



**Revisions to Chapter 3: *Sources of Accounting Principles and Reporting Requirements*, of
the AICPA Audit and Accounting Guide Life and Health Insurance Entities.**

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Chapter 3

Sources of Accounting Principles and Reporting Requirements

Boldface italic denotes new language. Deleted text is in strikethrough.

[No revision to paragraphs to paragraphs 3.01–3.20.]

Disclosure Issues

- 3.21** Financial statements prepared in accordance with a regulatory basis of accounting should include all informative disclosures that are appropriate for the basis of accounting used. That includes a summary of significant accounting policies that discusses the basis of presentation and describes how that basis differs from GAAP. As noted in the preamble of the NAIC manual, paragraph 62 states that
- to the extent that disclosures required by an SSAP are made within specific notes, schedules, or exhibits to the annual statement, those disclosures are not required to be duplicated in a separate note. Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (for example, annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer. Certain disclosures, as noted in individual SSAPs, are required in the annual audited statutory financial statements only.
- Paragraphs 6–7 of SSAP No. 1, Accounting Policies, Risk and Uncertainties, and Other Disclosures, require disclosure of the accounting policies used in the initial note to financial statements and of any prescribed or permitted accounting practices that differ from the manual and their impact on net income and statutory surplus. Additionally, a reference to that note shall be included in the individual notes to financial statements impacted by the prescribed or permitted practices as applicable.
- Additionally, paragraph 27 of the Preamble of the NAIC manual states that GAAP pronouncements do not become part of Statutory Accounting Principles until and unless adopted by the NAIC. However, provisions of the manual or any other explicit rejection of a GAAP disclosure do not negate the requirements of paragraph .17 of AU-C section 800. For further information, see exhibit 3-1, "Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis." The interpretation provides guidance in evaluating whether informative disclosures are reasonably adequate for financial statements prepared on a statutory basis.
- 3.21** *The NAIC Accounting Practices & Procedures Manual (AP&P Manual) establishes comprehensive guidance that addresses the accounting and disclosure requirements for the insurance statutory basis of accounting, which integrates the framework established by GAAP with objectives exclusive to statutory accounting. Paragraph 53 of the preamble of the NAIC AP&P Manual states that*

GAAP guidance that is not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt GAAP guidance to be included in statutory accounting. Elements of the FASB Codification do not become part of SAP⁶ until and unless adopted by the NAIC. Future SAP pronouncements will specifically identify any element of the FASB Codification that is to be included in SAP whether in whole, in part, or with modification as well as any rejected GAAP guidance. GAAP guidance which the NAIC has not addressed shall not be considered as providing authoritative guidance for reporting under the insurance statutory basis of accounting.

3.22 *Paragraph 62 of the preamble of the NAIC AP&P Manual further states that*

Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (e.g., annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer.

3.23 *To codify and maintain the insurance statutory basis of accounting, including related disclosures, an evaluation of GAAP accounting and disclosure guidance is performed to determine if the GAAP guidance is applicable and should be included in this basis. The NAIC established and appointed the Statutory Accounting Principles Working Group (SAPWG) with the responsibility of developing and proposing new Statements of Statutory Accounting Principles (SSAPs) and amendments to adopted SSAPs. SAPWG has a documented SAP Maintenance Process and is responsible for developing and adopting substantive, nonsubstantive and interpretation revisions to the AP&P Manual. This includes the review of all new or revised accounting and disclosure guidance in the GAAP Hierarchy to determine whether the guidance is applicable to the insurance statutory basis of accounting. The AP&P Manual provides the basis for insurers to prepare financial statements for financial regulation purposes. If the guidance is deemed applicable to insurance entities, SAPWG develops proposed guidance that is exposed for public comment via its national and interim meetings and on the NAIC website, similar to the exposure process for new GAAP guidance. After exposure, the NAIC publicly discusses comments received to finalize changes to existing SSAPs or new SSAPs. The process is deliberative and many issues go through more than one comment period. The NAIC also maintains a list of the conclusions of SAPWG, and the status of GAAP guidance currently being considered.*

3.24 *The insurance statutory basis of accounting is a regulatory basis of accounting,⁷ which is considered a special purpose framework. AU-C section 800, Special Considerations—Audits of Financial State-*

⁶ SAP is described in the NAIC AP&P Manual as the statutory accounting principles (i.e., the insurance statutory basis of accounting).

⁷ AU-C section 800 defines the regulatory basis of accounting as a basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).

ments Prepared in Accordance With Special Purpose Frameworks (AICPA, Professional Standards), addresses special considerations in the application of the auditing standards to an audit of financial statements prepared in accordance with a special purpose framework (e.g., regulatory basis of accounting).

- 3.25 *AU-C section 800 indicates that financial statements prepared in accordance with a special purpose framework, including a regulatory basis of accounting, should include all informative disclosures that are appropriate for the basis of accounting used. Paragraph .15 of AU-C section 800 indicates that the auditor should evaluate, among other things, whether the financial statements prepared in accordance with a regulatory basis of accounting include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified.*
- 3.26 *Paragraph .17 of AU-C section 800 states that*
- Section 700 requires the auditor to evaluate whether the financial statements achieve fair presentation. In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.*
- 3.27 *In applying the requirement in paragraph .17 of AU-C section 800 to financial statements prepared on the insurance statutory basis of accounting, factors for the auditor to consider include (a) the overall presentation, structure, and content of the financial statements and (b) whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.*
- 3.28 *Paragraph .A7 of AU-C section 800 notes that the financial reporting standards established by an organization that is recognized to promulgate standards for special purpose financial statements, will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. For the insurance statutory basis of accounting, the NAIC establishes financial reporting provisions to meet the requirements of insurance regulators, industry and users of financial statements, and states adopt these provisions as their regulatory basis of accounting. The NAIC follows a deliberative and comprehensive process for considering new disclosures, including those required by GAAP.*
- 3.29 *Accordingly, GAAP disclosure requirements that have been rejected by the NAIC in whole or in part would not need to be evaluated by the auditor in order to determine whether the annual audited statutory financial statements achieve fair presentation in accordance with the insurance statutory basis of accounting. However, if the NAIC has not finalized action on GAAP disclosure requirements, an auditor would need to assess whether informative disclosure in the annual audited statement financial statements would be needed to achieve fair presentation in accordance with paragraph .17 of AU-C*

section 800. This assessment would occur when the entity is required to adopt the new standard for GAAP.

3.30 *In accordance with AU-C section 730, Required Supplementary Information (AICPA, Professional Standards), required supplementary information (RSI) is not part of the basic financial statements and the auditor's opinion on the basic financial statements does not cover RSI. The auditor does not need to apply AU-C section 800 to RSI, because AU-C section 800 addresses the need for disclosure of financial information in order for the basic financial statements to achieve fair presentation and RSI by definition is not part of the basic financial statements.*

[Subsequent paragraphs and footnotes renumbered.]

Exhibit 3-1

Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis

Question. ~~Insurance entities issue financial statements prepared in accordance with accounting practices prescribed or permitted by insurance regulators (a *statutory basis*) in addition to, or instead of, financial statements prepared in accordance with generally accepted accounting principles (GAAP). All states have adopted the National Association of Insurance Commissioners' (NAIC's) *Accounting Practices and Procedures Manual* as the primary basis of prescribed statutory accounting principles (SAP). The *Accounting Practices and Procedures Manual*, as revised by NAIC's codification project along with any subsequent revisions, is referred to as the manual. The manual contains extensive disclosure requirements appropriate for the statutory basis of accounting.~~

How should auditors evaluate whether informative disclosures in financial statements prepared on a statutory basis are appropriate?

Interpretation. ~~[Paragraph .07](#) of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), states that financial statements prepared on a statutory basis (regulatory basis) are considered special purpose financial statements (prepared in accordance with a special purpose framework).~~

~~[Paragraph .17](#) of AU-C section 800 states the following:~~

~~[Section 700A](#) requires the auditor to evaluate whether the financial statements achieve fair presentation. In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.~~

The provisions of the manual preamble that state, "GAAP pronouncements do not become part of Statutory Accounting Principles until and unless adopted by the NAIC," or any other explicit rejection of a generally accepted accounting principles disclosure does not negate the requirements of [paragraph .17](#) of AU-C section 800.

Question. What types of items or matters might be considered by auditors when evaluating whether informative disclosures similar to those required by GAAP are reasonably adequate?

Interpretation. [Paragraph .11](#) of AU-C section 800 states the following:

[Section 210](#) requires the auditor to establish whether the preconditions for an audit are present. In an audit of special purpose financial statements, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including

- a.* a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.
- b.* informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.
- c.* a description of any significant interpretations of the contract on which the special purpose financial statements are based, in the case of special purpose financial statements prepared in accordance with a contractual basis of accounting.
- d.* additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation.

Question. How does the auditor evaluate whether "informative disclosures similar to those required by GAAP" are appropriate for

- a.* items and transactions that are accounted for essentially the same or in a similar manner under a statutory basis as under GAAP?
- b.* items and transactions that are accounted for differently under a statutory basis than under GAAP?
- c.* items and transactions that are accounted for differently under requirements of the state of domicile than under the manual?

Interpretation. Disclosures in statutory basis financial statements for items and transactions that are accounted for essentially the same or in a similar manner under the statutory basis as under GAAP should be the same as, or similar to, the disclosures required by GAAP unless the manual specifically states the NAIC codification rejected the GAAP disclosures. The provisions of the manual preamble that state,

~~"GAAP pronouncements do not become part of 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.~~

~~Disclosures should also include those required by the manual.~~

~~Disclosures in statutory basis financial statements for items or transactions that are accounted for differently under the statutory basis than under GAAP, but in accordance with the manual, should be the disclosures required by the manual.~~

~~If the accounting required by the state of domicile for an item or transaction differs from the accounting set forth in the manual for that item or transaction, but it is in accordance with GAAP or superseded GAAP, the disclosures in statutory basis financial statements for that item or transaction should be the applicable GAAP disclosures for the GAAP or superseded GAAP. If the accounting required by the state of domicile for an item or transaction differs from the accounting set forth in the manual, GAAP or superseded GAAP, sufficient relevant disclosures should be made.~~

~~Informative disclosures similar to those required by GAAP include disclosures related to matters that are not specifically identified on the face of the financial statements, such as (a) related party transactions, (b) restrictions on assets and owners' equity, (c) subsequent events, and (d) uncertainties. Other matters could be disclosed if such disclosures are necessary to keep the financial statements from being misleading.~~

[No further revisions to chapter 3.]