Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Going Concern**

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

This agenda item has been drafted due to the prevalence of SCAs being identified as a “going concern” in 2018 audit reports for SCA Sub 2 filings. The going concern principle is the assumption that a company will continue into the foreseeable future, unless there is evidence to the contrary. During a financial statement audit, the auditor has an obligation to review the company’s ability to continue as a going concern. If there is substantial doubt about the company’s ability to continue in the future, a going concern qualification is supposed to be included in the auditor’s opinion of the company’s financial statements. Indicators of going concern can include the following:

* Negative trends such as declining sales, increasing costs, recurring losses, adverse financial ratios, etc.
* Legal proceedings against the company, which may include pending liabilities and penalties related to the violation of environmental or other laws
* Loss or expiration of a key license or patent
* Default on a loan or inability to secure new financing
* Loss of a major customer or key supplier

Under statutory accounting, the investment in a company with a going concern audit opinion must be nonadmitted in the reporting insurance entity’s financial statements. However, statutory accounting procedures do not specify any action to be taken in the event that a going concern is noted in any other part of the audit report aside from the audit opinion. Over the last year there have been a few instances in which the audit opinions did not explicitly detail the going concern, but the notes in the audited financial statements identified that there was a going concern. (In one situation, the audit opinion originally reflected a going concern, but the audit opinion was refiled with the NAIC to eliminate the reference from the audit opinion. In this resubmission, the going concern for the company was still detailed in the audited financial statements.)

One of the key foundation concepts of statutory accounting is conservatism. Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. As such, if an unalleviated going concern is mentioned in any part of the audit report or accompanying financial statements / notes, the value of the SCA should be nonadmitted.

Existing Authoritative Literature:

SSAP No. 97:

Paragraph 8

1. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:
2. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity’s ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21.

**Paragraph 21**

1. The investment shall be nonadmitted if the audit opinion contains explanatory language indicating that there is substantial doubt about the investee’s ability to continue as a going concern.

Exhibit C – Implementation Questions and Answers

5. Q - Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?

5.1 **A –** Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity’s ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit **opinion** (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS):** None

Staff Recommendation:

Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as detailed below, to expand the parameters for nonadmittance of entities with going concern.

Proposed Revisions:

SSAP No. 97:

Paragraph 8

1. The following provides guidance regarding the audits for entities covered under paragraph 8.b.:
2. The investment in the SCA shall be nonadmitted if the audited financial statements include substantial doubt about the entity’s ability to continue as a going concern. Additionally, the investment shall be nonadmitted on the basis/contents of the audit opinion as detailed in paragraph 21.

**Paragraph 21**

1. The investment shall be nonadmitted if the audit report or accompanying financial statements / notes contains explanatory language indicating there is an unalleviated substantial doubt about the investee’s ability to continue as a going concern.

5. Q - Does the audit opinion provided on the subsidiaries financial statements have to be clean or unqualified in order for the SCA investment to be admitted?

5.1 **A –** Paragraph 21 addresses various opinions that can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. In certain cases, such as when the audit opinion is a disclaimer of opinion or there is indication that there is substantial doubt about the entity’s ability to continue as a going concern, the guidance states the investment shall be nonadmitted. In instances where there is a substantial doubt about the entity’s ability to continue as a going concern listed in any part of the audit report or accompanying financial statements / notes, the investment shall be nonadmitted. In addition, if there is a qualified opinion due to a departure from GAAP (or an adverse opinion) or due to a scope limitation, the investment shall be nonadmitted unless the impact of the departure is quantified within the audit **opinion** (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). In cases where the departure is quantified, the reporting entity would admit the amount after adjusting for the quantified departure from GAAP. An audit report that contains a qualified or adverse opinion for any other reason than for what is stated within paragraph 21 would result in the nonadmissibility of the investment within that subsidiary. There is no need to quantify the impact of a departure from GAAP in either the auditor’s report or the footnotes to the financial statements if a qualified audit opinion is issued due to a departure from GAAP and the departure is related to the valuation of an U.S. insurance entity on the basis of U.S. statutory accounting principles. In such cases, the investment shall be admitted without quantifying the departure.

Staff Review Completed by:

**Fatima Sediqzad - NAIC Staff**

**July 2019**

**Status:**

On August 3, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*, as illustrated above, to clarify that if an unalleviated going concern is noted in audited financial statements or audit opinion, the SCA shall be nonadmitted.

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