



SOCIETY OF ACTUARIES

**International Financial Reporting for Insurers: IFRS
and U.S. GAAP
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**Session 2: Introduction to US GAAP (Basic
Accounting/Expenses)**

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Introduction to US GAAP Product Classification and Expense Deferral

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Product Classification

- US GAAP accounting rules are different for different types of products
- **Product classification** is the first step in deciding how to account for any product.
- A **decision tree** can be used to classify products

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Product Classification

- Life Insurance or investment contract?
- For life insurance contracts, long duration or short duration?
- For long duration life insurance contracts, “traditional”, “universal life-type” or participating contract where dividends are distributed according to the “contribution principle”

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Product Classification

- Does the contract have **significant** mortality or morbidity risk?
 - Refer to FAS 97 and SOP 03-1
- No – Classify as investment contract.
Accounted for under FAS 97
- Yes – Classify as a life insurance contract

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Product Classification

- Is the life insurance contract short duration?
- Yes – Use FAS 60 short duration accounting
- No – Is the contract a participating contract where dividends are determined using the “contribution principle”?
- Yes – Must use FAS 120 if a mutual company (or stock sub). Can elect to use FAS 120 if a stock company

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Product Classification

- If the life long duration life insurance contract is not to be accounted for under FAS 120, is it a “universal life-type” contract, i.e. are any of the following true
 - Charges assessed against the policyholder are not fixed and guaranteed, or
 - Amounts credited to the policyholder are not fixed and guaranteed, or
 - Premium amount and timing may be varied without the consent of the insurer
- Yes – use FAS 97 “universal life-type” accounting rules.

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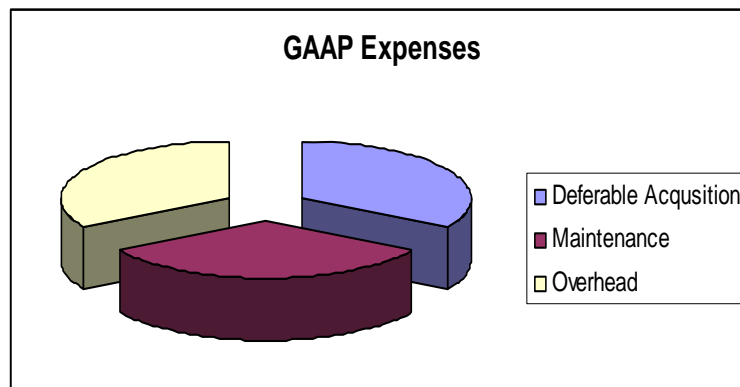
Product Classification

- If the contract is not a “universal life-type” contract – use FAS 60 long duration accounting rules.
 - As modified by FAS 97 for limited-payment policies, i.e. ones where the premium payment period is shorter than the benefit period.

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GAAP Expenses



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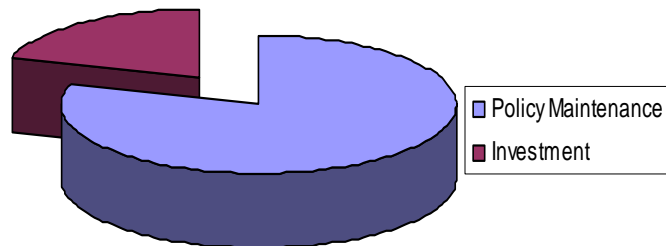
Deferrable Acquisition Costs

- **Related** to Production of New Business
- **Vary** with New Business Production

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Maintenance Costs



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Overhead

All Other Expenses

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Deferrable Acquisition Costs

- Commissions (Excess over renewal)
- Underwriting Expense
- Policy Issue Expense
- Medical Examination Expense
- Direct Mail Solicitation
- Production / Persistency Bonus

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Non Deferrable Acquisition Expenses

- General Advertising
- Agent Training Allowance
- Product Development Expense
- Agent Recruitment Expense
- Market Research

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GAAP Expense Use

- **Deferrable Acquisition** – Capitalized in DAC
- **Maintenance** – Included in Reserve (FAS 60) or DAC amortization (FAS 97, 120)
- **Investment** – Reduces Yield (DAC amortization)

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