



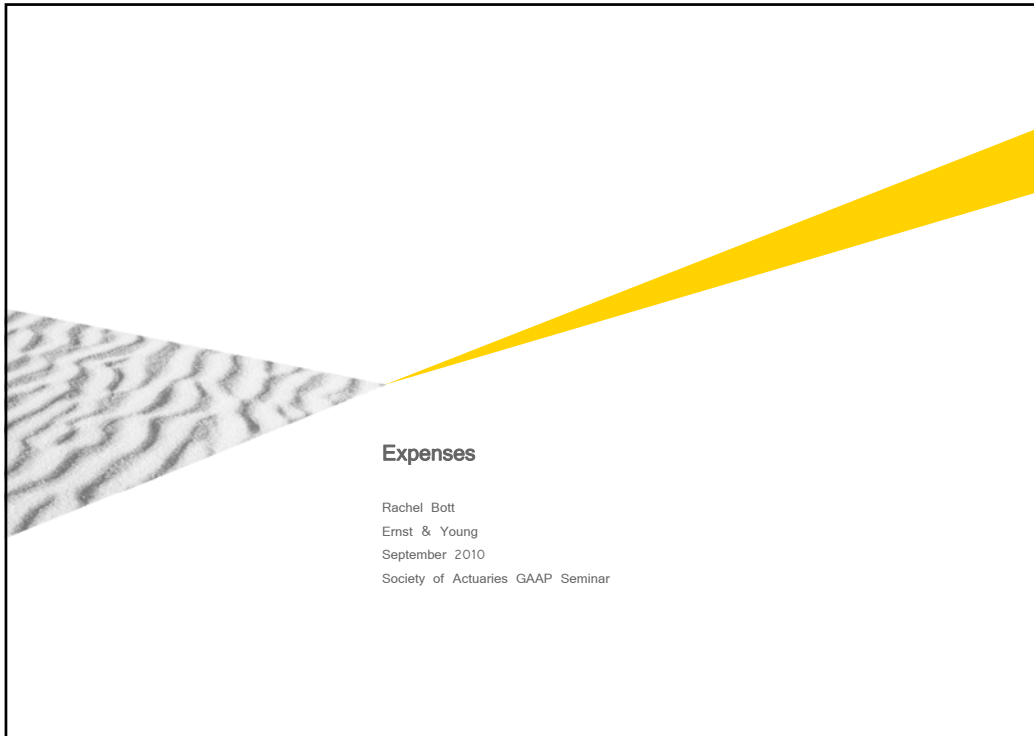
SOCIETY OF ACTUARIES

U.S. GAAP & IFRS: Today and Tomorrow
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Expenses Under GAAP

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Topics

- ▶ Types of expenses
- ▶ Accounting for expenses
- ▶ Financial statement impacts
- ▶ Implementation

Expense Categories

Deferrable acquisition costs	Asset on balance sheet Amortize through income
Non-deferrable acquisition and indirect costs	Expense/charge to income
Policy-related/maintenance costs	Expense through actuarial models (EGPs)

Acquisition costs – Definition

“Costs that are directly related to the successful acquisition of new or renewal insurance contracts.” (ASC 944-30-20)

- ▶ Proposed definition (likely adopted in September 2010)
- ▶ Key concepts:
 - ▶ Successful acquisition
 - ▶ Incremental direct costs of contract acquisition
- ▶ Prior definition: “Costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts.”
 - ▶ Diversity in practice
 - ▶ Unclear terms: “vary with” and “primarily related to”

Deferrable Acquisition Costs- Examples

- ▶ Incremental direct costs incurred with independent third parties related to contracts actually acquired
 - ▶ Commissions
 - ▶ Medical and inspection fees
- ▶ Portion of employee's total compensation for "acquisition activities" related to contracts actually acquired
 - ▶ Underwriting
 - ▶ Policy issuance and processing
 - ▶ Medical and inspection
 - ▶ Sales force contract selling
- ▶ Other costs related to contracts actually acquired
 - ▶ Reimbursement of costs related to acquisition activities
 - ▶ E.g., employee travel, mileage, long-distance phone calls
- ▶ Advertising costs that meet the criteria for direct response advertising (ASC 340-20-25-4)

Deferrable Acquisition - Accounting

- ▶ Captured initially as expense
- ▶ Deferred through entry- "capitalized expenses"
- ▶ Net deferred costs asset on balance sheet

Dr. Commissions expense (p/l)	100
Cr. Cash (b/s)	(100)
Dr. Deferred acquisition costs (b/s)	98
Cr. Capitalized expenses (p/l)	(98)

Deferrable Acquisition - Accounting

Financial Statement Summary

Assets:

▶ DAC	98
▶ Cash	(100)

Liabilities 0

Equity (2)

Income statement:

▶ Expenses	2
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Non-deferrable acquisition and indirect costs

- ▶ Solicitation
- ▶ Market research
- ▶ Training
- ▶ Administration
- ▶ Unsuccessful efforts
- ▶ Product development
- ▶ Indirect costs
 - ▶ Administrative costs
 - ▶ Rent
 - ▶ Depreciation
 - ▶ Occupancy costs
 - ▶ Equipment costs
 - ▶ Other general overhead

Non-deferrable acquisition costs - Accounting

- ▶ Captured as expense in ledger
- ▶ "Period Cost"- goes directly to p/l

DR. Product development expense	20
CR. Cash	(20)

Indirect costs - Accounting

- ▶ Captured as expense in ledger
- ▶ "Period Cost"- goes directly to p/l
- ▶ Not included in actuarial DAC model

DR. Rent expense	10
CR. Cash	(10)

Summary financial statements

Balance Sheet		Income Statement	
Assets		Expenses	
DAC	98	Commissions	100
Cash	<u>(130)</u>	Product development	20
Net Assets	(32)	Rent expense	10
		Capitalized expenses	<u>(98)</u>
Equity		Net expense	32
Net deficit	<u>32</u>		

Implementation

- ▶ Cost classification policy
- ▶ Capture costs by products, cohorts, lines of business
- ▶ Minimum of annual review for changes
 - Assess cost-volume relationships
 - Review general ledger accounts
- ▶ Reset policy and capture process if necessary