Statement of Financial Accounting Standards No. 60

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Accounting and Reporting by Insurance Enterprises

June 1982

Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 60 Summary

This Statement extracts the specialized principles and practices from the AICPA insurance industry related Guides and Statements of Position and establishes financial accounting and reporting standards for insurance enterprises other than mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies.

Insurance contracts, for purposes of this Statement, need to be classified as short-duration or long-duration contracts. Long-duration contracts include contracts, such as whole-life, guaranteed renewable term life, endowment, annuity, and title insurance contracts, that are expected to remain in force for an extended period. All other insurance contracts are considered short-duration contracts and include most property and liability insurance contracts.

Premiums from short-duration contracts ordinarily are recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. Claim costs, including estimates of costs for claims relating to insured events that have occurred but have not been reported to the insurer, are recognized when insured events occur.

Premiums from long-duration contracts are recognized as revenue when due from policyholders. The present value of estimated future policy benefits to be paid to or on behalf of policyholders less the present value of estimated future net premiums to be collected from policyholders are accrued when premium revenue is recognized. Those estimates are based on assumptions, such as estimates of expected investment yields, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made. Claim costs are recognized when insured events occur.

Costs that vary with and are primarily related to the acquisition of insurance contracts (acquisition costs) are capitalized and charged to expense in proportion to premium revenue recognized.

Investments are reported as follows: common and nonredeemable preferred stocks at market, bonds and redeemable preferred stocks at amortized cost, mortgage loans at outstanding principal or amortized cost, and real estate at depreciated cost. Realized investment gains and losses are reported in the income statement below operating income and net of applicable income taxes. Unrealized investment gains and losses, net of applicable income taxes, are included in stockholders' (policyholders') equity.

INTRODUCTION

1. The primary purpose of insurance is to provide economic protection from identified risks occurring or discovered within a specified period. Some types of risks insured include death, disability, property damage, injury to others, and business interruption. Insurance transactions may be characterized generally by the following:

a. The purchaser of an insurance contract makes an initial payment or deposit to the insurance enterprise in advance of the possible occurrence or discovery of an insured event.
b. When the insurance contract is made, the insurance enterprise ordinarily does not know if, how much, or when amounts will be paid under the contract.

2. Two methods of premium revenue and contract liability recognition for insurance contracts have developed, which are referred to as short-duration and long-duration contract accounting in this Statement. Generally, the two methods reflect the nature of the insurance enterprise's obligations and policyholder rights under the provisions of the contract.

3. Premiums from short-duration insurance contracts, such as most property and liability insurance contracts, are intended to cover expected **claim** [1] costs resulting from insured events that occur during a fixed period of short duration. The insurance enterprise ordinarily has the ability to cancel the contract or to revise the premium at the beginning of each contract period to cover future insured events. Therefore, premiums from short-duration contracts ordinarily are earned and recognized as revenue evenly as insurance protection is provided.

4. Premiums from long-duration insurance contracts, including many life insurance contracts, generally are level even though the expected policy benefits and services do not occur evenly over the periods of the contracts. Functions and services provided by the insurer include insurance protection, sales, premium collection, claim payment, investment, and other services. Because no single function or service is predominant over the periods of most types of long-duration contracts, premiums are recognized as revenue over the premium-paying periods of the contracts when due from policyholders. Premium revenue from long-duration contracts generally exceeds expected policy benefits in the early years of the contracts and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contracts. Accordingly, a liability for expected costs relating to most types of long-duration contracts is accrued over the current and expected renewal periods of the contracts.

5. Title insurance contracts provide protection for an extended period and therefore are considered long-duration contracts. Premiums from title insurance contracts ordinarily are recognized as revenue on the effective date of the contract because most of the services

associated with the contract have been rendered by that time. Estimated claim costs are recognized when premium revenue is recognized because the insurance provides protection against claims caused by problems with title to real estate arising out of ascertainable insured events that generally exist at that time.

APPLICABILITY AND SCOPE

6. This Statement establishes accounting and reporting standards for the general-purpose financial statements of stock **life insurance enterprises, property and liability insurance enterprises,**[2] and **title insurance enterprises.** Except for the sections on premium revenue and claim cost recognition and **acquisition costs** (paragraphs 9-11, 13-18, and 20-31), this Statement applies to **mortgage guaranty insurance enterprises.** It does not apply to mutual life insurance enterprises, **assessment enterprises,** or **fraternal benefit societies.**

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

General Principles

7. Insurance contracts, for purposes of this Statement, shall be classified as short-duration or long-duration contracts depending on whether the contracts are expected to remain in force [3] for an extended period. The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are:

a. *Short-duration contract.* The contract provides insurance protection for a fixed period of short duration and enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of premiums charged or coverage provided.
b. *Long-duration contract.* The contract generally is not subject to unilateral changes in its provisions, such as a noncancelable or guaranteed renewable contract, and requires the performance of various functions and services (including insurance protection) for an extended period.

8. Examples of short-duration contracts include most property and liability insurance contracts and certain **term life insurance** contracts, such as **credit life insurance.** Examples of long-duration contracts include **whole-life contracts,** guaranteed renewable term life contracts, **endowment contracts, annuity contracts,** and title insurance contracts. Accident and health insurance contracts may be short-duration or long-duration depending on whether the contracts are expected to remain in force for an extended period. For example, individual and **group insurance** contracts that are noncancelable or guaranteed renewable (renewable at the option of

the insured), or collectively renewable (individual contracts within a group are not cancelable), ordinarily are long-duration contracts.

9. Premiums from short-duration insurance contracts ordinarily shall be recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. A **liability for unpaid claims** (including estimates of costs for claims relating to insured events that have occurred but have not been reported to the insurer) and a **liability for claim adjustment expenses** shall be accrued when insured events occur.

10. Premiums from long-duration contracts shall be recognized as revenue when due from policyholders. A liability for expected costs relating to most types of long-duration contracts shall be accrued over the current and expected renewal periods of the contracts. The present value of estimated future policy benefits to be paid to or on behalf of policyholders less the present value of estimated future **net premiums** to be collected from policyholders (**liability for future policy benefits)** shall be accrued when premium revenue is recognized. Those estimates shall be based on assumptions, such as estimates of expected investment yields, **mortality, morbidity, terminations,** and expenses, applicable at the time the insurance contracts are made. In addition, liabilities for unpaid claims and claim adjustment expenses shall be accrued when insured events occur.

11. Costs that vary with and are primarily related to the acquisition of insurance contracts (acquisition costs) shall be capitalized and charged to expense in proportion to premium revenue recognized. Other costs incurred during the period, such as those relating to investments, general administration, and policy **maintenance,** shall be charged to expense as incurred.

12. Accounting for investments by insurance enterprises presumes that (a) insurance enterprises have both the ability and the intent to hold long-term investments, such as bonds, mortgage loans, and redeemable preferred stocks, to maturity and (b) there is no decline in the market value of the investments other than a temporary decline. Accordingly, bonds, mortgage loans, and redeemable preferred stocks shall be reported at amortized cost. Common and nonredeemable preferred stocks shall be reported at market, and real estate shall be reported at depreciated cost.

Premium Revenue Recognition

Short-Duration Contracts

13. Premiums from short-duration contracts ordinarily shall be recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. For those few types of contracts for which the period of risk differs significantly from the contract period, premiums shall be recognized as revenue over the period of risk in proportion to the amount of

insurance protection provided. That generally results in premiums being recognized as revenue evenly over the contract period (or the period of risk, if different), except for those few cases in which the amount of insurance protection declines according to a predetermined schedule.

14. If premiums are subject to adjustment (for example, retrospectively rated or other experience-rated insurance contracts for which the premium is determined after the period of the contract based on claim experience or reporting-form contracts for which the premium is adjusted after the period of the contract based on the value of insured property), premium revenue shall be recognized as follows:

a. If, as is usually the case, the ultimate premium is reasonably estimable, the estimated ultimate premium shall be recognized as revenue over the period of the contract. The estimated ultimate premium shall be revised to reflect current experience.
b. If the ultimate premium cannot be reasonably estimated, the **cost recovery method** or the **deposit method** may be used until the ultimate premium becomes reasonably estimable.

Long-Duration Contracts

15. Premiums from long-duration contracts, such as whole-life contracts (including limited-payment and single-premium life contracts), guaranteed renewable term life contracts, endowment contracts, annuity contracts, and title insurance contracts, shall be recognized as revenue when due from policyholders.

16. Premiums from title insurance contracts shall be considered due from policyholders and, accordingly, recognized as revenue on the effective date of the insurance contract. However, the binder date (the date a commitment to issue a policy is given) is appropriate if the insurance enterprise is legally or contractually entitled to the premium on the binder date. If reasonably estimable, premium revenue and costs relating to title insurance contracts issued by agents shall be recognized when the agents are legally or contractually entitled to the premiums, using estimates based on past experience and other sources. If not reasonably estimable, premium revenue and costs shall be recognized when agents report the issuance of title insurance contracts.

Claim Cost Recognition

17. A liability for unpaid claim costs relating to insurance contracts other than title insurance contracts, including estimates of costs relating to **incurred but not reported claims,** shall be accrued when insured events occur. A liability for estimated claim costs relating to title insurance contracts, including estimates of costs relating to incurred but not reported claims, shall be accrued when title insurance premiums are recognized as revenue (paragraphs 15 and 16).

18. The liability for unpaid claims shall be based on the estimated ultimate cost of settling the

claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience.[4] Changes in estimates of claim costs resulting from the continuous review process and differences between estimates and payments for claims shall be recognized in income of the period in which the estimates are changed or payments are made. Estimated recoveries on unsettled claims, such as **salvage, subrogation,** or a potential ownership interest in real estate, shall be evaluated in terms of their estimated realizable value and deducted from the liability for unpaid claims. Estimated recoveries on settled claims other than mortgage guaranty and title insurance claims also shall be deducted from the liability for unpaid claims.

19. Real estate acquired in settling mortgage guaranty and title insurance claims shall be reported at fair value, that is, the amount that reasonably could be expected to be received in a current sale between a willing buyer and a willing seller. If no market price is available, the expected cash flows (anticipated sales price less maintenance and selling costs of the real estate) may aid in estimating fair value provided the cash flows are discounted at a rate commensurate with the risk involved. Real estate acquired in settling claims shall be separately reported in the balance sheet and shall not be classified as an investment. Subsequent reductions in the reported amount and realized gains and losses on the sale of real estate acquired in settling claims shall be recognized as an adjustment to claim costs incurred.

20. A liability for all costs expected to be incurred in connection with the settlement of unpaid claims (**claim adjustment expenses)** shall be accrued when the related liability for unpaid claims is accrued. Claim adjustment expenses include costs associated directly with specific claims paid or in the process of settlement, such as legal and adjusters' fees. Claim adjustment expenses also include other costs that cannot be associated with specific claims but are related to claims paid or in the process of settlement, such as internal costs of the claims function.[5]

Liability for Future Policy Benefits

21. A liability for future policy benefits relating to long-duration contracts other than title insurance contracts (paragraph 17) shall be accrued when premium revenue is recognized. The liability, which represents the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums (portion of **gross premium** required to provide for all benefits and expenses), shall be estimated using methods that include assumptions, such as estimates of expected investment yields, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made. The liability also shall consider other assumptions relating to guaranteed contract benefits, such as coupons, annual endowments, and conversion privileges. The assumptions shall include provision for the **risk of adverse deviation.** Original assumptions shall continue to be used in subsequent accounting periods to determine changes in the liability for future policy benefits (often referred to as the "lock-in concept") unless a premium deficiency exists (paragraphs 35-37). Changes in the liability for future policy benefits that result from its periodic estimation for financial reporting purposes shall be recognized in income in the period in which the changes

occur.

Investment Yields

22. Interest assumptions used in estimating the liability for future policy benefits shall be based on estimates of investment yields (net of related investment expenses) expected at the time insurance contracts are made. The interest assumption for each block of new insurance contracts (a group of insurance contracts that may be limited to contracts issued under the same plan in a particular year) shall be consistent with circumstances, such as actual yields, trends in yields, portfolio mix and maturities, and the enterprise's general investment experience.

Mortality

23. Mortality assumptions used in estimating the liability for future policy benefits shall be based on estimates of expected mortality.

Morbidity

24. Morbidity assumptions used in estimating the liability for future policy benefits shall be based on estimates of expected incidences of disability and claim costs. Expected incidences of disability and claim costs for various types of insurance (for example, noncancelable and guaranteed renewable accident and health insurance contracts) and other factors, such as occupational class, waiting period, sex, age, and benefit period, shall be considered in making morbidity assumptions. The risk of antiselection (the tendency for lower terminations of poor risks) also shall be considered in making morbidity assumptions.

Terminations

25. Termination assumptions used in estimating the liability for future policy benefits shall be based on anticipated terminations and **nonforfeiture benefits,** using anticipated **termination rates** and contractual nonforfeiture benefits. Termination rates may vary by plan of insurance, age at issue, year of issue, frequency of premium payment, and other factors. If composite rates are used, the rates shall be representative of the enterprise's actual mix of business. Termination assumptions shall be made for long-duration insurance contracts without termination benefits because of the effects of terminations on anticipated premiums and claim costs.

Expenses

26. Expense assumptions used in estimating the liability for future policy benefits shall be based on estimates of expected nonlevel costs, such as termination or settlement costs, and costs after the premium-paying period. Renewal expense assumptions shall consider the possible effect of inflation on those expenses.

Costs Other Than Those Relating to Claims and Policy Benefits

27. Costs incurred during the period, such as those relating to investments, general

administration, and policy maintenance, that do not vary with and are not primarily related to the acquisition of new and renewal insurance contracts shall be charged to expense as incurred.

Acquisition Costs

28. Acquisition costs are those costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts. Commissions and other costs (for example, salaries of certain employees involved in the underwriting and policy issue functions, and medical and inspection fees) that are primarily related to insurance contracts issued or renewed during the period in which the costs are incurred shall be considered acquisition costs.

29. Acquisition costs shall be capitalized and charged to expense in proportion to premium revenue recognized. To associate acquisition costs with related premium revenue, acquisition costs shall be allocated by groupings of insurance contracts consistent with the enterprise's manner of acquiring, servicing, and measuring the profitability of its insurance contracts. Unamortized acquisition costs shall be classified as an asset.

30. If acquisition costs for short-duration contracts are determined based on a percentage relationship of costs incurred to premiums from contracts issued or renewed for a specified period, the percentage relationship and the period used, once determined, shall be applied to applicable unearned premiums throughout the period of the contracts.

31. Actual acquisition costs for long-duration contracts shall be used in determining acquisition costs to be capitalized as long as gross premiums are sufficient to cover actual costs. However, estimated acquisition costs may be used if the difference is not significant. Capitalized acquisition costs shall be charged to expense using methods that include the same assumptions used in estimating the liability for future policy benefits.

Premium Deficiency

32. A probable loss on insurance contracts exists if there is a premium deficiency relating to short-duration or long-duration contracts. Insurance contracts shall be grouped consistent with the enterprise's manner of acquiring, servicing, and measuring the profitability of its insurance contracts to determine if a premium deficiency exists.

Short-Duration Contracts

33. A premium deficiency shall be recognized if the sum of expected claim costs and claim adjustment expenses, expected **dividends to policyholders,** unamortized acquisition costs, and maintenance costs exceeds related unearned premiums.[6]

34. A premium deficiency shall first be recognized by charging any unamortized acquisition costs to expense to the extent required to eliminate the deficiency. If the premium deficiency is

greater than unamortized acquisition costs, a liability shall be accrued for the excess deficiency.

Long-Duration Contracts

35. Original policy benefit assumptions for long-duration contracts ordinarily continue to be used during the periods in which the liability for future policy benefits is accrued (paragraph 21). However, actual experience with respect to investment yields, mortality, morbidity, terminations, or expenses may indicate that existing contract liabilities, together with the present value of future gross premiums, will not be sufficient (a) to cover the present value of future benefits to be paid to or on behalf of policyholders and settlement and maintenance costs relating to a block of long-duration contracts and (b) to recover unamortized acquisition costs. In those circumstances, a premium deficiency shall be determined as follows:

Present value of future payments for benefits and related settlement and maintenance costs, determined using revised assumptions based on actual and anticipated experience	$XX
Less the present value of future gross premiums, determined using revised assumptions based on actual and anticipated experience	XX
Liability for future policy benefits using revised assumptions	XX
Less the liability for future policy benefits at the valuation date, reduced by unamortized acquisition costs	XX
Premium deficiency	$XX

36. A premium deficiency shall be recognized by a charge to income and (a) a reduction of unamortized acquisition costs or (b) an increase in the liability for future policy benefits. If a premium deficiency does occur, future changes in the liability shall be based on the revised assumptions. No loss shall be reported currently if it results in creating future income. The liability for future policy benefits using revised assumptions based on actual and anticipated experience shall be estimated periodically for comparison with the liability for future policy benefits (reduced by unamortized acquisition costs) at the valuation date.

37. A premium deficiency, at a minimum, shall be recognized if the aggregate liability on an entire line of business is deficient. In some instances, the liability on a particular line of business may not be deficient in the aggregate, but circumstances may be such that profits would be recognized in early years and losses in later years. In those situations, the liability shall be increased by an amount necessary to offset losses that would be recognized in later years.

Reinsurance

38. Amounts that are recoverable from reinsurers and that relate to paid claims and claim adjustment expenses shall be classified as assets, with an allowance for estimated uncollectible amounts. Estimated amounts recoverable from reinsurers that relate to the liabilities for unpaid claims and claim adjustment expenses shall be deducted from those liabilities. Ceded unearned premiums shall be netted with related unearned premiums. Receivables and payables from the same reinsurer, including amounts withheld, also shall be netted. **Reinsurance** premiums ceded and reinsurance recoveries on claims may be netted against related earned premiums and incurred claim costs in the income statement.

39. Proceeds from reinsurance transactions that represent recovery of acquisition costs shall reduce applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized (paragraph 29). If the ceding enterprise has agreed to service all of the related insurance contracts without reasonable compensation, a liability shall be accrued for estimated excess future servicing costs under the reinsurance contract. The net cost to the assuming enterprise shall be accounted for as an acquisition cost.

40. To the extent that a reinsurance contract does not, despite its form, provide for indemnification of the ceding enterprise by the reinsurer against loss or liability, the premium paid less the premium to be retained by the reinsurer shall be accounted for as a deposit by the ceding enterprise. Those contracts may be structured in various ways, but if, regardless of form, their substance is that all or part of the premium paid by the ceding enterprise is a deposit, the amount paid shall be accounted for as such. A net credit resulting from the contract shall be reported as a liability by the ceding enterprise. A net charge resulting from the contract shall be reported as an asset by the reinsurer.

Policyholder Dividends

41. Policyholder dividends shall be accrued using an estimate of the amount to be paid.

42. If limitations exist on the amount of net income from **participating insurance** contracts of life insurance enterprises that may be distributed to stockholders, the policyholders' share of net income on those contracts that cannot be distributed to stockholders shall be excluded from stockholders' equity by a charge to operations and a credit to a liability relating to participating policyholders' funds in a manner similar to the accounting for net income applicable to minority interests. Dividends declared or paid to participating policyholders shall reduce that liability; dividends declared or paid in excess of the liability shall be charged to operations. Income-based dividend provisions shall be based on net income that includes adjustments between general-purpose and statutory financial statements that will reverse and enter into future calculations of the dividend provision.

43. For life insurance enterprises for which there are no net income restrictions and that use life insurance dividend scales unrelated to actual net income, policyholder dividends (based on

dividends anticipated or intended in determining gross premiums or as shown in published dividend illustrations at the date insurance contracts are made) shall be accrued over the premium-paying periods of the contracts.

Retrospective and Contingent Commission Arrangements

44. If retrospective commission or experience refund arrangements exist under experience-rated insurance contracts, a separate liability shall be accrued for those amounts, based on experience and the provisions of the contract. Income in any period shall not include any amounts that are expected to be paid to agents or others in the form of experience refunds or additional commissions. Contingent commissions receivable or payable shall be accrued over the period in which related income is recognized.

Investments

45. Bonds shall be reported at amortized cost if the insurance enterprise has both the ability and the intent to hold the bonds until maturity and there is no decline in the market value of the bonds other than a temporary decline. If an insurance enterprise is a trader in bonds and does not intend to hold the bonds until maturity, bonds shall be reported at market and temporary changes in the market value of the bonds shall be recognized as unrealized gains or losses (paragraph 50).

46. Common and nonredeemable preferred stocks shall be reported at market and temporary changes in the market value of those securities shall be recognized as unrealized gains or losses (paragraph 50). Preferred stocks that by their provisions must be redeemed by the issuer shall be reported at amortized cost if the insurance enterprise has both the ability and the intent to hold the stocks until redemption and there is no decline in the market value of the stocks other than a temporary decline.

47. Mortgage loans shall be reported at outstanding principal balances if acquired at par value, or at amortized cost if purchased at a discount or premium, with an allowance for estimated uncollectible amounts, if any. Amortization and other related charges or credits shall be charged or credited to investment income. Changes in the allowance for estimated uncollectible amounts relating to mortgage loans shall be included in realized gains and losses.

48. Real estate investments shall be reported at cost less accumulated depreciation and an allowance for any impairment in value. Depreciation and other related charges or credits shall be charged or credited to investment income. Changes in the allowance for any impairment in value relating to real estate investments shall be included in realized gains and losses.

49. Normal commitment fees received in connection with the placement of mortgage loans (less direct costs) shall be capitalized and recognized as revenue over the commitment period. Commitment fees that exceed current (normal) fees for mortgage loan commitments shall be considered an adjustment of the effective interest yield on the loan. Those excess fees shall be

capitalized until the loan is made and then recognized as revenue over the period of the mortgage loan. If the mortgage loan is not ultimately made, the unamortized commitment fee shall be recognized as revenue at the end of the commitment period.

50. Realized gains and losses on all investments (including, but not limited to, stocks, bonds, mortgage loans, real estate, and joint ventures) shall be reported in the income statement below operating income and net of applicable income taxes. Realized gains and losses on the sale of assets other than investments, such as real estate used in the business, shall be reported in accordance with APB Opinion No. 30, *Reporting the Results of Operations.* Unrealized investment gains and losses, net of applicable income taxes, shall be reported as a separate component of stockholders' (policyholders') equity. Except as discussed in paragraph 51, unrealized gains or losses on common stocks, preferred stocks, or publicly traded bonds shall not be recognized in income until the sale, maturity, or other disposition of the investment.[7]

51. If a decline in the value of a common stock, preferred stock, or publicly traded bond below its cost or amortized cost is considered to be other than temporary, the investment shall be reduced to its net realizable value, which becomes the new cost basis. The amount of the reduction shall be reported as a realized loss. A recovery from the new cost basis shall be recognized as a realized gain only at the sale, maturity, or other disposition of the investment.

Real Estate Used in the Business

52. Real estate shall be classified either as an investment or as real estate used in the enterprise's operations, depending on its predominant use. Depreciation and other real estate operating costs shall be classified as investment expenses or operating expenses consistent with the balance sheet classification of the related asset. Imputed investment income and rental expense shall not be recognized for real estate used in the business.

Separate Accounts

53. Separate accounts represent assets and liabilities that are maintained by an insurance enterprise for purposes of funding fixed-benefit or **variable annuity contracts,** pension plans, and similar activities. The contract holder generally assumes the investment risk, and the insurance enterprise receives a fee for investment management, certain administrative expenses, and mortality and expense risks assumed.

54. Investments in separate accounts shall be reported at market except for separate account contracts with guaranteed investment returns. For those separate accounts, the related assets shall be reported in accordance with paragraphs 45-51. Separate account assets and liabilities ordinarily shall be reported as summary totals in the financial statements of the insurance enterprise.

Income Taxes of Life Insurance Enterprises

Deferred Income Taxes

55. Because of the provisions of the Life Insurance Company Income Tax Act of 1959 (Act),[8] timing differences (paragraph 13(e) of APB Opinion No. 11, *Accounting for Income Taxes*) of life insurance enterprises arising in the current period may not affect the determination of income taxes in future periods when those timing differences reverse. Amounts determined in the with-and-without calculation (paragraph 36 of Opinion 11) need to be considered further to determine whether the difference will reverse in the future. Deferred taxes need not be provided for the current tax effect of timing differences if circumstances indicate that the current tax effect will not reverse in the future. Similarly, a change in category of taxation (the basis on which the enterprise determines its income tax liability) resulting from the with-and-without calculation need not be recognized unless circumstances indicate that a change in category will result when the timing difference reverses. If the reversal of tax effects cannot be reasonably determined, deferred income taxes shall be provided based on the differential determined using the with-and-without calculation as if the enterprise's tax return was filed on the basis on which financial statements are prepared, including any resulting change in category of taxation.

56. Although (a) special deductions (allowable only for income tax purposes) never enter into the determination of pretax accounting income in any period and (b) the amount of policyholder dividend deductions and special deductions may be limited on the tax return (the unused deductions cannot be carried forward to subsequent periods), the amount of policyholder dividend deductions and available special deductions and limitations on those deductions may properly be determined based on pretax accounting income. For example, unused policyholder dividend deductions and special deductions may be used to offset timing differences that affect taxable income to the extent that the limitations on those deductions change when based on pretax accounting income, unless known or anticipated circumstances indicate that future taxable income resulting from the reversal of timing differences will not be offset by like deductions. In the case of provisions for policyholder dividends (including policyholder dividends deducted as part of the change in the liability for future policy benefits), which may be timing differences themselves, statutory limitations shall not be applied to eliminate their current tax effect unless circumstances indicate that the dividends will be limited when the timing differences reverse. Special deductions that are directly affected by timing differences need to be redetermined in the with-and-without calculation unless circumstances indicate that future special deductions will not be directly affected by the timing differences when the timing differences reverse. If the reversal of tax effects cannot be reasonably determined, special deductions that are not affected by timing differences and, therefore, do not reverse shall be limited to amounts available in the tax return.

57. A life insurance enterprise's liability for future policy benefits and capitalization and

amortization of acquisition costs indirectly affect the amount of taxable investment income used in determining the income tax provision for financial reporting purposes. Differences in taxable investment income caused by differences between the liability for future policy benefits and capitalization and amortization of acquisition costs for income tax and financial reporting purposes shall be considered permanent differences (paragraph 13(f) of Opinion 11).

58. If deferred income taxes have not been provided on timing differences on the presumption that the timing differences will not have tax effects when they reverse and circumstances change so that it becomes apparent that tax effects will result, deferred income taxes attributable to those timing differences shall be accrued and reported as income tax expense in that period; those income taxes shall not be reported as an extraordinary item. If deferred income taxes have been provided on timing differences and circumstances change so that it becomes apparent that the tax effects will differ from those originally expected, income taxes previously deferred shall be included in income only as the related timing differences reverse, regardless of whether the life insurance enterprise uses the gross change or net change method (paragraph 37 of Opinion 11).

Policyholders' Surplus

59. A difference between taxable income and pretax accounting income attributable to amounts designated as policyholders' surplus of a life insurance enterprise may not reverse until indefinite future periods or may never reverse. The insurance enterprise controls the events that create the tax consequences, and the enterprise generally is required to take specific action before the initial difference reverses. Therefore, a life insurance enterprise shall not accrue income taxes on the difference between taxable income and pretax accounting income attributable to amounts designated as policyholders' surplus. However, if circumstances indicate that the insurance enterprise is likely to pay income taxes, either currently or in later years, because of a known or expected reduction in policyholders' surplus, income taxes attributable to that reduction shall be accrued as a tax expense of the current period; the accrual of those income taxes shall not be accounted for as an extraordinary item.

Disclosures

60. Insurance enterprises shall disclose the following in their financial statements:

a. The basis for estimating the liabilities for unpaid claims and claim adjustment expenses
b. The methods and assumptions used in estimating the liability for future policy benefits with disclosure of the average rate of assumed investment yields in effect for the current year encouraged
c. The nature of acquisition costs capitalized, the method of amortizing those costs, and the amount of those costs amortized for the period
d. The carrying amount of liabilities for unpaid claims and claim adjustment expenses relating to short-duration contracts that are presented at present value in the financial statements and the range of interest rates used to discount those liabilities

e. Whether the insurance enterprise considers anticipated investment income in determining if a premium deficiency relating to short-duration contracts exists
f. The nature and significance of reinsurance transactions to the insurance enterprise's operations, including reinsurance premiums assumed and ceded, and estimated amounts that are recoverable from reinsurers and that reduce the liabilities for unpaid claims and claim adjustment expenses
g. The relative percentage of participating insurance, the method of accounting for policyholder dividends, the amount of dividends, and the amount of any additional income allocated to participating policyholders
h. The following information relating to stockholders' equity, statutory capital and surplus, and the effects of **statutory accounting practices** on the enterprise's ability to pay dividends to stockholders:
    (1) The amount of statutory capital and surplus
    (2) The amount of statutory capital and surplus necessary to satisfy regulatory requirements (based on the enterprise's current operations) if significant in relation to the enterprise's statutory capital and surplus
    (3) The nature of statutory restrictions on the payment of dividends and the amount of retained earnings that is not available for the payment of dividends to stockholders
i. For life insurance enterprises or a parent of a life insurance enterprise that is either consolidated or accounted for by the equity method:
    (1) The treatment of policyholders' surplus under the U.S. Internal Revenue Code and that income taxes may be payable if the enterprise takes certain specified actions, which shall be appropriately described
    (2) The accumulated amount of policyholders' surplus for which income taxes have not been accrued
j. For life insurance enterprises, any retained earnings in excess of policyholders' surplus on which no current or deferred federal income tax provisions have been made and the reasons for not providing the deferred taxes

Amendments to Other Pronouncements

61. The following footnote is added to the end of paragraph 6 of Opinion 11:

> For life insurance enterprises, also refer to paragraphs 55-59 and subparagraphs 60(i) and 60(j) of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises.*

62. The provisions of APB Opinion No. 23, *Accounting for Income Taxes—Special Areas,* that discuss policyholders' surplus of life insurance enterprises have been included in this Statement without reconsideration, and paragraphs 26-30 and footnote 11 of Opinion 23 are superseded by this Statement.

63. The references to AICPA insurance industry related Guides in footnote 8 of Opinion 30,

paragraphs 41 and 102 of FASB Statement No. 5, *Accounting for Contingencies,* paragraph 4 of FASB Interpretation No. 15, *Translation of Unamortized Policy Acquisition Costs by a Stock Life Insurance Company,* and paragraph 7 of FASB Interpretation No. 22, *Applicability of Indefinite Reversal Criteria to Timing Differences,* are replaced by a reference to FASB Statement No. 60, A*ccounting and Reporting by Insurance Enterprises.* The references to AICPA Statements of Position (SOPs) 78-6, *Accounting for Property and Liability Insurance Companies,* and 79-3, *Accounting for Investments of Stock Life Insurance Companies,* and to the AICPA Industry Audit Guides, *Audits of Fire and Casualty Insurance Companies* and *Audits of Stock Life Insurance Companies,* are deleted from Appendix A of FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters.* The reference to the AICPA project on accounting by title insurance companies, which resulted in the issuance of SOP 80-1, *Accounting for Title Insurance Companies,* is deleted from Appendix B of Statement 32.

Effective Date and Transition

64. This Statement shall be effective for fiscal years beginning after December 15, 1982, with earlier application encouraged. Accounting changes adopted to conform to the provisions of this Statement shall be applied retroactively. In the year that this Statement is first applied, the financial statements shall disclose the nature of any restatement and its effect on income before extraordinary items, net income, and related per share amounts for each year presented. The individual effects of changing to conform to the provisions of this Statement shall be disclosed in the financial statements.

65. If retroactive restatement of all years presented is not practicable, the financial statements presented shall be restated for as many consecutive years as practicable and the cumulative effect of applying this Statement shall be included in determining net income of the earliest year restated (not necessarily the earliest year presented). If it is not practicable to restate any prior year, the cumulative effect shall be included in net income in the year in which this Statement is first applied. (Refer to paragraph 20 of APB Opinion No. 20, *Accounting Changes.*)

The provisions of this Statement need not be applied to immaterial items.

This Statement was approved by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso

Robert T. Sprouse
Ralph E. Walters

Appendix A: GLOSSARY

66. This appendix defines certain terms that are used in this Statement.

Acquisition costs

Costs incurred in the acquisition of new and renewal insurance contracts. Acquisition costs include those costs that vary with and are primarily related to the acquisition of insurance contracts (for example, agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees).

Annuity contract

A contract that provides fixed or variable periodic payments made from a stated or contingent date and continuing for a specified period, such as for a number of years or for life. Also refer to variable annuity contract.

Assessment enterprise

An insurance enterprise that sells insurance to groups with similar interests, such as church denominations or professional groups. Some assessment enterprises also sell insurance directly to the general public. If funds are not sufficient to pay claims, then assessments may be made against members.

Claim

A demand for payment of a policy benefit because of the occurrence of an insured event, such as the death or disability of the insured; the maturity of an endowment; the incurrence of hospital or medical bills; the destruction or damage of property and related deaths or injuries; defects in, liens on, or challenges to the title to real estate; or the occurrence of a surety loss.

Claim adjustment expenses

Expenses incurred in the course of investigating and settling claims. Claim adjustment expenses include any legal and adjusters' fees, and the costs of paying claims and all related expenses.

Cost recovery method

Under the cost recovery method, premiums are recognized as revenue in an amount equal to estimated claim costs as insured events occur until the ultimate premium is reasonably estimable, and recognition of income is postponed until that time.

Credit life insurance

Life insurance, generally in the form of decreasing term insurance, that is issued on the lives of borrowers to cover payment of loan balances in case of death.

Deposit method

Under the deposit method, premiums are not recognized as revenue and claim costs are not charged to expense until the ultimate premium is reasonably estimable, and recognition of income is postponed until that time.

Dividends to policyholders

Amounts distributable to policyholders of participating insurance contracts as determined by the insurer. Under various state insurance laws, dividends are apportioned to policyholders on an equitable basis. The dividend allotted to any contract often is based on the amount that the contract, as one of a class of similar contracts, has contributed to the income available for distribution as dividends.

Endowment contract

An insurance contract that provides insurance from inception of the contract to the maturity date (endowment period). The contract specifies that a stated amount, adjusted for items such as policy loans and dividends, if any, will be paid to the beneficiary if the insured dies before the maturity date. If the insured is still living at the maturity date, the policyholder will receive the maturity amount under the contract after adjustments, if any. Endowment contracts generally mature at a specified age of the insured or at the end of a specified period.

Fraternal benefit society

An organization that provides life or health insurance to its members and their beneficiaries. Policyholders normally participate in the earnings of the society, and insurance contracts stipulate that the society has the power to assess its members if the funds available for future policy benefits are not sufficient to provide for benefits and expenses.

Gross premium

The premium charged to a policyholder for an insurance contract. Also refer to net premium.

Group insurance

Insurance protecting a group of persons, usually employees of an entity and their dependents. A single insurance contract is issued to their employer or other representative of the group. Individual certificates often are given to each insured individual or family unit. The insurance usually has an annual renewable contract period, although the insurer may guarantee premium rates for two or three years. Adjustments to premiums relating to the actual experience of the group of insured persons are common.

Incurred but not reported claims

Claims relating to insured events that have occurred but have not yet been reported to the insurer or reinsurer as of the date of the financial statements.

Liability for claim adjustment expenses

The amount needed to provide for the estimated ultimate cost required to investigate and settle claims relating to insured events that have occurred on or before a particular date (ordinarily, the balance sheet date), whether or not reported to the insurer at that date.

Liability for future policy benefits

An accrued obligation to policyholders that relates to insured events, such as death or disability. The liability for future policy benefits can be viewed as either (a) the present value of future benefits to be paid to or on behalf of policyholders and expenses less the present value of future net premiums payable under the insurance contracts or (b) the accumulated amount of net premiums already collected less the accumulated amount of benefits and expenses already paid to or on behalf of policyholders.

Liability for unpaid claims

The amount needed to provide for the estimated ultimate cost of settling claims relating to insured events that have occurred on or before a particular date (ordinarily, the balance sheet date). The estimated liability includes the amount of money that will be required for future payments on both (a) claims that have been reported to the insurer and (b) claims relating to insured events that have occurred but have not been reported to the insurer as of the date the liability is estimated.

Life insurance enterprise

An enterprise that can issue annuity, endowment, and accident and health insurance contracts as well as life insurance contracts. Life insurance enterprises may be either stock or mutual organizations.

Maintenance costs

Costs associated with maintaining records relating to insurance contracts and with the processing of premium collections and commissions.

Morbidity

The relative incidence of disability due to disease or physical impairment.

Mortality

The relative incidence of death in a given time or place.

Mortgage guaranty insurance enterprise

An insurance enterprise that issues insurance contracts that guarantee lenders, such as savings and loan associations, against nonpayment by mortgagors.

Net premium

As used in this Statement for long-duration insurance contracts, the portion of the gross premium required to provide for all benefits and expenses.

Nonforfeiture benefits

Those benefits in a life insurance contract that the policyholder does not forfeit, even for failure to pay premiums. Nonforfeiture benefits usually include cash value, paid-up insurance value, or extended-term insurance value.

Participating insurance

Insurance in which the policyholder is entitled to participate in the earnings or surplus of the insurance enterprise. The participation occurs through the distribution of dividends to policyholders.

Property and liability insurance enterprise

An enterprise that issues insurance contracts providing protection against (a) damage to, or loss of, property caused by various perils, such as fire and theft, or (b) legal liability resulting from injuries to other persons or damage to their property. Property and liability insurance enterprises also can issue accident and health insurance contracts. The term property and liability insurance enterprise is the current terminology used to describe a fire and casualty insurance enterprise. Property and liability insurance enterprises may be either stock or mutual organizations.

Reciprocal or interinsurance exchange

A group of persons, firms, or corporations commonly referred to as "subscribers" that exchange insurance contracts through an attorney-in-fact (an attorney authorized by a person to act in that person's behalf).

Reinsurance

A transaction in which a reinsurer (assuming enterprise), for a consideration (premium), assumes all or part of a risk undertaken originally by another insurer (ceding enterprise). However, the legal rights of the insured are not affected by the reinsurance transaction and the insurance enterprise issuing the insurance contract remains liable to the insured for payment of policy benefits.

Risk of adverse deviation

A concept used by life insurance enterprises in estimating the liability for future policy benefits relating to long-duration contracts. The risk of adverse deviation allows for possible unfavorable deviations from assumptions, such as estimates of expected investment yields, mortality, morbidity, terminations, and expenses. The concept is referred to as risk load when used by property and liability insurance enterprises.

Salvage

The amount received by an insurer from the sale of property (usually damaged) on which the insurer has paid a total claim to the insured and has obtained title to the property.

Statutory accounting practices

Accounting principles required by statute, regulation, or rule, or permitted by specific approval, that an insurance enterprise is required to follow when submitting its financial statements to state insurance departments.

Subrogation

The right of an insurer to pursue any course of recovery of damages, in its name or in the name of the policyholder, against a third party who is liable for costs relating to an insured event that have been paid by the insurer.

Term life insurance

Insurance that provides a benefit if the insured dies within the period specified in the contract. The insurance is for level or declining amounts for stated periods, such as 1, 5, or 10 years, or to a stated age. Term life insurance generally has no loan or cash value.

Termination

In general, the failure to renew an insurance contract. Involuntary terminations include death, expirations, and maturities of contracts. Voluntary terminations of life insurance contracts include lapses with or without cash surrender value and contract modifications that reduce paid-up whole-life benefits or term-life benefits.

Termination rate

The rate at which insurance contracts fail to renew. Termination rates usually are expressed as a ratio of the number of contracts on which insureds failed to pay premiums during a given period to the total number of contracts at the beginning of the period from which those terminations occurred. The complement of the termination rate is persistency, which is the renewal quality of insurance contracts, that is, the number of insureds that keep their insurance in force during a period. Persistency varies by plan of insurance, age at issue, year of issue, frequency of premium payment, and other factors.

Title insurance enterprise

An enterprise that issues title insurance contracts to real estate owners, purchasers, and mortgage lenders, indemnifying them against loss or damage arising out of defects in, liens on, or challenges to their title to real estate.

Variable annuity contract

An annuity in which the amount of payments to be made are specified in units, rather than in dollars. When payment is due, the amount is determined based on the value of the investments in the annuity fund.

Whole-life contract

Insurance that may be kept in force for a person's entire life by paying one or more premiums. It is paid for in one of three different ways: (a) ordinary life insurance (premiums are payable as long as the insured lives), (b) limited-payment life insurance (premiums are payable over a specified number of years), and (c) single-premium life insurance (a lump-sum amount paid at the inception of the insurance contract). The insurance contract pays a benefit (contractual amount adjusted for items such as policy loans and dividends, if any) at the death of the insured. Whole-life insurance contracts also build up nonforfeiture benefits.

Appendix B: BACKGROUND INFORMATION AND SUMMARY OF CONSIDERATION OF COMMENTS ON EXPOSURE DRAFT

67. As discussed in Statement 32, the FASB is extracting the specialized [9] accounting and reporting principles and practices from AICPA SOPs and Guides on accounting and auditing matters and issuing them as FASB Statements after appropriate due process. This Statement extracts without significant change the specialized principles and practices relating to insurance enterprises from the AICPA Industry Audit Guides, *Audits of Stock Life Insurance Companies* and *Audits of Fire and Casualty Insurance Companies;* and AICPA SOPs 78-6, 79-3, and 80-1; and Opinion 23. Accounting and reporting standards that apply to enterprises in general also apply to insurance enterprises, and the standards in this Statement are in addition to those standards.

68. Board members have assented to the issuance of this Statement on the basis that it is an appropriate extraction of existing specialized principles and practices and that a comprehensive reconsideration of those principles and practices was not contemplated in undertaking this FASB project. Most of the background material and discussion of accounting alternatives have not been carried forward from the AICPA insurance industry related Guides and SOPs. The Board's conceptual framework project on accounting recognition criteria will address recognition issues relating to elements of financial statements. A Statement of Financial Accounting Concepts resulting from that project in due course will serve as a basis for evaluating existing standards and practices. Accordingly, the Board may wish to evaluate the standards in this Statement when its conceptual framework project is completed.

69. This Statement does not address issues that currently are being studied by the insurance industry and the accounting and actuarial professions. Some of those issues include:

a. What financial accounting and reporting principles should mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies follow in their general-purpose financial statements?

b. How should universal life insurance contracts and similar products that have been developed since the AICPA insurance industry related Guides and SOPs were originally issued be accounted for?

c. For short-duration contracts:
   (1) Should certain claim liabilities be discounted?
   (2) Should anticipated investment income be considered in determining if a premium deficiency exists?

d. What circumstances constitute a transfer of economic risk under a reinsurance contract?

70. An Exposure Draft of a proposed FASB Statement, *Accounting and Reporting by Insurance Enterprises*, was issued on November 18, 1981. The Board received 56 comment letters in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them are discussed in this appendix.

Criteria for Distinguishing between Short-Duration and Long-Duration Contracts

71. Respondents commented on the appropriateness of the proposed criteria for distinguishing between short-duration and long-duration contracts and on whether the criteria could be improved. Some respondents said that the criteria were not well defined and could result in unintended changes in current accounting principles or practices because the criteria focused too narrowly on whether an insurance contract can be expected to remain in force for an extended period. They suggested that the criteria be clarified so that the nature of the insurance enterprise's obligations and policyholder rights under the provisions of the contract is considered.

72. Other respondents recommended that (a) accounting for insurance contracts should depend on the type of insurance enterprise issuing the contract, (b) the criteria for distinguishing between the two types of contracts should be based on the period of the contract, or (c) contracts should be specified by type of insurance protection that should be considered short-duration or long-duration so that the Statement can be specifically applied without exception or ambiguity.

73. In extracting the specialized principles and practices from the AICPA insurance industry related Guides and SOPs, the Board decided to establish a framework for accounting by insurance enterprises based on the nature of insurance contracts rather than type of insurance enterprise. The Board concluded that the criteria for distinguishing between short-duration and long-duration contracts should be clarified so that the nature of the insurance enterprise's obligations and policyholder rights under the provisions of the contract is considered, because that is consistent with (a) a general framework, (b) the principles in the AICPA insurance industry related Guides and SOPs, and (c) current practice.

Impairment in Value of Publicly Traded Securities

74. If an investment in a publicly traded security is reduced to its net realizable value,

paragraph 51 requires that a gain not be recognized until the sale, maturity, or other disposition of the investment. Some respondents argued that permanent impairment is too absolute and often cannot be determined until after the event causing the impairment has occurred. In addition, they said that accounting for impaired amounts relating to publicly traded securities should be consistent with accounting for mortgage loans and real estate investments and reflective of an insurance enterprise's estimate of its ability to recover the carrying amount of those securities. They suggested that a standard consistent with Statement 5 be included to require adjustments of the carrying amount as circumstances change.

75. Other respondents agreed with paragraph 51 because it is an accurate extraction of SOPs 78-6, 79-3, and 80-1 and is consistent with principles and practices applicable to enterprises in other industries. Based on that reasoning, the Board concluded that adjustments for increases in value of previously impaired publicly traded securities should continue to be proscribed.

Acquisition Costs: Primarily versus Directly Related

76. Some respondents commented on the definition in paragraph 28 that states that acquisition costs are those costs that vary with and are *primarily* related to the acquisition of new and renewal insurance contracts. They pointed out that, while the term *primarily* currently is used in practice by life insurance enterprises, the term *directly* is used in practice by property and liability insurance enterprises. They said that using the term *primarily* for all insurance enterprises could produce a different result for property and liability insurance enterprises. They recommended that the distinction between *primarily* and *directly* be retained in prescribing accounting principles for acquisition costs.

77. The Board believes that accounting principles and practices should not be applied differently among insurance enterprises without differences in underlying circumstances. Because the term *primarily* encompasses *directly,* the Board acknowledges that use of the term *primarily* might allow property and liability insurance enterprises to adopt broader guidelines in defining acquisition costs that are capitalizable. However, the Board believes that the use of the term *primarily* should not cause insurance enterprises to change their methods of defining acquisition costs to be capitalized.

Disclosure of the Average Rate of Assumed Investment Yields

78. Respondents commented on the benefits and costs of specifically requiring a disclosure of the average rate of assumed investment yields used in estimating the liability for future policy benefits. Some respondents said that disclosure of the average rate of assumed investment yields should be required because the disclosure would be relevant to users in assessing the reasonableness of estimated rates of return in relation to current investment yields and in comparing insurance enterprises. They also expressed the view that the cost to the reporting enterprise would be minimal and that the benefit to users of insurance enterprise financial statements would outweigh the related cost.

79. Other respondents said it is likely that the development of a single average interest rate would involve a time-consuming and costly process that would not be justified by the benefit. They also argued that the weighted average of interest rate assumptions has little meaning when there are other significant assumptions that also must be considered in estimating the liability for future policy benefits and that the disclosure would likely result in a general perception that the rate possessed more significance and value than deserved.

80. The Board agrees with those respondents that said disclosure of the average rate of assumed investment yields is useful in assessing the reasonableness of estimated rates of return in relation to current investment yields and in comparing insurance enterprises. However, because of uncertainties relating to the cost of providing that disclosure, the Board decided to encourage but not require disclosure of that yield rate.

Disclosure of Discounting Short-Duration Contract Claim Liabilities and Considering Anticipated Investment Income in Determining Premium Deficiencies

81. The Exposure Draft would have required disclosure of (a) the effects (including amounts) of discounting short-duration contract claim liabilities and (b) the effects (including amounts) of an enterprise's considering anticipated investment income in determining if a premium deficiency relating to short-duration contracts exists. Some respondents said that insurance enterprises generally are not disclosing *amounts* in their notes because they believe disclosure of amounts is not required in the AICPA insurance industry related Guides and SOPs, which require disclosure of only the *effects.* Other respondents recommended that the Exposure Draft be revised to require disclosure of the carrying amount of claim liabilities carried at present value in the balance sheet, the range of interest rates used to discount the claim liabilities, and the period of years over which the claims are being paid.

82. The phrase *including amounts* was included in the Exposure Draft to clarify what the Board understands was meant by *effects on the financial statements* in SOP 78-6. The Board believes that quantitative disclosures relating to the discounting of short-duration claim liabilities is necessary and, accordingly, decided to require disclosure of the carrying amount of short-duration contract liabilities that are presented at present value and the range of discount rates. However, the Board agreed that disclosure of amounts relating to an insurance enterprise's consideration of anticipated investment income in determining whether a premium deficiency exists is not necessary, and decided to require disclosure of only whether the insurance enterprise considers anticipated investment income in making that determination.

Disclosure of Statutory Requirements

83. With respect to the proposed disclosure of information relating to statutory capital and surplus requirements, some respondents suggested that disclosure be limited to the amount of statutory capital and surplus, minimum statutory requirements when significant, and statutory

limitations on the payment of dividends. Other respondents recommended that the proposed disclosures parallel those in the SEC's recent revision of Article 7 of Regulation S-X. The Board agreed that the disclosure relating to statutory requirements needed clarification and revised the disclosure in accordance with the first sentence of this paragraph.

Reconciliation Disclosure

84. Respondents commented on whether disclosure of a reconciliation between financial reporting and statutory capital and income should be required. Some respondents said the disclosure should be required because the differences between statutory accounting practices and generally accepted accounting principles are an important element in the analysis of an insurance enterprise's general-purpose financial statements. They pointed out that statutory accounting determines the amount of dividends that can be paid as well as the sufficiency of statutory capital and surplus for regulatory purposes and, therefore, is important to users of insurance enterprise financial statements.

85. Other respondents said the reconciliation disclosure should not be required because the original purpose of the reconciliation was intended principally to provide relevant information during the life insurance industry's transition from statutory reporting. They also said that the disclosure may cast doubt on the appropriateness of accounting principles used in the general-purpose financial statements.

86. The Board believes that the disclosure in paragraph 60(h) relating to statutory requirements is sufficient for the general-purpose financial statements of insurance enterprises.

Other Comments

87. Some respondents noted that paragraph 10 of the Exposure Draft would require a liability for claim adjustment expenses to be accrued when insured events occur and that life insurance enterprises currently are not accruing those costs. They said that accruing claim adjustment expenses associated with unpaid claims would require an accounting change for life insurance enterprises and that, although it may be appropriate to require life insurance enterprises to accrue a liability for those costs, those enterprises should be excluded from that requirement since the AICPA stock life insurance guide does not require that accrual. However, they acknowledged that the change is not likely to significantly affect the financial statements of life insurance enterprises. The Board believes that the requirement is appropriate and that it meets a criterion for change—that is, practices among insurance enterprises are different without differences in circumstances. In addition, the Board believes the requirement is consistent with the provisions of Statement 5.

88. Several respondents suggested various substantive changes to the Exposure Draft. Adoption of those suggestions would have required a reconsideration of some of the provisions of the Guides and SOPs. Such a reconsideration is not contemplated in the extraction project

unless a proposed change meets one of the three criteria for change included in the "Notice for Recipients" of the Exposure Draft or is broadly supported. The proposed changes did not met the criteria for change and were not broadly supported. Accordingly, the Board did not adopt those suggestions. However, based on suggestions from respondents to the Exposure Draft, the Board has made several other changes that it believes clarify the Statement.

89. The Board has concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraphs 64 and 65 are advisable in the circumstances.

Footnotes

FAS60, Footnote 1--Terms defined in the glossary (Appendix A) are in **boldface type** the first time they appear in this Statement.

FAS60, Footnote 2--Property and liability insurance enterprises, for purposes of this Statement, include stock enterprises, mutual enterprises, and **reciprocal or interinsurance exchanges.**

FAS60, Footnote 3--*In force* refers to the period of coverage, that is, the period during which the occurrence of insured events can result in liabilities of the insurance enterprise.

FAS60, Footnote 4--Certain disclosures are required if the time value of money is considered in estimating liabilities for unpaid claims and claim adjustment expenses relating to short-duration contracts (paragraph 60(d)).

FAS60, Footnote 5--Title insurance internal claim adjustment expenses, which generally consist of fixed costs associated with a permanent staff handling a variety of functions including claim adjustment, ordinarily are expensed as period costs because the costs are insignificant.

FAS60, Footnote 6--Disclosure is required regarding whether the insurance enterprise considers anticipated investment income in determining if a premium deficiency relating to short-duration contracts exists (paragraph 60(e)).

FAS60, Footnote 7--This paragraph is not intended to preclude the accrual of losses on private-placement bonds when both conditions in paragraph 8 of FASB Statement No. 5, *Accounting for Contingencies,* are met.

FAS60, Footnote 8--The Act contemplated taxation of total income of life insurance enterprises, but the determination of tax is complex because of the manner in which total taxable income is classified as investment income, gain from operations (including investment income and less special deductions for certain accident and health, group life, and nonparticipating insurance contracts), policyholders' surplus (gain from operations previously excluded from tax and the special deductions), and the interrelationship of those elements. Taxable income consists of (a) taxable investment income, (b) 50 percent of the amount by which gain from operations exceeds taxable investment income, and (c) any reductions in policyholders' surplus. If gain from operations is less than taxable investment income, the lesser amount, plus any reductions in policyholders' surplus, is taxable income. If a loss from operations occurs, there is no taxable income except to the extent that there are reductions in policyholders' surplus. Deductions from gain from operations for policyholder dividends and the special deductions are limited and unused deductions cannot be carried forward to subsequent periods.

FAS60, Appendix B, Footnote 9--The term *specialized* is used to refer to those accounting and reporting principles and practices in AICPA Guides and SOPs that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.