Insurance Entities Expert Panel

Highlights of the December 16-17, 2015, Meeting

The Insurance Entities Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the insurance industry to deliberate and come to agreement on key issues.

The Insurance Expert Panel met on December 16, 2015 at the DC offices of KPMG for an Expert Panel meeting, and the morning of December 17 at the SEC offices.

The Expert Panel discussed the following topics:

1. **ASU 2015-09 Implementation Issues:** The Expert Panel had initial discussions on the following issues related to the implementation of ASU 2015-09:
    a. **Opinion language – GAAS & PCAOB**
    b. **Illustrative disclosures**
    c. **Claim counts/frequency**
    d. **Foreign exchange rates**
    e. **Acquisitions/dispositions**
    f. **Other entities that may apply the guidance**

    The Expert Panel plans to continue discussing potential ASU 2015-09 implementation issues, and develop illustrative disclosures and opinion language to be included in the AICPA Insurance Audit and Accounting Guides.

2. **Statutory Practice Issues:**
    a. **ASU 2015-09 Disclosures in Statutory Financial Statements –** As part of the process of determining any potential modifications to Statements of Statutory Accounting Principles (SSAPs) due to newly issued GAAP accounting standards updates, the NAIC will review the disclosures in ASU 2015-09 to determine applicability.

        As explained in the AICPA Insurance Audit and Accounting Guides[1], the provisions of the NAIC manual preamble that state, "GAAP pronouncements do not become part of

[1] Exhibit 3-1, *Evaluation of the Appropriateness of Informative Disclosures in Insurance Entities' Financial Statements Prepared on a Statutory Basis*, of the AICPA Audit and Accounting Guide: *Life and Health Insurance Entities*, and Exhibit 1-1, *Evaluation of the Appropriateness of Informative Disclosures in Insurance*

Statutory Accounting Principles until and unless adopted by the NAIC," or any other explicit rejection of a GAAP disclosure does not negate the requirements of paragraph .17 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

Thus if the NAIC rejects the disclosures in ASU 2015-09, the auditor still needs to consider the requirements of AU-C section 800.17. However, the auditor would not need to apply section AU-C 800.17 to any required supplementary information (RSI) because this section addresses the need for disclosures in order for the basic financial statements to achieve fair presentation. AU-C 730, *Required Supplementary Information*, explains that the auditor's opinion on the basic financial statements does not cover RSI and by definition RSI is not part of the basic financial statements. Since RSI is not necessary for fair presentation of the basic financial statements, RSI would not be necessary to be included in statutory financial statements for fair presentation.

b. NAIC AICPA Working Group – As part of the NAIC's initiative to eliminate any groups that do not meet frequently, the AICPA NAIC Task Force (Task Force) was asked if it would oppose the elimination of the NAIC AICPA Working Group (WG). The Task Force responded to the NAIC that it feels strongly that the NAIC AICPA WG is essential in serving as the sounding board to address the implications of potential statutory audit requirements and audit related inquires by the insurance regulators, and should remain intact but can function via conference calls.

3. Revenue Recognition – During 2015, the Insurance Revenue Recognition Task Force (task force) submitted two questions on scope to the FASB IASB Transition Resource Group (TRG): i) What guidance should investment contracts within the scope of ASC 944 follow, and ii) Interaction of contracts accounted for under ASC 944 and the guidance in ASC 606-10-15-2 and 15-4.

The TRG did not address either question, but the task force has had several discussions with the FASB Staff.

It is expected that the question of whether investment contracts within the scope of ASC 944 should be included in the scope exemption in ASC 606-10-15-2(b) will be addressed in the upcoming FASB Technical Corrections Exposure Draft.

In response to discussions with the FASB Staff, the task force has submitted to the AICPA Revenue Recognition Working Group an implementation issue related to how contracts accounted for under ASC 944 should apply the scope exemption guidance in ASC 606-10-15-2 and 15-4. After clearance by the Revenue Recognition Working Group and FinREC, a draft revenue recognition implementation issue will be exposed for informal comment later in 2016.

Additional information on the Insurance Revenue Recognition Task Force can be found at: http://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/RevenueRecognition/Pages/RRTF-Insurance.aspx

During the meeting on December 17, 2015, the SEC staff discussed the following topics of interest with the Expert Panel:

1. **Disclosure Observations: Common Comments on Filing Reviews** –

Entities' Financial Statements Prepared on a Statutory Basis, of the AICPA Audit and Accounting Guide: *Property and Liability Insurance Entities*.

a. **Fair Value**: The SEC Staff's comments mainly focused on recommended improvements to fair value disclosures to help users assess the valuation techniques and inputs for determining fair value. It was mentioned that the SEC had recently solidified its positions on what fair value disclosures should be provided, and advised that registrants should not rely on past comment letter responses on this topic.

The SEC Staff reminded registrants to consider the following (FASB ASC 820-10-50-1A) when determining if the fair value disclosure requirements of FASB ASC 820-10-50-1 have been met:

a. The level of detail necessary to satisfy the disclosure requirements

b. How much emphasis to place on each of the various requirements

c. How much aggregation or disaggregation to undertake

d. Whether users of financial statements need additional information to evaluate the quantitative information disclosed.

The Staff provided several examples of fair value disclosures that would not be adequate:

i. Aggregation of several types of debt securities in a single class – the Staff explained that only securities with the same characteristics and level of fair value hierarchy should be aggregated. It is also assumed that securities with different fair value inputs would be aggregated into different classes, such as agency and nonagency asset backed securities.
ii. Disclosure of valuation approach only – the Staff noted that an explanation of the specific valuation method used should be disclosed.
iii. Disclose that valuation technique was a third party – the Staff explained that the valuation technique used by the third party should be disclosed, not just that it was performed by a third party.
iv. Aggregation of all the valuation techniques and inputs that may be used for a class – the Staff explained that the disclosure should clearly indicate what inputs are used for each valuation technique, and which classes use which specific technique and inputs. The Staff further noted that it is not appropriate to include valuation techniques that are not currently being used in the periods presented.

The SEC Staff also noted that recent insurance industry areas of comments include the following areas:

b. **Changes in loss Reserves**
c. **Minimum requirements related to statutory capital and surplus**
d. **Dividend restrictions**
e. **Impact of low interest rate environment**

2. **Accounting Issues**
   a. **ASU 2015-09, Disclosures about Short-Duration Contracts:** The Expert Panel provided the SEC with observations on the following aspects of ASU 2015-09:
      i. Implementation issues
      ii. Interaction with SEC Guide 6 disclosures
   b. **ASU 2014-09, Revenue from Contracts with Customer:** The Expert Panel provided the SEC with an overview of the potential impacts of the new revenue recognition standard to insurance entities.
   c. **Premium deficiency - profits followed by losses:**
   There have been questions regarding how to apply the guidance in FASB ASC 944-60-25-9 related to premium deficiency for situations with overall positive profit margin, but profits followed by losses.

   FASB ASC 944-60-25-9, states: "A premium deficiency, at a minimum, shall be recognized if the aggregate liability on an entire line of business is deficient. In some instances, the liability on a particular line of business may not be deficient in the aggregate, but circumstances may be such that profits would be recognized in early years and losses in later years. In those situations, the liability shall be increased by an amount necessary to offset losses that would be recognized in later years."

The SEC Staff noted that for traditional contracts with locked in assumptions, depending on facts and circumstances, it would not object to a company in a profits followed by losses situation either:

1) Accruing a liability, during the period of gains, to offset the losses using a dynamic method updated over time (when updating calculations if profits followed by losses no longer exists, the liability could be released over time). Registrants should discuss the specifics of each transaction with the SEC Staff, as the Staff may not accept all approaches for accruing the liability over time. OR

2) Accruing an immediate liability to offset the present value of losses that would be recognized in later years (this would be considered a locked calculation not subject to reversal).

The SEC Staff noted that it would expect companies to apply a consistent accounting policy for profits followed by losses.

The SEC Staff explained that internal controls over financial reporting are required to identify contracts in profits followed by losses situations. The Staff also noted that the related disclosures should explain how the calculations will be handled if the liability is accrued over time, and entities should consider if this information should be included in the management discussion and analysis disclosures for changing trends if this is expected in the future.

3. **FASB Projects:** The Expert Panel provided the SEC with an over view of the status of the following projects:
   a. **Insurance Contracts Project –** FASB's long-duration targeted improvements project.
   b. **Financial Instruments –** FASB's classification and measurement and impairment projects.