21. (2.5 points)

A company is considering the acquisition of two small insurers (all dollar figures are in thousands):

Insurer A

Assets -- Buildings & Furniture	$400
Assets -- Other than Buildings & Furniture	$9,000
Liabilities	$6,000

Insurer B

Assets -- Buildings & Furniture	$500
Assets -- Other than Buildings & Furniture	$8,000
Liabilities	$7,000

- The purchase price for Insurer A is $3,000
- The purchase price for Insurer B is $3,000
- Assume a 0% tax rate

a. (1 point)

Calculate the U.S. GAAP goodwill that would result from the acquisition of each insurer.

b. (0.5 point)

Briefly describe how the acquisition of each insurer would impact the purchasing company's U.S. GAAP income statement.

c. (1 point)

Describe how the valuation of a goodwill asset changes over subsequent reporting periods under each of SAP and U.S. GAAP.

Common errors include:
- Only providing one point of contrast
- Confusion between GAAP vs SAP accounting methodology
- Vague answers with limited details/explanation.

Part d

Candidates were expected to detail how the treatment of bonds under SAP accounting principles conflicts with its primary purpose of ensuring insurer solvency.

Common errors include:

- Not differentiating between classes 1 and 2 versus the other bond classes in their respective valuation treatments
- Not articulating the basis for the conflict, i.e. insufficient to just say classes 1-2 bonds are valued at amortized cost which is greater than fair market value without reference to not holding bonds to maturity
- Inferring that a deterioration in bond rating would cause the conflict

FALL 2019 EXAM 6U, QUESTION 21	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C3**
SAMPLE ANSWERS	
Part a: 1 point	

Sample 1
Goodwill = Purchase Price – (Fair Value of Assets – Fair Value of Liabilities)
GAAP so no non-admitted assets.
A: 3000 – (9400-6000) = -400, so no goodwill
B: 3000 – (8500 – 7000) = 1500

Sample 2
Insurer A:
    Goodwill = 3000 – (9400-6000) = -400
    Minimum value 0
    Goodwill = 0
Insurer B:
     Goodwill = 3000 – (8500 – 7000) = 1500

Sample 3
A: max(3000 – (9000+400-6000),0) = 0
B: max(3000 – (8000+500-7000),0) = 1500

Part b: 0.5 point

One response is needed for Insurer A and one response for insurer B.

Sample Responses for Insurer A
- Since purchase price is lower than the surplus, a gain of 400 will be recorded.
- Income increases by 400.

Sample Responses for Insurer B
- Goodwill asset is established, and there is no impact to the income statement.
- No immediate impact.
- Goodwill asset offsets the difference between purchase price and surplus – No impact

Part c: 1 point

One of the following responses is needed for SAP and one of the following responses is needed for GAAP.

Sample Responses for SAP
- Amortized for the period the acquiring company benefits, up to a maximum of 10 years.
- Goodwill value is amortized over time to unrealized capital gains.

Sample Responses for GAAP
- GAAP does not amortize goodwill but it is evaluated regularly for impairment.
- Recognized immediately, and regularly tested for impairment.
- Goodwill asset is held indefinitely, but regularly tested for impairment

EXAMINER'S REPORT

- Candidates were expected to know the differences between SAP & GAAP accounting, understand the concept of purchase accounting including goodwill, impact on the income statement and how it changes over time.

Part a

Candidates were expected to know the formula for goodwill including the floor and that there are no non-admitted assets in GAAP.

Common errors included:
- Not including the floor in the formula and therefore recognizing negative goodwill for Insurer A, rather than 0.
- Not including non-admitted assets in the calculation.
- Flipping the formula order, subtracting purchase price from the fair value of the company, rather than vice versa.

Part b

Candidates were expected to know what items appear on the income statement, understand how purchase price, surplus and goodwill affect the income statement and state the impact to income.

Common errors included:
- Discussing balance sheet items.
- Missing the fact that the goodwill asset for B offsets the excess paid and stating an income decrease.
- Linking positive goodwill to an income increase and vice versa.

Part c

Candidates were expected to know the differences in how SAP and GAAP accounting treat goodwill over time.

Common errors included:
- Stating that SAP was amortized over 10 years but not recognizing this is a maximum timeframe.
- Using the word depreciation rather than amortization.
- Only including that GAAP goodwill is tested for impairment.

FALL 2019 EXAM 6U, Question 22	
TOTAL POINT VALUE: 2.75	**LEARNING OBJECTIVE: D**
SAMPLE ANSWERS	
Part a: 2.5 points	

Sample 1
I believe it is necessary to issue a qualified opinion of Company's reserves, due to material inconsistencies in the data preventing a review of the reasonability of the WC reserves. These reserves account for 36% of net carried reserves, or $50M. In regards to the remaining reserves, in my opinion the items listed in Exhibit A:
 A: Meet the requirements of insurance laws in State X
 B: Are computed in accordance with actuarial standards & practices.
 C: Make a reasonable provision for all net unpaid loss and LAE obligations under company's contracts and agreements. However, the company makes an excessive provision for gross unpaid loss and LAE obligations. The carried amount is $2M higher than the maximum reserves I deem to be reasonable.

Sample 2
In my opinion, the amounts carried in Exhibit A for loss & LAE Reserves are:
 a) Computed using methods and assumption accepted by actuarial standards
 b) Follow the laws and regulation of state X.
 c) Make for a reasonable amount on a net basis. The amounts on a gross basis are redundant as my high end is 98M. With this, the difference is 2M. I was not able to analyze WC reserves due to material inconsistencies in the data. The amount carried