Statutory Issue Paper No. 77

Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 1

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. GAAP guidance for the disclosure of accounting policies is contained in *Accounting Principles Board Opinion No. 22*, *Disclosure of Accounting Policies* (APB 22). This guidance requires the identification and description of accounting principles followed by a company and the methods of applying those principles that materially affect the determination of financial position or results of operations. Current statutory guidance requires a general disclosure that the financial statements have been prepared in accordance with the Annual Statement Instructions and Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies (Life/A&H and P&C Accounting Practices and Procedures Manuals) except to the extent state laws differ. The impact of such deviations is required to be disclosed if material. The disclosure of certain accounting policies within specific notes to the Annual Statement is required by the Annual Statement Instructions.

2. GAAP guidance for the disclosure of permitted accounting practices is contained in *AICPA Statement of Position No. 94-5, Disclosure of Certain Matters in the Financial Statements of Insurance Enterprises* (SOP 94-5). This guidance requires the disclosure of those permitted statutory accounting practices that have a material impact on statutory surplus or risk based capital or when prescribed statutory accounting practices do not address the accounting for the transaction. Current statutory guidance is contained in the Annual Statement Instructions for both Property and Casualty and Life, Accident and Health Insurance Compan

issue paper are made within specific notes, schedules or exhibits to the financial statements, those disclosures are not required to be duplicated in a separate note. Annual statutory financial statements

loss of the business relationship. For the purposes of this issue paper, it is always considered at least reasonably possible that any customer will be lost in the near term.

b. *Concentrations in revenue from particular products or services*. The potential for severe impact can result, for example, from volume or price changes for a particular source of revenue.

c. Concentrations in the available sources of materials, labor, services, licenses, or other rights used in the entity's operations. The potential for severe impact can result, for example, from changes in the availability to the entity of a resource or a right.

d. *Concentrations in the market or geographic area in which an entity conducts its operations*. The potential for severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For the purposes of this issue paper, it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

Other Disclosures

18. Separate issue papers have disclosure requirements specific to the topics addressed in those issue papers. Additional disclosure requirements not addressed in other issue papers are included herein.

19. For each year that a balance sheet is presented, reporting entities shall disclose the following information in the notes to the financial statements:

a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies.

b. The amount and nature of any assets pledged to others as collateral.

20. The financial statements shall disclose forward commitments which are not derivative instruments (e.g., the commitment to purchase a GNMA security two months after the commitment date,

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9. The Board also concludes that information about the accounting policies adopted and followed by not-for-profit entities should be presented as an integral part of their financial statements.

10. The provisions of paragraphs 8 and 9 above are not intended to apply to unaudited financial statements issued as of a date between annual reporting dates (e.g., each quarter) if the reporting entity has not changed its accounting policies since the end of its preceding fiscal year. [2]

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[2] The Board recognizes also that it may be appropriate to omit disclosure in some other circumstances for example, from financial statements restricted to internal use only (see Statement on Auditing Procedures No. 38, paragraphs 5 and 6) and from certain special reports in which incomplete or no financial presentations are made (see Statement on Auditing Procedures No. 33, Chapter 13, paragraphs 9 and 10).

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11. This Opinion does not supersede any prior pronouncement of the American Institute of Certified Public Accountants relating to disclosure requirements.

Content

12. Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect

the foregoing guides in this Opinion. The Board believes that the disclosure is particularly useful if given in a separate Summary of Significant Accounting Policies preceding the notes to financial statements or as the initial note. Accordingly, it expresses its preference for that format under the same or a similar title.

30. SOP 94-6 provides the following guidance:

Introduction
.01 The volatile business and economic environment underscores a need for improved disclosure about the significant risks and uncertainties that face reporting entities. In 1987, the AICPA issued the Report of the Task Force on Risks and Uncertainties (the Report), which was intended to help standards setting bodies and others identify practical methods of improving the information communicated to users of financial statements to help them assess those risks and uncertainties. This Statement of Position (SOP) is largely based on the Report. The central feature of this SOP's disclosure requirements is selectivity: specified criteria serve to screen the host of risks and uncertainties that affect every entity so that required disclosures are limited to matters significant to a particular entity.

.02 The disclosures focus primarily on risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity. The risks and uncertainties this SOP deals with can stem from the nature of the entity's operations, from the necessary use of estimates in the preparation of the entity's financial

Scope
.03 This SOP applies to financial statements prepared in confor accounting principles (GAAP) applicable to nongovernmental entitie issue such statements

[1] While this SOP applies to complete interim financial statements, it does also statements. If comparative finan statements are presented, the disclosure requirements apply only to the financial statements the most recent fiscal period presented.

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[1] However, see *Accounting Principles Board (APB) Opinion No. 28, Interim Financial Reporting*, paragraph 30, for guidance on disclos

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.04 The disclosure requirements do not encompass risks and uncertainties that might be proposed changes in government regulations; proposed changes in accounting principles,[2] or deficiencies in the internal control structure. Nor do they encompass tal contingency, war, or sudden catastrophes.

Relationship to Other Pronouncements
.05 The disclosures are similar to or overlap the m any circumstances requirements of this SOP disclosure requirements in certain pronouncement

Definitions

.07 This SOP uses the following terms with the definitions indicated:

example assets, revenues, or earnings. Not-for-profit organizations' disclosures should briefly describe the principal services performed by the entity and the revenue sources for the entity's services. Disclosures about the nature of operations need not be quantified; relative importance could be conveyed by use of terms such as predominately, about equally, or major and other.[5]

Use of Estimates in the Preparation of Financial Statements

.11 Financial statements should include an explanation that the preparation of financial statements in conformity with GAAP requires the use of management's estimates.

Certain Significant Estimates

.12 Various accounting pronouncements require disclosures about uncertainties addressed by those pronouncements. In particular, paragraphs 9-12, and 17.b. and footnote 6 of FASB Statement No. 5 specify disclosures to be made about contingencies [6] that exist at the date of the financial statements. The disclosure requirements of paragraphs 9-12 of Statement No. 5 are further clarified in *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss.* In addition to disclosures required by FASB Statement No. 5 and other accounting pronouncements, this SOP requires disclosures regarding estimates used in the determination of the carrying amounts of assets or liabilities or in disclosure of gain or loss contingencies, as described below

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[5] See paragraph B-17 in appendix B [paragraph .28] for a comparison of this SOP's disclosure requirements concerning nature of operations with the disclosure requirements for public companies in *FASB Statement No. 14, Financial Reporting for Segments of a Business Enterprise.*

[6] FASB Statement No. 5 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (hereinafter a 'gain contingency') or loss (hereinafter a 'loss contingency') to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the

- Amounts reported for long-term obligations, such as amounts reported for pensions and postemployment benefits
- Estimated net proceeds recoverable, the provisions for expected loss to be incurred, or both, on disposition of a business or assets
- Amounts reported for long-term contracts

The above list is not intended to be all-inclusive.

.19 The following are examples of events or changes in circumstances that indicate that an estimate associated with the carrying amount of a long-lived asset may be particularly sensitive to change in the near term:[10]

a. A significant decrease in the market value of an asset

b. A significant change in the extent or manner in which an asset is used

c. A significant adverse change in legal factors or in the business climate that affects the value of an asset

d. An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset

e. A history of losses associated with an asset, a projection or forecast (if either is available) that demonstrates continuing losses associated with an asset, or both

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[10] On November 29, 1993, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, Accounting for the Impairment of Long-Lived Assets. This list was derived from the list in the FASB exposure draft of examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of a long-lived asset should be assessed for impairment. Any final Statement may contain additional or revised examples.

Current Vulnerability Due to Certain Concentrations

.20 Vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Such risks of loss manifest purposes of this SOP, it is always considered at least reasonably possible that any customer, grantor, or contributor will be lost in the near term.

b. Concentrations in revenue from particular products, services, or fund-raising events. The potential for the severe impact can result, for example, from volume or price changes or the loss of patent protection for the particular source of revenue.

c. Concentrations in the available sources of supply of materials, labor, or services, or of licenses or other rights used in the entity's operations. The potential for the severe impact can result, for example, from changes in the availability to the entity of a resource or a right.

d. Concentrations in the market or geographic area [11] in which an entity conducts its operations. The potential for the severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For purposes of this SOP, it is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

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31. SOP 94-5 provides the following guidance:

Introduction

.01 Most of the accounting principles related to disclosures for insurance enterprises were promulgated over twenty years ago when the insurance regulatory and business environments were less complex and volatile. Accordingly, the AICPA Accounting Standards Executive Committee (AcSEC) added a project to its agenda to consider whether new disclosures should be required in insurance enterprises' financial statements. This statement of position (SOP) is a result of that project.

.02 This SOP applies to annual and complete sets of interim financial statements prepared in conformity with generally accepted accounting principles (GAAP) of life and health insurance enterprises (including mutual life insurance enterprises), property and casualty insurance enterprises, reinsurance enterprises, title insurance enterprises, mortgage guaranty insurance enterprises, financial guaranty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, pools other than public-entity risk pools, syndicates, and captive insurance companies. Furthermore, AICPA Auditing Interpretation No. 12, "Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis" (AICPA, *Professional Standards, vol. 1,* AU section 9623.60.79), requires auditors to apply the same disclosure criteria for statutory financial statements as they do for financial statements prepared in conformity with GAAP.

Relationship to Other Pronouncements

.03 In some circumstances, the disclosure requirements in this SOP may be similar to, or overlap, the disclosure requirements in certain other authoritative accounting pronouncements issued by the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA), and the Securities and Exchange Commission (SEC). For example—

- *FASB Statement of Financial Accounting Standards No. 5, Accounting for Contingencies,* requires certain disclosures related to loss contingencies, including catastrophe losses of property and casualty insurance companies.
- *FASB Statement No. 60*, *Accounting and Reporting by Insurance Enterprises,* requires certain disclosures about liabilities for unpaid claims and claim adjustment expenses and statutory capital.
- *FASB Statement No. 113*, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, requires certain disclosures about reinsurance transactions.
- *AICPA Statement of Position 94-6*, *Disclosure* of *Certain Significant Risks and Uncertainties* requires disclosures about certain significant estimates.

The SEC Securities Act Guide 6, *Disclosures Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters,* requires disclosures of information about liabilities for unpaid claims and claim adjustment expenses.

The disclosure requirements in this SOP supplement the disclosure requirements in other authoritative pronouncements. This SOP does not alter the requirements of any FASB or SEC pronouncement.

Conclusions

has a project under way to codify statutory accounting practices through a complete revision of its *Accounting Practices and Procedures Manuals,* that, when complete, is expected to replace prescribed or permitted statutory accounting practices as the statutory basis of accounting for

Note X. Permitted Statutory Accounting Practices
Property and Casualty Company, Inc., domiciled in ABC State, prepares its statutory financial statements in accordance with accounting practices prescribed or permitted by the ABC State Insurance Department. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

The company received written approval from the ABC State Insurance Department to discount loss reserves at a rate of X percent for statutory accounting purposes, which differs from prescribed statutory accounting practices. Statutory accounting practices prescribed by ABC state require that loss reserves be discounted at Y percent. As of December 31, 19X3, that permitted transaction increased statutory surplus by $XX million over what it would have been had prescribed accounting practice been followed.

RELEVANT LITERATURE

Statutory Accounting
- NAIC Annual Statement Instructions
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*

Generally Accepted Accounting Principles
- *Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies*
- *Accounting Research Bulletin No. 43, Chapter 2A, FeAmof ASounting b 2 .*