Insurance Entities Expert Panel

Highlights of the December 7-8, 2016, Meetings

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 the afternoon of December 7 and morning of December 8, 2016 for an Expert Panel meeting, and the afternoon of December 8 with the SEC Staff (the Staff) at the SEC offices.

The Expert Panel discussed the following topics:

1. **ASU 2015-09 Implementation Issues:** During 2016, the Expert Panel and members of the Staff had several discussions about the new disclosures of cumulative incurred and paid claim information in the claims development tables required in FASB ASU 2015-09: Disclosures about Short-Duration Contracts, (FASB ASC 944-40-50-4B through 50-4D), related to the presentation of acquisitions, dispositions and the effects of foreign currency.

   Below is the link to the Insurance Expert Panel webpage for highlights of calls held on November 1 & 17, 2016 with observations from the Staff: http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/DownloadableDocuments/INS/INS_EP_Minutes/2016/INS_EP_November_2016_Meeting.pdf

   The Expert Panel continued discussion on the following issues related to the implementation of ASU 2015-09:
   a. Opinion language – GAAS & PCAOB
   b. Illustrative disclosures

   The Expert Panel plans to continue discussing potential ASU 2015-09 implementation issues, and develop 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 is in the process of reviewing the disclosures in FASB ASU 2015-09 to determine applicability.

      If the NAIC rejects the disclosures in ASU 2015-09, the auditor still needs to consider the requirements of AU-C section 800.17, Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks – Fair Presentation.

      As noted in AICPA Technical Questions and Answers Section 9180.01: Required Supplementary Information in Historical Prior Periods and Auditor Independence of the Entity:

Reply—Generally accepted auditing standards require the auditor to be independent for any period being audited and covered by the auditor's opinion. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover RSI. In accordance with AU-C section 730, RSI is not part of the basic financial statements. Furthermore, the specified procedures required to be performed on RSI are limited and do not provide the auditor with sufficient appropriate audit evidence to express an opinion or provide any assurance on the RSI.

Since RSI is not necessary for fair presentation of the basic financial statements, it would not be necessary for RSI to be included in audited statutory-basis financial statements for fair presentation.

The AICPA NAIC Task Force is working with the AICPA Auditing Standards Board to develop an audit interpretation to help auditors evaluate the requirements of AU-C Section 800 for application to statutory-basis financial statements.

b. **Principle-Based Reserving (PBR):** The Expert Panel had initial discussions on potential audit considerations related to the new PBR standards. Insurers can voluntarily adopt PBR for new business starting January 1, 2017 with full adoption required by January 1, 2020. Adoption is prospective and can be implemented on a product by product basis.

   It was decided that a subgroup (between the Expert Panel and AICPA NAIC Task Force) should be formed to discuss and develop audit considerations related to PBR that will be included in the AICPA Audit and Accounting insurance guides. The appointed subgroup will start discussions in the fall of 2017.

3. **Revenue Recognition:** During 2016, the AICPA Insurance Revenue Recognition Task Force (task force) continued to discuss questions related to application of the scope guidance in FASB ASC 606-10-15-2 and 15-4 to contracts sold by insurance entities and accounted for under FASB ASC 944.

   The task force has had several discussions with the FASB Staff and has submitted a revenue recognition implementation issue to the AICPA Revenue Recognition Working Group that incorporates the following information from the FASB Accounting Standards Update (ASU) 2016-20: *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*.

   BC13 – BC15 of FASB ASU 2016-20: Technical Corrections and Improvements to Topic 606, Revenue from Contracts from Customers, state:

   BC13. The amendment to paragraph 606-10-15-2(b) clarifies that all contracts (that is, not only insurance contracts) within the scope of Topic 944, Financial Services – Insurance, are excluded from the scope of Topic 606. This exclusion applies to contracts within the scope of Topic 944 such as life and health insurance, property and liability insurance, title insurance, and mortgage guarantee insurance. Topic 944 provides guidance on accounting and financial reporting for those contracts, including guidance that is applied to both insurance and investment contracts to determine the revenue recognition for fees. Investment contracts (defined in the Master Glossary as long-duration contracts that do not subject the insurance entity to risks arising from policyholder mortality or morbidity) are included within the scope of Topic 944. For example, Subtopic 944-825 provides guidance on the accounting for and the financial reporting of financial instruments, including guidance on investment contracts. Those contracts are accounted for under a deposit accounting model, similar to financial instrument contracts issued by entities other than insurance entities. As noted in paragraph 606-10-15-2(c), financial instruments issued by entities other than insurance entities also are excluded from the scope of Topic 606, and, therefore, this technical correction is consistent with the existing scope exceptions for insurance and financial instrument contracts.

   BC14. Contracts within the scope of Topic 944 are excluded from the scope of Topic 606. That scope exception applies to contracts within the scope of Topic 944 and does not apply to all contracts of insurance entities. An insurance entity might need to consider whether a contract with a customer is for goods or services that are not within the scope of Topic 944. For example, the Board understands that a contract for administrative services (such as claims processing) without any insurance element is at present accounted for as a revenue arrangement within the scope of Topic 605. The Board expects that those types of service arrangements would be accounted for under Topic 606.

   BC15. The Board has received questions about the interaction of the guidance in paragraph 606-10-15-2 and the guidance in paragraph 606-10-15-4. Some stakeholders questioned whether the guidance in paragraph 606-10-15-4 requires an insurance entity to bifurcate contracts (within the scope of Topic 944) into elements within the scope of Topic 944 and elements within the scope of Topic 606. The guidance in paragraph 606-10-

15-4 is applied *after* applying the guidance in paragraph 606-10-15-2. For example, if an entity reaches an appropriate conclusion that it has a contract entirely within the scope of Topic 944, then the entity would not apply the guidance in paragraph 606-10-15-4. This is because there are no elements of the contract within the scope of Topic 606 based on the entity's conclusion that the entire contract is included within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of contracts are within the scope of Topic 944 or Topic 605 currently. There could be other activities in the contract, such as insurance risk mitigation or cost containment activities that relate to costs to fulfill the contract within the scope of Topic 944. Those fulfillment activities would not be within the scope of Topic 606 and, instead, similar to current practice, would be considered part of the contract within the scope of Topic 944. This assessment is similar to how an insurance entity determines whether elements of a contract are within the scope of Topic 944 or Topic 605 today.

At the January 2017 FinREC meeting, the draft revenue recognition implementation issue was cleared for exposure and will be posted to the AICPA Insurance Revenue Recognition Task Force webpage on February 1, 2017 for a 60 day informal comment period.

The task force is also developing a revenue recognition implementation issue on extended warranty contracts issued by non-insurance entities. The issue will focus on the changes in accounting that result from moving from current guidance in FASB ASC 605, which is analogous to the accounting for short-duration insurance contracts under FASB ASC 944 with the exception of capitalizable DAC costs, to the new FASB ASC 606 model

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

On December 8, 2016 the Staff discussed the following topics of interest with the Expert Panel:

1. **Disclosure Observations:**
   a. **Non-GAAP Measures:**
      i. The Staff discussed several broad themes related to non-GAAP measures (not insurance company specific):
         1. **Prominence:** The Staff noted that companies should present the GAAP measure first in the required non-GAAP reconciliation (i.e., reconciling from GAAP to the non-GAAP measure) because (a) leading with the non-GAAP measure gives it undue prominence and (b) it will be more intuitive/easier for readers to determine what is being added or subtracted from the GAAP measure to arrive at the non-GAAP measure. The Staff also noted that if an unreasonable effort is needed to reconcile a forward-looking non-GAAP measure to a GAAP measure, then the reconciliation may be omitted pursuant to Item 10(e)(1)(i)(B) of Regulation S-K provided that the registrant discloses the reason(s) for its omission (e.g. unreasonable efforts) and identifies the information that is unavailable and its probable significance in a location of equal or greater prominence. The Staff also mentioned that discussion and analysis should be provided to describe changes in GAAP measures in a location with equal or greater prominence to the non-GAAP measure, and that a full non-GAAP income statement or its equivalent should not be disclosed under any circumstance. See the Division of Corporation Finance's Compliance & Disclosure Interpretation ("C&DI") 102.10.
         2. **Individually Tailored Accounting Principles**: The Staff explained that companies should use caution when presenting non-GAAP measures that use individually tailored accounting principles. It was also noted that in limited situations where companies make certain adjustments to revenue based on facts and circumstances (e.g., adjustments that reflect the expected effects of ASC 606), these adjustments should be discussed in advance with the staff. See C&DI 100.04
         3. **Per Share Measures:** The Staff noted that non-GAAP liquidity measures presented on a per share basis are prohibited. C&DI 102.05 notes that whether a non-GAAP per share measure is prohibited depends on whether the measure "can" be used as a liquidity measure , even if management presents it solely as a performance measure. When analyzing these questions, the Staff will focus on the substance of the non-GAAP measure and not management's characterization of the measure. See C&DI 102.05
         4. **Income Taxes**: The Staff explained that companies are required to display tax impacts for non-GAAP measures, but that the presentation should be on a gross basis, with the tax effects shown separately. The effective tax rate(s) applied to the adjustments should be a rate appropriate for the circumstances; i.e., the rate should make sense in the context of the non-GAAP income rather than using the effective

rate applicable to the reported GAAP income. See the Division of Corporation Finance's Compliance & Disclosure Interpretation ("C&DI") 102.11.

5. **Misleading Measures** – The Staff highlighted C&DI 100.01 and its discussion about measures that exclude recurring cash operating expenses.

ii. The Staff discussed the following insurance-specific themes related to non-GAAP measures:

1. **Labeling**: While no specific comment letters have been issued by the Staff to-date, they expressed broad concern to the Expert Panel over labeling non-GAAP measures with similar titles as GAAP measures. Specifically the Staff noted that "operating income", "operating earnings" or related terms that include the word "operating", are used by many insurers to describe non-GAAP performance measures and that media outlets and newswires often quote these measures from companies' press releases and other filings without mentioning the comparable GAAP measures. As such, the Staff indicated their concern with insurers continuing to use the term "operating" to label their primary non-GAAP measure, given the similarity of this term used in GAAP measures. The Staff is expecting all companies that have this type of label for their non-GAAP measure to change this label in their press releases and filings such that when these non-GAAP measures are quoted in newswires and other media outlets that they cannot be confused with a defined GAAP measure. The Staff did not give a timeframe for when it expects registrants to make this change, nor did they indicate what may be an acceptable label, other than indicating that insertion of the phrase "non-GAAP" or "adjusted" before the word "operating" would be possible approaches to consider if the term "operating" continued to be used. The Staff noted that it has seen instances within filings where the same label is used to represent different amounts throughout the filing and does not think this practice is appropriate.
2. **Catastrophe (CAT) Losses**: The Staff indicated that they were unclear why some companies present non-GAAP earnings measure(s) that exclude insurance CAT losses, and would benefit from insight as to why the exclusion is viewed as appropriate under Regulation G, Regulation S-K and the Staff's C&DIs and consistent with the underlying business of providing insurance coverage, in which CAT losses are typically normal, recurring cash operating expenses.. The Staff acknowledged that their comment was not aimed at the practice of separately quantifying and analyzing CAT losses when explaining earning trends, such as in Management's Discussion and Analysis.

b. **Common Comments on Filing Reviews** –

i. **Fair Value**: In the prior year the Staff discussed observations with respect to fair value disclosures. See the link below to the December 2015 Insurance Expert Panel meeting minutes:
http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/DownloadableDocuments/INS/INS_EP_Minutes/2015/INS_EP_December_2015_Meeting.pdf

Their objective is to help users assess the valuation techniques and inputs for determining fair value. In this regard, the Staff continued to observe instances of disclosures in the current year that:

1. Included the overall valuation approach without describing the specific valuation technique;
2. Were incomplete or vague as to the specific valuation technique;
3. Omitted a description of the inputs used for the valuation technique; and/or
4. Were not made by class.

The Staff also pointed out that FASB ASU 2016-19 *Technical Corrections and Improvements* reaffirms that disclosing a valuation approach does not satisfy the requirement to describe a specific valuation technique. Because the ASU may trigger a need for revised or incremental disclosure about specific valuation techniques, the Staff wanted to highlight valuation technique disclosures again this year so that disclosures comply with the ASU no later than its effective date.

ii. **Change in Loss Reserves**: The Staff mentioned that it continues to look for improved disclosures in MD&A on significant changes in estimates and the underlying causes of changes to loss reserves. Useful disclosures should include descriptions and quantification explaining the various underlying causes of the changes at a disaggregated level. For example, if qualitative disclosures cited four factors for a net reserve change, each should be separately quantified.

iii. **Accounting Policy Disclosures**:

1. Deferred Acquisition Costs (DAC) Capitalization: The Staff noted that companies should ensure it is clear from their accounting policy disclosure that capitalized acquisition costs are "directly related" to the "successful" acquisition of new or renewal insurance contracts.
2. DAC – Contract Modifications: The Staff also observed that companies should disclose their accounting policy for internal replacements and the impact on DAC in connection with contract modifications, under FASB ASC 944-30-35 and 30-40 (i.e., whether certain modifications would result in a substantially unchanged or changed contract).

iv. Comment Process – The Staff reiterated that comments are an invitation to dialogue and not necessarily a request to revise disclosure.

2. **Accounting Issues**

   a. ASU 2014-09, Revenue from Contracts with Customer: The Expert Panel provided the Staff with an overview of the potential impacts of the new revenue recognition standard to insurance entities, and revenue recognition implementation issues that the AICPA Insurance Revenue Recognition Task Force is in the process of evaluating.

3. FASB Projects: The Expert Panel provided the Staff with an overview of the following FASB Proposed Accounting Standards Updates, including key observations and concerns raised in the AICPA's comment letters to the FASB, which can be found on the FASB website (www.fasb.org):

   a. Financial Services – Insurance (Topic 944) Targeted Improvements to the Accounting for Long-Duration Contracts

   b. Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedging Activities