reasonably descriptive names, for example, patents, franchises, trademarks, and the like. Other types of intangible assets lack specific identifiability. Both identifiable and unidentifiable assets may be developed internally. Identifiable intangible assets may be acquired singly, as a part of a group of assets, or as part of an entire enterprise, but unidentifiable assets cannot be acquired singly. The excess of the cost of an acquired company over the sum of identifiable net assets, usually called goodwill, is the most common unidentifiable intangible asset.

2. Accounting for an intangible asset involves the same kinds of problems as accounting for other long-lived assets, namely, determining an initial carrying amount, accounting for that amount after acquisition under normal business conditions (amortization), and accounting for that amount if the value declines substantially and permanently. Solving the problems is complicated by the characteristics of an intangible asset: its lack of physical qualities makes evidence of its existence elusive, its value is often difficult to estimate, and its useful life may be indeterminable.

Conclusions

9. The Board concludes that a company should record as assets the costs of intangible assets acquired from others, including goodwill acquired in a business combination. A company should record as expenses the costs to develop intangible assets which are not specifically identifiable. The Board also concludes that the cost of each type of intangible asset should be amortized by systematic charges to income over the period estimated to be benefited. The period of amortization should not, however, exceed forty years.

28. *FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprise an amendment of APB Opinion No. 16* (FAS 38), deals with preacquisition contingencies. Amounts that can be reasonably estimated that are considered probable are recorded as a part of the allocation of the purchase price. Subsequent adjustments are included in net income when the adjustments are determined except in limited circumstances.

Summary

This Statement specifies how an acquiring enterprise should account for contingencies of an acquired enterprise that were in existence at the purchase date and for subsequent adjustments that result from those contingencies. Amounts that can be reasonably estimated for contingencies that are considered probable are recorded as a part of the allocation of the purchase price. Subsequent adjustments are included in net income when the adjustments are determined except in limited circumstances described in this Statement.

29. *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises* (FAS 79), amends APB 16 to eliminate the requirement for nonpublic enterprises to disclose pro forma results of operations for business combinations accounted for by the purchase method:

INTRODUCTION

1. The FASB has undertaken research on financial reporting by private and small public companies to obtain information about the practices and views of managers, financial statement users, and public accountants involved with those companies.[1] A number of participants in those research efforts stated that the requirement to disclose pro forma results of operations for business combinations accounted for by the purchase method was unnecessary and too costly for private companies.

[1] Refer to (a) FASB Invitation to Comment, Financial Reporting by Private and Small Public Companies, 1981; (b) FASB Special Report, Financial Reporting by Privately Owned Companies: Summary of Responses to FASB Invitation to Comment, 1983; and (c) FASB Research Report, Financial Reporting by Private Companies: Analysis and Diagnosis, prepared by A. Rashad Abdel-Khalik, 1983.

2. Paragraph 96 of *APB Opinion No. 16, Business Combinations*, requires an acquiring enterprise to disclose the following information in financial statements of the period in

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> 3. The Board has concluded that the disclosures prescribed by paragraph 96 of Opinion 16 should not be required in the financial statements of nonpublic enterprises. The basis for the Board's conclusions is presented in the appendix to this Statement.
>
> STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING
>
> 4. Disclosures of pro forma results of operations prescribed in paragraph 96 of Opinion 16 for business combinations accounted for by the purchase method are not required for nonpublic enterprises.
>
> 5. For purposes of this Statement, a nonpublic enterprise is an enterprise other than one (a) whose debt or equity securities are traded in a public market, including those traded on a stock exchange or in the over-the-counter market (including securities quoted only locally or regionally), or (b) whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities.
>
> Amendment to APB Opinion No. 16
>
> 6. The following footnote is added to the end of paragraph 96 of Opinion 16:
>
> * The disclosures prescribed by paragraph 96 are not required in the financial statements of nonpublic enterprises as defined by *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises*.
>
> Effective Date
>
> 7. This Statement shall be effective for financial statements for fiscal years beginning after December 15, 1983. Earlier application is permitted in financial statements that have not previously been issued.

30. GAAP literature is silent on push-down basis of accounting, although it was raised by the FASB in a 1976 Discussion Memorandum on business combinations. The FASB has included the issue of push down in the New Basis Accounting part of its Consolidations and Related Matters project. The SEC staff's views regarding the application of pushdown accounting are discussed Staff Accounting Bulletin Topic 5J. The staff believes that purchase transactions that result in an entity becoming substantially wholly owned, should establish a new basis of accounting for the purchased assets and liabilities which should be reflected in the acquired entity's separate financial statements. In circumstances where outside interest in the form of minority stockholders, or holders of public debt or preferred stock remain, the staff would encourage but generally not insist on the application of pushdown accounting.

31. *FASB Statement No 121*, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* provides the following guidance with respect to the impairment of goodwill.

> Goodwill
>
> 12. If an asset being tested for recoverability was acquired in a business combination accounted for using the purchase method, the goodwill that arose in that transaction shall be included as part of the asset grouping (paragraph 8) in determining recoverability. If some but not all of the assets acquired in that transaction are being tested, goodwill shall be allocated to the assets being tested for recoverability on a pro rata basis using the relative fair values of the long-lived assets and identifiable intangibles acquired at the acquisition date unless there is evidence to suggest that some other method of associating the goodwill with those assets is more appropriate. In instances where goodwill is identified with assets that are subject to an impairment loss, the carrying amount of the identified goodwill shall be eliminated before making any reduction of the carrying amounts of impaired long-lived assets and identifiable intangibles.

Reporting and Disclosure

13. An impairment loss for assets to be held and used shall be reported as a component of income from continuing operations before inco

> regulatory approvals. Task Force members observed that the reasonable period of time referred to in paragraph 74 of Opinion 16 is intended to be very short, such as a few days before and after the acquisition is agreed to and announced. Task Force members also observed that in transactions involving a hostile tender offer, the measurement date for the value of the marketable equity securities occurs when the proposed transaction is announced and sufficient shares have been tendered to make the offer binding or when the proposed acquisition becomes nonhostile, as evidenced by the target company's agreement to the purchase price.
>
> The Task Force also reached a consensus that if the purchase price (the number of shares or other consideration) is subsequently changed, a new measurement date for valuing the marketable equity securities that will be issued to effect the combination is established as of the date of the change. Task Force members observed that a change to the purchase price may result from further negotiations or from changes in the market price of the equity securities causing, perhaps pursuant to the initial agreement, a change in the security's exchange ratio or in a cash component of the purchase price.
>
> The Task Force reached a consensus that the consensuses described in this Issue should only be applied prospectively to purchase business combinations consummated after November 16, 1995.

33. The draft discussion material from previous Life codification project provides the following guidance on mergers in the Introduction section under Accounting for Assets Transferred Between Affiliates:

> A merger or consolidation of insurance companies under common control is to be recorded at book value. The combined surplus should not be enhanced or reduced as a result of the restructuring. A bulk reinsurance agreement of are[ )-6(betred BetweenIntt)Trrecoc a he a noel be r]TJ0

- *FASB Statement No 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*

  FASB Emerging Issues Task Force Issue No. 95-19, Determination of the Measurement Date for the Market Price of Securities Issued in a Purchase Business Combination

- *Accounting Principles Board Opinion No. 16, Business Combinations*
- *Accounting Principles Board Opinion No. 17, Intangible Assets*
- *FASB Statement No. 38, Accounting for Preacquisition Contingencies of Purchased Enterprises*
- *FASB Statement No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises*

- *AICPA Accounting Interpretations, Business Combinations: Accounting Interpretations of Accounting Principles Board Opinion No. 16*
- *FASB Statement No. 10, Extension of "Grandfather" Provisions for Business Combinations*
- *AICPA Accounting Interpretations, Intangible Assets: Unofficial Accounting Interpretations of Accounting Principles Board Opinion No. 17*
- *FASB Emerging Issues Task Force No. 85-14, Securities That Can Be Acquired for Cash in a Pooling of Interests*
- *FASB Emerging Issues Task Force No. 86-9, IRC Section 338 and Push-Down Accounting*
- *FASB Emerging Issues Task Force No. 86-10, Pooli*

- *FASB Emerging Issues Task Force No. 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination*
- *FASB Emerging Issues Task Force No. 95-12, Pooling of Interests with a Common Interest in a Joint Venture*
- *FASB Emerging Issues Task Force No. 95-14, Recognition of Liabilities in Anticipation of a Business Combination*
- *FASB Emerging Issues Task Force No. 96-8, Accounting for a Business Combination When the Issuing Company Has Targeted Stock*
- *FASB Technical Bulletin 85-5, Issues Related to Accounting for Business Combinations*
- *FASB Interpretations No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method an interpretation of FASB Statement No. 2*

- Indiana Insurance Statutes Title 27, Article 1, Chapter 12, *Life Insurance Company Powers and Policy Requirements*
- Indiana Insurance Statutes Title 27, Article 1, Chapter 13, *Casualty, Fire and Marine Insurance Company Powers and Policy Requirements*
- Pennsylvania Advance Laws to the Insurance Code, *Act 8--SB701*

- Draft discussion material from previous Life Codification projects.

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