20. (2.5 points)

a. (0.5 point)

Contrast the purpose of U.S. GAAP and SAP accounting.

b. (2 points)

Briefly describe how each of the following is treated under both U.S. GAAP and SAP accounting, and briefly explain how the difference in treatment supports the respective purposes described in part a. above:

i. Acquisition Costs

ii. Nonadmitted Assets

CONTINUED ON NEXT PAGE

Common errors include:

- Reversing the SAP formula for goodwill as surplus/equity minus purchase price.
- Stating that the surplus/equity used is that of the acquiring company
- Incorrectly stating that GAAP amortizes goodwill.

QUESTION 20	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C3**
SAMPLE ANSWERS	
Part a: 0.5 point	
Sample answers include: • US GAAP accounting is based on going-concern whereas SAP accounting is focused on solvency & liquidity concerns. • SAP Purpose: Regulators use to determine the company's ability to pay out current liabilities and protect policyholder. GAAP Purpose is to provide information to investors, creditors and other stakeholders. Look at the company on a going-concern. • GAAP: Accurate measurement of earnings. Used primarily by investors. SAP: conservative accounting rules for solvency regulation. Used primarily by regulators.	
Part b: 2 points	
Sample responses for Acquisition Cost include: • SAP: recognized immediately. This is consistent with purpose because it assumes these costs would not be recovered if the company was to go out of business. GAAP: deferred to match the recognition of income. This is consistent with its purpose because want to see the profitability of the business as time goes on. • GAAP amortized acquisition costs over the life of the asset, while SAP recognizes the acquisition costs immediately. For SAP, this could be done because the money has already been spent. For GAAP, we want to match timing of assets & liability to think of company as a going concern. • SAP Treatment: charged as expense 100% at time incurred. Purpose: All cost is paid at time business acquired and funds not available should company become insolvent. GAAP Treatment: deferred acquisition cost account established to match costs as policies earn. Purpose: recognizes matching of premium costs over time. Sample responses for Non-admitted Assets include: • US GAAP does not have non-admitted assets as all assets are used. SAP disallows certain assets from being used in valuations because of low liquidity. These assets are called non-admitted assets. • SAP – doesn't allow for non-admitted assets. Non-admitted assets cannot be liquidated in the event of an insolvency so it supports the solvency purpose of SAP. GAAP – non-admitted assets are recognized. They are still assets and of value to the company, so it supports the going-concern purpose of GAAP.	

- SAP Treatment: excluded from assets and therefore PHS (surplus). Purpose: assets that are considered not liquid or uncollectible, and would likely not be available in case of insolvency. GAAP Treatment: no distinction of "non-admitted". Purpose: all assets are "available" over lifetime of company.

EXAMINER'S REPORT

Candidates were expected to compare the purpose of different accounting standards (SAP and GAAP) and to describe the accounting treatment for acquisition costs and non-admitted assets

Part a

Candidates were expected to contrast the purpose of U.S. GAAP and SAP accounting.

Common errors include:

- Simply stating who used each type of accounting (e.g., investors vs. regulators).
- For GAAP, simply stating that this is for "measuring financial performance" (SAP also measures financial performance).
- For GAAP, stating that this is used for tax purposes without provide further rationale.
- For GAAP, stating that this is used for comparability to other industries without providing further rationale.

Part b

Candidates were expected to describe the treatment and the purpose for the treatment under GAAP and SAP of acquisition costs and non-admitted assets.

Common errors include:

- Providing the treatment but not explaining the purpose for the treatment.
- Stating that GAAP used DAC but not stating how costs were deferred or simply stating that costs were deferred "over time" without being more specific.
- Simply stating that the SAP treatment was "conservative" or "supported solvency" without providing a rationale as to why the conservative treatment was appropriate.

QUESTION 21

TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C4**

SAMPLE ANSWERS

Sample 1

RTI: EP: 399 - (72-57)	= 384	
20% Δ UEPR: .2 (72-57)		= 3
Paid Loss: -223		= -223
Δ Discounted Rsvs: (79-99)	= -20	
Muni Interest: 20*.15	= 3	
Dividends: 440*.2 + 440*.8*.15	=<u>140.8</u>	