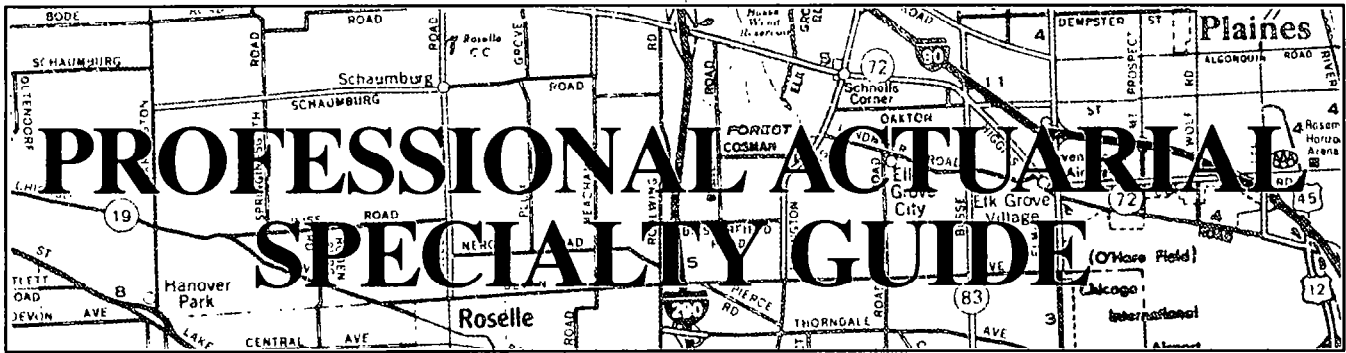


SOCIETY OF ACTUARIES



COMMITTEE ON CONTINUING EDUCATION

U.S.—GAAP FINANCIAL REPORTING

Overview

Generally accepted accounting principles (GAAP) are those that apply to external financial reporting of publicly owned business enterprises. The principles that constitute GAAP vary between stock and mutual insurers, from product class to product class, and according to the purchase status of the business.

At one time, the generally accepted basis of accounting for life insurance companies was statutory accounting (i.e., those practices prescribed or permitted by insurance regulatory authorities), which emphasizes the balance sheet and the ability of insurers to meet their obligations to policyholders.

However, by the early 1970s, the needs of investors and other users of financial statements with respect to evaluating the earnings performance of stock life insurance companies led to the formulation and application of a set of principles for GAAP accounting and reporting that focused on the matching of costs (benefits and expenses) with revenues over time. These principles were published in *Audits of Stock Life Insurance Companies* (Audit Guide) issued by the American Institute of Certified Public Accountants (AICPA) in 1972 and later codified in Statement of Financial Accounting Standards No. 60 (SFAS 60) issued by the Financial Accounting Standards Board (FASB).

The mechanisms by which matching is accomplished under SFAS 60 include the deferral and amortization of certain policy acquisition costs in relation to premium revenue, with "lock-in" of assumptions used in calculating such amortization schedules, the establishment of prospective benefit reserves based on best estimate assumptions with provisions for adverse deviation, the accrual of deferred taxes, and the redefinition of asset bases.

In 1987, the issuance of SFAS 97 clarified the accounting and revised the reporting for products such as universal life to accommodate their dynamic characteristics, investment contracts to account for them as financial instruments, and limited-payment contracts to spread reported income over the product's full term rather than the premium paying period. Life insurers were required to restate prior financial statements when the provisions of SFAS 97 were adopted. As the accounting and reporting for these products varies from GAAP for traditional products in several significant respects, the appropriate classification of products is a key first step in assuring proper GAAP treatment.

The principles of accounting for universal life-type contracts under SFAS 97 include a retrospective deposit method of determining the basic liability for policy benefits, deferral and amortization of deferrable policy acquisition costs and unearned revenues based on estimated gross profits (i.e., margins, rather than premiums), and retrospective adjustment (unlocking) of such amortization schedules when estimates of gross profits change. SFAS 97 defines revenues for such contracts as policy charges (rather than premiums) and includes only benefits in excess of policyholder balances as expenses.

For all product lines, a different set of accounting principles Purchase Accounting (PGAAP) applies when the reporting company has acquired a block of business but is not the original issuer.

For mutual life insurers, exempted from the standards established for publicly owned (i.e., stock) companies, statutory accounting principles continue to be used for GAAP purposes. This exemption may not apply to certain stock life insurance subsidiaries of mutual insurers when reporting to the Securities and Exchange Commission (SEC) is required, and would cease to apply if demutualization (conversion of the mutual insurer to a stock form) occurs. As a point of clarification, it should be noted that the various forms of "Mutual GAAP" reporting adopted by many mutual insurers are *internal* financial reporting systems and do not constitute a set of generally accepted accounting principles for the *external* reporting of mutual companies. Internal financial reporting bases, including variations such as the value-added approach, are beyond the scope of this specialty guide.

The Actuary's Role

The actuary is involved with financial reporting for life insurance companies through experience and training in estimating the financial effects of life and other contingencies utilizing the time value of money. Those responsible for the calculation of GAAP actuarial values such as traditional product benefit reserves, deferred policy acquisition costs, or deferred taxes should possess a knowledge of the authoritative guidance and accepted interpretations of such guidance that apply to their work. In addition, a firm grounding in GAAP will be useful to actuaries involved in financial reporting for mergers and acquisitions, source-of-earnings analysis, management-basis financial reporting or "GAAP" for mutual insurance companies, or the use of GAAP in price testing or setting return on equity (ROE) targets.

Many areas of GAAP involve professional judgments, and qualified actuaries may reach differing conclusions. In the area of GAAP reserve calculations, there are many acceptable variations in use within the insurance industry. Assumptions and methods should be selected and applied with integrity, informed judgment, and perspective in relation to the purpose for which the results are intended. The practicing actuary should be familiar with authoritative accounting and actuarial standards, as well as prevailing accounting practice in areas not specifically addressed by a SFAS and pertinent accounting and actuarial literature.

Actuaries who become deeply involved in GAAP issues inevitably will be drawn into a broader familiarity with relevant accounting guidance and tax law. The Professional Actuarial Specialty Guides (PASG's) on U.S. Taxation—Life Insurance, U.S. Statutory Financial Reporting and the Valuation Actuary, Mergers and Acquisitions—Life Insurance, and other topics may assist the actuary in exploring the available literature.

The Professional Actuarial Specialty Guides Committee on Continuing Education of the Society of Actuaries provides these Specialty Guides to persons wishing to use them for continuing education purposes. They are intended to provide the user with a summary of representative sources of current general knowledge. Neither the Society of Actuaries nor the Committee intend or represent these Specialty Guides to be complete or their use necessarily required or sufficient for the purpose of meeting continuing education requirements or any other professional competency standards of any organization.

INTRODUCTORY MATERIAL

The material in this section provides an introduction to the evolution of generally accepted accounting principles as they apply to stock life insurance companies.

Ian MacKay and Ben Korbly, "Financial Reporting: The Standards Setters," *The Actuarial Update* (March 1991), p. 1.

This article provides background on the process by which GAAP is established and applies to life insurers, focusing on the roles of standard setting bodies such as FASB, the SEC, and the AICPA and its Accounting Standards Executive Committee (AcSEC).

Level: Basic

Pages: 3

Robert W. Stein, "Interrelationships of Various Life Insurance Company Valuations," *The Valuation Actuary Handbook* Society of Actuaries (June 1987), Chapter IV p. IV-1. Also available as Society of Actuaries Study Note 443-89-89.

This paper compares and contrasts the purposes and audiences for GAAP, statutory, and other valuation bases, focusing on their complementary nature.

Level: Basic

Pages: 23

Richard G. Horn, "Life Insurance Earnings and the Release from Risk Policy Reserve System," *TSA XXIII* (1971), p. 391.

This paper clarifies the operation of the policy reserve system for traditional insurance products as the timing mechanism which determines the incidence of earnings through "provisions for adverse deviation" and "release from risk," which are inherent in GAAP for traditional products. The paper also describes how source-of-earnings analyses allocate differences between actual and expected results to component influences such as deviations from assumed persistency, mortality, investment income, and expenses.

Level: Basic

Pages: 9

AUTHORITATIVE ACCOUNTING STANDARDS

In this section we review the range of authoritative accounting guidance regarding the application of GAAP to stock life insurance companies. The AICPA has resolved that its members shall not express an opinion that financial statements are presented in conformity with GAAP if such statements contain any departure from an accounting principle promulgated in FASB Statements of Financial Accounting Standards, together with those Accounting Research Bulletins and Accounting Practice Board Opinions which are not superseded by action of the FASB. Other pronouncements by accounting bodies, such as the AICPA Practice Bulletins, provide guidance on specific issues that practitioners are encouraged to follow to enhance the quality and comparability of financial statements.

The AICPA publishes an annual series, *Current Text – Accounting Standards*, which presents accounting standards organized by accounting issue in *Volume 1 – General Standards* and the applicable standards for the life insurance industry in *Volume 2 – Industry Standards*. The AICPA's *Original Pronouncements – Accounting Standards* presents the original text in chronological order. Subscription service also is available.

AICPA publications are available from the AICPA Order Department, P.O. Box 1003, New York, NY 10108-1003, (800) 248-0445 from New York state, (800) 334-6961 from other states. Copies of issued and proposed SFASs may be obtained from the FASB Order Department, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, (203) 847-0700.

Accounting Guidance Specific to the Life Insurance Industry

The following guidance is specific to the life insurance industry, addressing issues such as the definitions of revenues, expenses, and policyholder liabilities, the determination of deferrable costs and revenues, bases for amortizing deferrable costs and revenues, definitions of loss recognition and recoverability, and accounting treatment of reinsurance contracts.

Audits of Stock Life Insurance Companies, AICPA, Fourth Edition (1985).

This audit guide, first issued in 1972 prior to the creation of the FASB, contained the original definition of GAAP for stock life insurers. While its guidance does not address universal life and investment contracts, it provides an authoritative exposition of GAAP for traditional products. A revised audit guide currently is in preparation.

Level: Basic

Pages: 198

SFAS 60, "Accounting and Reporting by Insurance Enterprises," FASB (June 1982). Also included in *Accounting Standards – Volume 2*, AICPA.

SFAS 60 codified the principles from the 1972 Audit Guide, and represents the currently applicable authoritative guidance for accounting and reporting for traditional life and accident and health insurance.

Level: Basic

Pages: 40

SFAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments," FASB (December 1987). Also included in *Accounting Standards – Volume 2*, AICPA.

This FASB statement, issued in 1987, establishes standards of accounting and reporting for universal life and similar contracts, and addresses the accounting for limited-payment insurance contracts and investment

contracts. In addition, the statement revised reporting for realized capital gains and losses by requiring them to be reported as components of net income, and ended the practice by some companies of continuing the deferral of acquisition costs when traditional life contracts were replaced internally by universal life-type contracts. The statement's guidance, which is quite brief, is supplemented by appendices providing background information and the basis for the FASB's conclusions as well as an illustration of accounting for capitalized acquisition costs.

Level: Basic

Pages: 32

Practice Bulletin 8, "Application of FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, to Insurance Enterprises," AICPA (November 1990).

This practice bulletin, issued in November 1990, provides guidance in the form of questions and answers for certain controversial SFAS 97 implementation issues, including the applicability of unlocking and loss recognition on investment contracts, the inclusion of capital gains and losses and certain expenses in estimated gross profits used as the basis of amortization of deferred costs and unearned revenue for universal life-type contracts, and the applicability of SFAS 97's prohibition of rolling over deferred cost balances on internal replacements.

Level: Basic

Pages: 8

Exposure Draft Proposed SFAS, "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts," FASB (March 20, 1992).

This proposed SFAS, which would be effective in 1993 if adopted, is intended to provide guidance for gross reporting of reinsurance ceded, what constitutes transfer of insurance risk, and recognition of income for prospective and retrospective provisions of reinsurance contracts.

Level: Advanced

Pages: 33

Accounting Guidance Regarding Deferred Taxes

Deferred taxes are the accrual, without interest, of the tax effects of the timing differences between the tax and GAAP bases of assets and liabilities. Recent history has seen a transition from an approach based on accruing income statement tax differences to various versions of a liability method, in which deferred taxes are based on the current tax rate times cumulative "temporary differences" in the balance sheet.

Accounting Practice Board (APB) Opinion 11, "Accounting for Income Taxes" (December 1967). Included in *Accounting Standards—Volume 1*, AICPA.

Under APB 11, GAAP deferred taxes for life insurance companies were simply the accrual of the differences in tax between GAAP and tax-basis income statements. APB 11 remains the basis for determining deferred taxes for many companies, although some companies have adopted the principles of SFAS 96.

Level: Intermediate

Pages: 15

SFAS 96, "Accounting for Income Taxes," FASB (December 1987). Also included in *Accounting Standards—Volume 1*, AICPA.

SFAS 96, originally proposed to be effective for reporting in 1989, required the use of a liability method and introduced considerable complexity into the determination of the deferred tax liability. SFAS 96 generated such numerous complaints that its effective date was postponed by issuance of SFAS 101 in December 1988. For the companies that have adopted its principles, SFAS 96 continues to be pertinent until SFAS 109 is adopted for reporting in 1993.

Level: Advanced

Pages: 126

SFAS 109, "Accounting for Income Taxes," FASB (February 1992).

SFAS 109, issued in 1992 and effective for reporting in 1993, supersedes both APB 11 and SFAS 96. This statement, while retaining the liability method, reflects the FASB's efforts to address the two principal criticisms of SFAS 96—the overly restrictive criteria relating to the recognition of deferred tax assets and the complexities associated with its implementation.

Level: Advanced

Pages: 128

Accounting Guidance Regarding Purchase Accounting

The purchase method of accounting requires the updating of asset, liability and amortization assumptions to current values and the replacing of deferred acquisition costs with the value of the business acquired when one enterprise is purchased by another.

APB 16, "Business Combinations" (August 1970). Included in *Accounting Standards—Volume 1*, AICPA.

Under APB 16's guidance for purchase accounting, assets and liabilities of the acquired business are revalued at current cost (i.e., market value at date of the acquisition of the enterprise). For insurance enterprises, the present value of profits from the existing business is capitalized and amortized over the remaining lifetime of the contracts. The residual between the purchase price and the excess of revalued assets over liabilities is capitalized as goodwill and amortized over a period such as 40 years.

Level: Advanced

Pages: 67

Other Relevant Accounting Guidance

This Specialty Guide is not intended to represent a full course in accounting principles; however, the guidance referenced here often is considered in accounting for the life insurance industry.

SFAS 5, "Accounting for Contingencies," FASB (March 1975). Also included in *Accounting Standards—Volume 1*, AICPA.

This accounting standard defines the conditions under which an accrual for a loss contingency should occur, namely that the impairment of an asset or incurrence of a liability be *probable* as of the date of the financial statement and that the amount can be *reasonably estimated*. Recognition of gain contingencies is prohibited as premature recognition of income. SFAS 5 is not intended to replace the guidance directly applicable to the insurance industry, but often is referred to when asset writedowns, loss recognition, or contingency reserves are considered.

Level: Advanced

Pages: 18

SFAS 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases," FASB (December 1986).

Some interpreters have looked to SFAS 91 for guidance regarding the accounting treatment of acquisition costs for investment contracts, even though SFAS 91 describes the acquisition of assets such as loans rather than liabilities such as deposits. SFAS 91 describes the "constant effective yield" or "interest" method of accounting, which provides for the emergence of earnings in relation to the underlying assets.

Level: Advanced

Pages: 26

RELEVANT ACTUARIAL STANDARDS

Actuarial Standards of Practice (ASP) indicate how fundamental concepts and methodological principles should be applied and take into account problems arising from limited information, time constraints, and other practical difficulties, as well as conflicts with regulatory or other restrictions. Copies of Actuarial Standards may be obtained from The Actuarial Standards Board, 1720 I Street, N.W., Washington, D.C. 20006, Phone (202) 223-8196 Fax (202) 872-1948. The following Actuarial Standards of Practice specifically address GAAP issues.

Financial Reporting Recommendation 1 and Interpretations 1-A through 1-H, "Actuarial Methods and Assumptions For Use in Financial Statements of Stock Life Insurance

Companies Prepared In Accordance with Generally Accepted Accounting Principles," American Academy of Actuaries, Actuarial Standards Board (reprinted 1990).

These recommendations and interpretations comprise an actuarial standard of practice concerning methods and assumptions for use in stock life insurance company financial statements prepared in accordance with GAAP, as defined under SFAS 60. Specific guidance is provided regarding the underlying theory of GAAP; the appropriate consideration of conservatism, expenses, mortality and morbidity, lapses, and interest and the relation of such assumptions to gross premium assumptions; purchase accounting; and accounting for nonparticipating guaranteed renewable life and accident and health insurance policies. The Actuarial Standards Board has indicated its intention to update and codify these standards in an Actuarial Standard of Practice.

Level: Basic

Pages: 15

ASP No. 10, "Methods and Assumptions for Use in Stock Life Insurance Company Financial Statements Prepared in Accordance with GAAP," Actuarial Standards Board (July 1989, reprinted 1990).

Recognizing the specificity of the Financial Reporting Recommendations and Interpretations, as well as changes in GAAP resulting from SFAS 97 and evolution of actuarial practice, the Actuarial Standards Board set out in ASP 10 a more generally applicable standard of actuarial practice with respect to the determination of policy benefit liabilities and deferred policy acquisition costs assets in accordance with GAAP. Where there is a conflict between this standard and the Recommendations and Interpretations, this standard supersedes the earlier guidance.

Level: Basic

Pages: 7

ASP No. 11, "The Treatment of Reinsurance Transactions in Life and Health Insurance Company Financial Statements," Actuarial Standards Board (July 1989, reprinted 1990).

This standard supersedes Recommendation 4 and Interpretation 4-A of the Financial Reporting Recommendations and Interpretations of the American Academy of Actuaries. It provides guidance for valuation of financial statement items for reinsurance ceded and assumed.

Level: Basic

Pages: 4

INTERPRETATIONS AND APPLICATIONS OF STANDARDS

The core material for this Specialty Guide consists of interpretations of the available guidance by professionals or professional service firms in this practice area. While such interpretations are not in themselves authoritative, they often provide a depth of understanding of the application of principles that is not easily gleaned from the original guidance. Further, the widespread adoption of such interpretations in practice may result in *de facto* recognition as being generally accepted.

GAAP for Traditional Products

Traditional life and accident and health insurance products are those with fixed benefits and premiums for which the guidance of SFAS 60 continues to apply.

R. Larry Warnock, "GAAP Reserves," Society of Actuaries Study Note 340-21-78.

This study note addresses the application of the Audit Guide (SFAS 60) to actuarial items included in GAAP financial statements. It is limited in scope, as it relates only to non-participating ordinary and industrial life insurance contracts issued by stock companies, and accounting concepts are presented only to the extent that an understanding of such concepts is necessary for a complete understanding of the related actuarial concepts. However, it goes into some depth in analyzing acceptable formulas for GAAP reserve calculations, considerations for selection of appropriate actuarial assumptions, concepts of reserve adequacy, and practical problems frequently encountered by the practicing actuary.

Level: Basic

Pages: 60

Steven D. Sommer, "Addendum to GAAP Reserves Note (340-21-78)," Society of Actuaries Study Note 340-22-88.

This note should be read in conjunction with Warnock's "GAAP Reserves," as it supplements and corrects certain sections of that study note.

Level: Basic

Pages: 5

Robert L. Posnack, *GAAP: Stock Life Companies*, Ernst & Ernst (1974). Available from National Insurance Services, Ernst & Young, 277 Park Avenue, New York, NY 10172, Phone (212) 773-3020 Fax (212) 773-3035.

This book presents a comprehensive analysis and illustration of GAAP concepts that was invaluable to those charged with the initial implementation of those principles. It is widely regarded as the best reference

regarding the application of SFAS 60's guidance, particularly for special lines of business such as health insurance, credit and group insurance, variable products, and reinsurance, and special problems such as recoverability and loss recognition, restricted participating business, and business combinations.

Level: Intermediate

Pages: 682

Kriss Cloninger, "GAAP for Nonguaranteed-Premium Life Insurance," TSA XXXIII (1981), p. 499.

This article illustrates the process involved in adapting GAAP principles to a new product. The discussion of whether the lock-in principle of GAAP for traditional products should apply to new products with non-guaranteed elements is especially interesting in light of SFAS 97's later unlocking requirement for universal life-type products.

Level: Advanced

Pages: 12

GAAP for Universal Life, Limited Payment and Investment Products

SFAS 97 revised the accounting and reporting for universal life-type, limited-payment, and investment products. The following references provide an introduction to the application of its guidance to the calculation of actuarial items in GAAP financial statements.

John W. Brumbach, Douglas A. Eckley, Craig A. Merdian, and Craig R. Raymond, *SFAS 97—A White Paper* Tillinghast (1988), Sections I-IV and Appendices, available from John W. Brumbach, Tillinghast/Towers Perrin, One Atlanta Plaza, 950 East Paces Ferry Road, Atlanta, GA 30326-1119, Phone (404) 365-1617, Fax (404) 365-1662. Also published as "Revised GAAP Accounting for Universal life, Limited Payment and Investment Contracts," Society of Actuaries Study Note 443-88-89.

This material begins with a discussion of the revised product classifications introduced by SFAS 97, then briefly addresses the revised accounting standards for limited-payment long duration contracts and for investment contracts. It concludes with an in-depth discussion of the accounting standards applicable to universal life-type contracts. Numerous examples illustrating various aspects of the accounting methodology for universal life-type contracts are presented in the appendices.

Level: Intermediate

Pages: 214

S. Michael McLaughlin, "SFAS 97—Open Forum," *The Financial Reporter*, Newsletter of the Life Insurance Company Financial Reporting Section of the Society of Actuaries (December 1988), p. 1.

The discussions contained in this article briefly address some of the questions and issues faced by actuaries in implementing SFAS 97's guidance. More definitive guidance for interpreting certain of the issues later was provided by AICPA Practice Bulletin 8.

Level: Intermediate

Pages: 6

"FAS 97—Where Are We Now?" RSA 15 No. 3A (1989), p. 1145.

The topics related to SFAS 97 addressed by this panel include an example of the earnings volatility that may result from the "unlocking" of amortization schedules, interpretations of the accounting for annuities as investment contracts, an overview of purchase accounting, advice for dealing with negative gross profit elements in amortization of acquisition costs for universal life-type contracts, and a discussion of the implementation process for a large insurer. The results of a brief survey regarding the implementation effort and financial impact of adopting the new guidance also are provided.

Level: Intermediate

Pages: 18

Note: Many accounting and actuarial firms, as well as industry groups and educational institutions, offer seminars or have published commentaries on life insurance accounting and reporting, including aspects of SFAS 97. Such offerings vary considerably in focus and depth, but generally provide consistent interpretations of authoritative guidance. The following publications are representative of those available and may be obtained from the firms indicated.

Accounting by Insurance Enterprises—An Explanation of FASB Statement No. 97 (Subject File IN7352, Item 6, 88-4021) Arthur Andersen & Co. Pages: 59. Available from Ed Bader, Arthur Andersen & Co., One Financial Plaza, Hartford, CT 06103, Phone (203) 280-0601.

FASB Statement 97—An Analysis and Implementation Guide (July 1988) Coopers & Lybrand. Pages: 39. Available from Henry Rusek, Marketing Department, Coopers & Lybrand, 1251 Avenue of the Americas, New York, NY 10020, Phone (212) 536-1571.

Accounting for Life Insurance and Annuity Products—Understanding and Implementing FASB Statement No. 97 (June 1988) Ernst & Whinney. Pages: 100. Available from National Insurance Services, Ernst & Young, 277 Park Avenue, New York, NY 10172, Phone (212) 773-3020 Fax (212) 773-3035.

FASB 97 Revisited—A Survey of Life Insurance Accounting Practices (February 1991) Ernst & Young. Pages: 65. Available from National Insurance Services, Ernst & Young, 277 Park Avenue, New York, NY 10172, Phone (212) 773-3020 Fax (212) 773-3035.

"Statement of Financial Accounting Standards No. 97—An Evolving Perspective" *Insurance Industry Issues and Trends* (April 1988) KPMG Peat Marwick. Pages: 9. Available from Tina Periera, KPMG Peat Marwick, 345 Park Avenue, New York, NY 10172. Phone (212) 872-6528.

Principles & Presentation—Insurance (Annual series) KPMG Peat Marwick. Available from Distribution Center, KPMG Peat Marwick, 3 Chestnut Ridge Road, Montvale, NJ 07645 Phone (201) 307-7000.

GAAP for Reinsurance Ceded and Assumed

Accounting and reporting for reinsurance under GAAP requires a determination of whether risk is transferred under the reinsurance agreement. If risk is not transferred, the agreement is accounted for as a deposit. If risk is transferred, the accounting for ceded contracts is determined by the classification of the reinsurance product, with net deferred acquisition costs amortized in relation to net premiums or estimated gross profits, as appropriate. Accounting for reinsurance assumed may not mirror the accounting for the reinsurance ceded, as the accounting is determined by the classification of the reinsurance product and assumptions depend on the experience of the assuming company.

Richard S. Robertson, "GAAP Accounting for Reinsurance Ceded," TSA XXVII (1975), p. 397.

This paper proposes solutions to certain problems in implementing GAAP for reinsurance ceded and identifies where there may be differences of opinion in accounting and reporting for such reinsurance.

Level: Advanced

Pages: 17

Richard S. Robertson, "GAAP Accounting for Reinsurance Accepted," TSA XXVII (1975), p. 375.

GAAP accounting for reinsurance accepted presents a number of practical problems for the assuming company actuary, including treatment of product features not present in direct contracts and lack of access to the detailed policy or experience information of the assuming company.

Level: Advanced

Pages: 22

SPECIAL TOPICS

This section addresses topics which are not considered "core material" but which may be encountered in advanced applications of GAAP by actuaries.

Deferred Taxes

Calculation of the deferred tax item in GAAP financial statements requires a thorough understanding of the applicable tax law and related tax guidance and interpretations as well as the relevant actuarial and accounting guidance and interpretations. The following reference illustrates the process and considerations involved in applying tax and accounting guidance to deferred tax issues.

"FAS 96," RSA 15 No. 2 (1989), p. 841.

This record of this panel discussion briefly describes SFAS 96's liability model for deferred taxes, and includes examples of scheduling of temporary differences and calculation of the deferred tax asset/liability at both the company and the product level.

Level: Advanced

Pages: 28

Purchase Accounting

The readings listed under the "Purchase Accounting" heading in PASG C-1-90, "Mergers and Acquisitions - Life Insurance," address the purchase accounting principles applicable to business subject to SFAS 60. The following reference addresses considerations in applying SFAS 97 methodology to limited-payment, investment, and universal life-type contracts that are subject to PGAAP.

"Purchase GAAP Considerations," Section V of *SFAS 97—a white paper*, Tillinghast (1988), p. 88. Available from John W. Brumbach, Tillinghast/Towers Perrin, One Atlanta Plaza, 950 East Paces Ferry Road, Atlanta, GA 30326-1119, Phone (404) 365-1617, Fax (404) 365-1662.

This brief chapter (not included in Study Note 443-88-89) describes the application of three common methods—the defined initial reserve method, the defined valuation premium (or defined gross profit) method, and the return on investment method—for determining PGAAP actuarial items under SFAS 97.

Level: Advanced

Pages: 7

Recoverability and Loss Recognition

The GAAP concepts of recoverability and loss recognition were designed to avoid the inappropriate deferral of losses to future periods by assuring that the net GAAP liability is at least as large as a gross premium valuation based on best estimate assumptions. The recoverability principle limits the

original amount of deferrable expenses to that which may be recovered from future profits. The loss recognition principle applies subsequent to issue, and requires that deferred cost balances be reduced to the amount recoverable from future profits or that an additional reserve be established to cover future losses.

"GAAP Recoverability Issues for Interest-Sensitive Products," RSA 14 No. 3 (1988), p. 1229.

The record of this panel discussion addresses recoverability and loss recognition issues under SFAS 97.

Level: Advanced

Pages: 18

Analysis of Source-of-Earnings and Unlocking Effects under SFAS 97

Interpreting the financial results for business subject to accounting and reporting under SFAS 97 may be difficult, especially if amortization schedules have been unlocked. Source-of-earnings analyses comparing actual and expected gains by source may be enhanced by segregating the effects of unlocking from deviations in gross margins.

J.H. Tan, "Source-of-Earnings Analysis under FAS 97 Universal Life Accounting," TSA XLI (1989), p. 443.

This paper defines a procedure for analyzing the sources of profit for a sample universal life product accounted for under SFAS 97.

Level: Advanced

Pages: 64

Michael V. Eckman, "Additional Source-of-Earnings Analysis under FAS 97 Universal Life Accounting and Some Observation on the Effect of Unlocking Assumptions," TSA XLII (1990), p. 59.

This paper extends Tan's analysis to consider the effect of actual experience varying from expected and the effect of those variances on assumptions for the future. Also, the paper illustrates examples of the effect of changing future assumptions (unlocking) on the magnitude and incidence of actual profits. The discussion of the components of the change in reported income due to unlocking is especially valuable to those interested in analyzing the effects of unlocking.

Level: Advanced

Pages: 32

Bruce R. Darling, "Unlocking FAS 97's Management Potential," *The Financial Reporter*, Newsletter of the Life Insurance Company Financial Reporting Section of the Society of Actuaries (March 1992), p. 15.

This article expands on Eckman's discussion of the effects of unlocking on financial results, focusing on the effects on financial results of deviations in experience or future estimated gross margins from those original expected.

Level: Intermediate

Pages: 4

This Actuarial Specialty Guide was developed under the auspices of the Professional Actuarial Specialty Guides Committee on Continuing Education.

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