Issue #13: Impact of FASB ASU 2018-12 on Shadow Accounting

Wording to be Included in the Audit and Accounting Guide: Life and Health Insurance Entities

1. As a result of inquiries and comments by SEC registrants and their auditors, the SEC staff made an announcement regarding the effects of FASB ASC 320-10 on certain assets and liabilities. FASB staff believes that both public and nonpublic entities should comply with the guidance in this announcement. FASB ASC 320-10 provides guidance on the reporting of unrealized gains or losses. The text of this SEC Staff Announcement, Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of Subtopic 320-10, is as follows and is also located at FASB ASC 320-10-S99-2 for reference.

- The SEC staff has been asked whether certain assets and liabilities, such as noncontrolling interests, certain life insurance policyholder liabilities, deferred acquisition costs, and intangible assets arising from insurance contracts acquired in business combinations, should be adjusted with a corresponding adjustment to other comprehensive income at the same time unrealized holding gains and losses from securities classified as available-for-sale are recognized in other comprehensive income. That is, should the carrying value of these assets and liabilities be adjusted to the amount that would have been reported had unrealized gains and losses been realized?

- Paragraph 740-20-45-11(b) addresses specifically the classification of the deferred tax effects of unrealized holding gains and losses reported in other comprehensive income. Paragraph 740-20-45-11(b) requires that the tax effects of those gains and losses be reported as charges or credits directly to other comprehensive income. That is, the recognition of unrealized holding gains and losses in equity may create temporary differences for which deferred taxes would be recognized, the effect of which would be reported in accumulated other comprehensive income along with the related unrealized holding gains and losses. Therefore, deferred tax assets and liabilities are required to be recognized for the temporary differences relating to unrealized holding gains and losses as though those gains and losses actually had been realized, except the corresponding charges or credits are reported in other comprehensive income rather than as charges or credits to income in the statement of income.

- By analogy to paragraph 740-20-45-11(b), the SEC staff believes that, in addition to adjusting deferred tax assets and liabilities, registrants should adjust other assets and liabilities that would have been adjusted if the unrealized holding gains and losses from securities classified as available-for-sale actually had been realized. That is, to the extent that unrealized holding gains or losses from securities classified as available-
for-sale would result in adjustments of noncontrolling interest, policyholder liabilities, deferred acquisition costs that are amortized using the gross-profits method, or intangible assets arising from insurance contracts acquired in business combinations that are amortized using the gross-profits method had those gains or losses actually been realized, the SEC staff believes that those balance sheet amounts should be adjusted with corresponding credits or charges reported directly to other comprehensive income. As a practical matter, the staff, at this time, would not extend those adjustments to other accounts such as liabilities for compensation to employees. The adjustments to asset accounts should be accomplished by way of valuation allowances that would be adjusted at subsequent balance sheet dates.

- For example, certain policyholder liabilities should be adjusted to the extent that liabilities exist for insurance policies that, by contract, credit or charge the policyholders for either a portion or all of the realized gains or losses of specific securities classified as available-for-sale. Further, asset amounts that are amortized using the gross-profits method, such as deferred acquisition costs accounted for under paragraphs 944-30-35-4 and 944-30-35-11 and certain intangible assets arising from insurance contracts acquired in business combinations, should be adjusted to reflect the effects that would have been recognized had the unrealized holding gains and losses actually been realized. Further, capitalized acquisition costs associated with insurance contracts covered by paragraphs 944-30-35-1 through 35-3A and 944-30-35-17 should not be adjusted for an unrealized holding gain or loss unless a “premium deficiency” would have resulted had the gain or loss actually been realized.

- This announcement should not affect reported net income. It addresses only the adjustment of certain assets and liabilities and the reporting of unrealized holding gains and losses from securities classified as available-for-sale.

2. The following is a list of some changes to the applicability of FASB ASC 320-10-S99-2 as a result of the accounting guidance included in FASB ASU 2018-12:

a. DAC Amortization - As explained in FASB ASC 944-30-35-3A, the amortization of deferred acquisition costs (and certain other balances amortized like deferred acquisition costs either as required in ASC Topic 944 or as a result of an accounting policy election) is no longer a function of revenue or profit emergence under FASB ASU 2018-12. As such, upon adoption of ASU 2018-12, FinREC believes that the guidance within FASB ASC 320-10-S99-2 is:
   i. not applicable for deferred acquisition costs or other balances for which amortization does not consider anticipated income from the realization of gains and losses and anticipated investment income relating to securities classified as available for sale.
   ii. still applicable for balances that are amortized considering anticipated income from the realization of gains and losses and anticipated investment income relating to securities classified as available for sale.

b. Premium Deficiency (Loss Recognition) – FASB ASU 2018-12 removes the requirement for premium deficiency (or loss recognition) testing for traditional and limited-payment contracts, except for intangible assets arising from insurance contracts acquired in business combinations. Therefore, upon adoption of ASU 2018-12, FinREC believes the guidance in FASB ASC 320-10-S99-2 related to premium deficiency and loss recognition testing is not applicable to traditional and limited-payment contracts, other than for intangible assets arising from insurance contracts acquired in business combinations when loss recognition testing considers anticipated investment income.

Comments should be received by July 17, 2020, and sent by electronic mail to Kim Kushmerick at kim.kushmerick@aicpa-cima.com, or you can send them by mail to attention: Kim Kushmerick, 1345 Avenue of the Americas, New York, N.Y., 10105.