

18. (2 points)

a. (0.5 point)

Briefly describe two reasons for the codification of SAP.

b. (0.25 point)

In accordance with specific statutes or regulations promulgated by individual states, identify the source publication(s) for preparing and issuing statutory financial statements for insurance companies in the U.S.

c. (0.75 point)

Fully describe the process to find guidance when preparing statutory financial statements if the source identified in part b. above does not provide appropriate guidance.

d. (0.5 point)

Briefly describe two considerations for a preparer of statutory financial statements when making a judgment about whether an error contained in a financial statement is material.

## SAMPLE ANSWERS AND EXAMINER'S REPORT

<b>QUESTION 18</b>	
<b>TOTAL POINT VALUE: 2</b>	<b>LEARNING OBJECTIVE: C3</b>
<b>SAMPLE ANSWERS (BY PART, AS APPLICABLE)</b>	
<b>Part a: 0.5 point</b>	
<p>Candidates received full credit for two of the following responses that reflect different ideas:</p> <ul style="list-style-type: none"> <li>• Allow regulators and NAIC to aggregate financial information more easily</li> <li>• Financial information is comparable between companies</li> <li>• Consistency in reporting allows for more reliable and efficient analysis by regulators</li> <li>• To provide further national uniformity to financial reporting</li> <li>• To standardize financial reporting for insurers</li> <li>• Ease regulatory burden of insurers that operated in multiple states</li> <li>• Makes it easier for companies operating in multiple states to complete financial statements</li> <li>• Provide efficiency of reporting</li> <li>• Simplifying the process</li> <li>• Lower costs to insurers since they don't have to alter the way they report financials for each state</li> <li>• Require certain disclosures for regulators to easily detect risks</li> <li>• Rules of SAP are clear and easily interpreted.</li> </ul>	
<b>Part b: 0.25 point</b>	
<p>Candidates received full credit for any of the following responses:</p> <ul style="list-style-type: none"> <li>• Statements of Statutory Accounting Principles (SSAPs)</li> <li>• NAIC's Accounting Practices and Procedures Manual (APPM)</li> </ul>	
<b>Part c: 0.75 point</b>	
<p>Candidates received full credit for any of the following responses:</p> <ul style="list-style-type: none"> <li>• Utilize hierarchy including SSAPs, findings of working groups, non-binding GAAP literature.</li> <li>• SSAP, Emerging Accounting Issues Working Group, NAIC Annual Statement Instructions, Certain GAAP Publications. Sources are to be considered in the order listed.</li> </ul> <p>Candidates received partial credit for any of the following responses:</p> <ul style="list-style-type: none"> <li>• Contact the DOI in the state of domicile.</li> <li>• Seek guidance from the NAIC.</li> </ul>	
<b>Part d: 0.5 point</b>	
<p>Candidates received full credit for any two of the following responses:</p> <ul style="list-style-type: none"> <li>• An error is material if it affects the decision-making of an end-user or a conclusion that he/she reached or causes the statement to be misleading</li> <li>• Consider the error as a % of DWP or % of policyholder surplus</li> <li>• Percentage difference from actual amount in the financial statement</li> <li>• Will the error trigger an RBC company action level if triggered?</li> <li>• Would it cause the insurer to breach IRIS or RBC ratios?</li> <li>• Would the error change a profit into a loss?</li> <li>• Whether it will change a reserve analysis opinion in SAO</li> <li>• Will the error cause a drop in the financial strength ratings?</li> <li>• Context, as the relative size of the error is more important than the absolute size / How</li> </ul>	

## SAMPLE ANSWERS AND EXAMINER'S REPORT

does the error compare to the overall amount?

- Whether the error, although small, arose out of unusual activity
- The preparer should determine how precise the financial statement item is. As precision increases, the smaller the variation may be considered material.

### EXAMINER'S REPORT (BY PART, AS APPLICABLE)

To respond successfully to this question, candidates needed to understand the purposes of codification of SAP; identify either the SSAPs or the NAIC Accounting Practices and Procedures Manual as the source publication for preparing and issuing statutory financial statements for companies in the U.S.; be able to fully describe the process by which to find guidance for preparing statutory financial statements when the SSAPs do not provide appropriate guidance (as described in the Statutory Accounting Principles Preamble; and describe considerations for a preparer of statutory financial statements in making a judgment as to whether an error contained in a financial statement is material (as described in the Statutory Accounting Principles Preamble).

Overall candidates had difficulty with all subparts of this item. The primary source of difficulty appeared to be due to inadequate coverage of these topics in preparation for the exam.

#### Part a

- Candidate was expected to know the purpose of codification as described in the Statutory Accounting Principles Preamble or Financial Reporting Through the Lens of a Property/Casualty Actuary Introduction.
- To obtain full credit the candidate needed to identify two of the purposes of codification discussed in either of these sources. If more than two purposes were presented, the first two were evaluated for grading purposes.
- Common incorrect responses included
  - to ensure a conservative view of solvency
  - to protect the policyholder's interests
  - to have a liquidation view
  - to bring SAP more in line with GAAP
  - provide guidance in accounting principles
  - remove management judgment
  - to have written rules to follow
  - easy to track modifications
  - clarity
  - not subject to manipulation
  - desire for increased transparency
  - increased international business is increasing the need for consistent accounting with other countries
- Candidates who described two essentially synonymous purposes (e.g. "uniformity" and "consistency" were viewed as having presented a single concept.
- A number of candidates did not understand what was meant by "codification"

#### Part b

Candidates generally did poorly on this section and were unable to identify the exact publication. Some candidates identified the NAIC which is the organization that promulgates the SAPs instead of the publication itself. Another common wrong answer was the Instructions for the Annual Statement Blanks.

## SAMPLE ANSWERS AND EXAMINER'S REPORT

### Part c

Candidates struggled with fully describing the process to find guidance if the source publication does not provide it. To receive full credit, the answer needed to discuss multiple sources and reference a hierarchy or order to which the sources referenced should be used. They generally needed to include a Level 2, 3, 4 or 5 source. Level 1 was also accepted if SSAP wasn't already identified in part b. A common answer received was to contact regulators, the DOI or the NAIC. While this is certainly one step that can be taken, that answer alone wasn't enough to receive full credit. Somewhat less common wrong answers were to reference ASOPs, consult with a reserving actuary or CPA, or contact the SEC.

### Part d

- Candidate was expected to know considerations for making a judgment about materiality when confronted with an error in a statutory financial statement (as described in the Statutory Accounting Principles Preamble).
- To obtain full credit the candidate needed to identify two of the considerations specifically related to evaluating an error in a statutory financial statement. If more than two considerations were presented, the first two were evaluated for grading purposes.
- Common incorrect responses included
  - It would affect/impact the user ( the candidate needed to explain that the presence of the error would impact the user's decision)
  - The intended user
  - Compare error to materiality standard / relation to materiality standard
  - Size of error (the candidate needed to discuss that the relative magnitude of the error must be considered)
  - Was error purposely misleading?
  - The intended user's sophistication
  - The amount of time that has passed since the statement was issued
  - Prudent person consideration
- Candidates presenting synonymous considerations were given credit for one consideration (e.g. 1) impact user's decision-making; 2) make the financial statement misleading)