



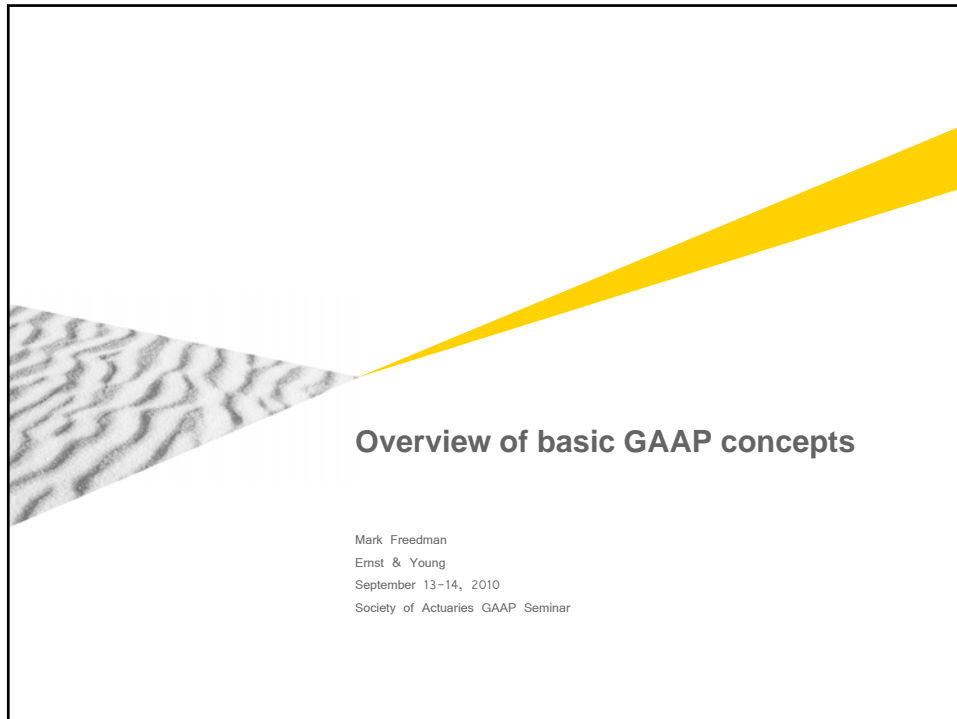
SOCIETY OF ACTUARIES

**U.S. GAAP & IFRS: Today and Tomorrow**  
**Sept. 13-14, 2010**

**New York**

**Overview of Basic GAAP**

[Mark Freedman](#)



## Overview of basic GAAP concepts

Mark Freedman  
Ernst & Young  
September 13-14, 2010  
Society of Actuaries GAAP Seminar

### What's important to remember about GAAP

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- ▶ Income statement focus in contrast to balance sheet focus in regulatory accounting
  - ▶ Product features determine accounting model
    - ▶ Terms are fixed and guaranteed – traditional (SFAS 60)
    - ▶ Dividends – traditional participating (SFAS 120 and SOP 95-1)
    - ▶ No mortality or morbidity risk – investment (SFAS 97)
    - ▶ None of the above – universal life (SFAS 97)
  - ▶ Acquisition costs are deferred and amortized (deferral requirements in SFAS 60 for all products)
  - ▶ Recoverability and loss recognition requirement (requirements in SFAS 60 for all products)
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## SFAS 60 principles

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- ▶ Apply to traditional insurance contracts
- ▶ Short versus long-duration contracts
- ▶ For long-duration contracts
  - ▶ Revenue = premium
  - ▶ Net level reserves for all benefits
  - ▶ Deferrable expenses are amortized in proportion to gross premiums
  - ▶ Deferred profit liability for limited payment contracts (per SFAS 97 requirements)
  - ▶ Assumptions locked in at issue are equal to best estimate plus provisions for adverse deviation (“PADs”)
- ▶ Potential land mine – loss recognition (premium deficiency)

## SFAS 97 principles

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- ▶ Apply to “universal life” type contracts and investment contracts
- ▶ Deposit accounting (revenue is not equal to premium)
- ▶ For universal life type contracts
  - ▶ Liability is account balance plus:
    - ▶ Deferred revenue amounts
    - ▶ Additional liability for “other insurance benefit features” (SOP 03-1)
    - ▶ Loss recognition reserves, if any
  - ▶ Deferrable expenses are amortized in proportion to estimated gross profits (“EGPs”)
  - ▶ Assumptions are best estimates and are not locked in
  - ▶ Potential land mine – volatility from unlocking

## SFAS 120 and SOP 95-1 principles

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- ▶ Criteria that must be met
  - ▶ Policyholder dividends must be based on actual company experience
  - ▶ “Contribution principle” must be applied
- ▶ Revenue = premium
- ▶ Reserves are net level, using dividend fund interest and cash value mortality
  - ▶ No lapses are assumed
  - ▶ No direct recognition of dividends
- ▶ Deferrable expenses are amortized in proportion to estimated gross margins (“EGMs”)
- ▶ Assumptions are best estimates and are not locked in
- ▶ Potential land mine – volatility from unlocking

## Expense considerations

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- ▶ Acquisition – deferrable versus non-deferrable
  - ▶ Cannot include non-deferred expenses in EGPs / EGMs
- ▶ Maintenance versus overhead
  - ▶ Overhead is expensed in the current period
- ▶ Potential land mine – EITF 09-G

## Expected pre-tax earnings emergence

Component	Traditional non-par	Universal Life	Traditional par
Level % of	Premiums	EGPs	EGMs
Release of PADs	Yes	No	No
Experience variances	Yes	Yes	Yes
Unlocking	Only from loss recognition	Yes	Yes
Less (interest earned less credited) on DAC	No	Yes	No
Less non-deferrable and overhead expenses	Yes	Yes	Yes
Investment income on GAAP equity	Yes	Yes	Yes

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## Investment accounting Debt and equity investments

Classification	Carrying Amount	Treatment of Change in Value
Held to maturity	Amortized cost	N/A*
Trading	Market	Income
Available for sale	Market	Unrealized: equity* Realized: income

\* Credit related impairments must be recognized in the income statement as a charge / loss.

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## Deferred tax – basic concepts

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- ▶ Recognize a current tax liability or asset for current year's tax payable or refundable.
- ▶ Recognize a DTL or DTA for future estimated tax effects attributable to temporary differences and carry-forwards.
- ▶ Measure the current and deferred tax liabilities or assets, based on provisions of enacted laws; effects of future tax law changes are not anticipated.
- ▶ Reduce DTA by valuation allowance if a portion of its effect on future taxes is not expected to be realized.

## Other important GAAP literature

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- ▶ SFAS 113: Reinsurance
- ▶ SFAS 133: Derivatives and embedded derivatives
- ▶ SFAS 141/142/160: Business combinations
- ▶ SFAS 157: Fair value measurement
- ▶ EITF D-41: Shadow DAC
- ▶ SOP 00-3: Closed blocks of participating contracts
- ▶ AICPA Practice Bulletin 8: Clarifications of SFAS 97 issues