23. (1.75 points)

a. (0.75 point)

Briefly explain how reinsurance recoveries on unpaid losses are recorded on the balance sheet under Statutory Accounting Principles (SAP), Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

b. (0.5 point)

Contrast how discounting of loss reserves are treated under SAP and IFRS.

c. (0.5 point)

Contrast how acquisition costs are recorded under SAP and GAAP.

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23) Sample Answer

Answer 1

A)
- SAP – will reduce loss reserve
- GAAP – will be recorded as assets
- IFRS – no offsetting is allowed

B)
- SAP generally doesn't allow discounting of reserves, except 3 circumstances:
  - Tabular discount
  - Allowed by Insurance Commissioner
  - Certain Med Mal writers
- IFRS allows discounting if the payment pattern is known or can be reasonably estimated.

C)
- SAP – acquisition costs are expensed and deducted as soon as it is incurred.
- GAAP – will setup an asset called deferred acquisition costs and amortize it in proportion to the revenue recognition (in the same pace as the corresponding premium being earned).

Answer 2

A)
- SAP – unpaid reins recoveries are included within reserve liability and serve to reduce the value.
- GAAP – unpaid loss recoveries are recorded as an asset; "ceded reins recoverable"
- IFRS – no offsetting is allowed for recoverable

B)
- SAP – only tabular discounts are allowed for certain lines; non-tab discounts may apply in certain exceptions, but generally loss reserves are not discounted under SAP.
- IFRS – loss reserves are discounted, but then an explicit re-margin is applied.

C)
- SAP – acquisition costs are expensed at once when the policy is written.
- GAAP – acquisition costs are capitalized and deferred; a DPAC asset is established and amortized over the life of the policy terms.

Answer 3

A)
- SAP – reserves are shown net of R/I recoveries
- GAAP – R/I recoveries are shown separately as an asset under "ceded recoverable"
- IFRS – offsetting of reserves by ceded recoveries is prohibited.

B)
- SAP – reserves are presented on undiscounted basis, unless permitted by Insurance Commissioner under special circumstances
- IFRS – discounting is permitted and a risk margin is also added.

C)
- SAP – all acquisition costs are recognized immediately at time they are incurred

- GAAP – a deferred policy acquisitioncost (DPAC) asset is set up to defer the recognition of acquisition cost to match revenue to expense. The DPAC is amortized over the remaining term of the contract.

Examiner's Report

On part a, the most common error was to state that GAAP and IFRS were the same, which isn't exactly right. Another common error was to state that for SAP the recoverables were a contra liability, but didn't state to what entry they were a contra liability (the reserves). In general, candidates did best on SAP, then GAAP, then IFRS.

On part b, the use of absolutes got some candidates in trouble. For example, SAP does not "only allow tabular". It was acceptable to state that "SAP generally doesn't allow discounting, while IFRS does." Candidates appeared to do well on part b.

On part c, we felt the key was the timing of the recognition. SAP fully records the acquisition costs immediately, while GAAP reflects them over the earning period of the underlying policy. The creation of the DPAC asset in GAAP is part of the mechanism that makes that so, but we felt it not correct to only state that "GAAP creates an asset" without further explaining how the costs are recognized over time. It was acceptable as an answer to ignore the DPAC asset and contrast the recognition as "SAP fully recognizes acquisition costs immediately, while GAAP recognizes them over the earning period of the policy." That distinction on the GAAP answer is likely where most lost some credits on part c.