Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: SSAP No. 97 – Audit Opinions**

**Check (applicable entity):**

 P/C Life Health

Modification of Existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue: *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* provides guidance for the various audit opinions that can be issued when an entity records certain investments utilizing the U.S. GAAP equity method of accounting.

The complete guidance for the various audit opinions is included in the ‘Existing Authoritative Literature,” however the relevant guidance is summarized as:

* Disclaimers of opinion shall be nonadmitted.
* Qualified opinions due to a scope limitation can only be admitted if the limitation is quantified, then the quantified limitation is nonadmitted.
* Qualified opinions due to a GAAP departure can only be admitted if the departure is quantified (then the departure is nonadmitted), OR if the departure is as the result of utilizing a statutory accounting principle in lieu of following GAAP (in such cases, a quantification of the departure is not required).
* Adverse opinions due to a GAAP departure can only be admitted if the departure is quantified (then the quantified departure is nonadmitted), OR if the departure is as the result of utilizing a statutory accounting principle in lieu of following GAAP (in such cases, a quantification of the departure is not required).

The allowance of qualified or adverse audit opinions for admission of SCA investments without quantification are only permitted for U.S. insurance entities (commonly referred to as an 8.b.i entity). This agenda item proposes to expand the quantification exception guidance to 8.b.iii entities (referred to as U.S. GAAP SCA entities) in limited situations. Particularly, the proposed exception would allow U.S. GAAP SCA entities that depart from a U.S. GAAP provision that has been rejected for statutory accounting to be admitted SCAs without quantification if the departure from U.S. GAAP results in a more conservative position (i.e. fewer assets or greater liabilities), as a result of the departure.

Although specific quantification is not needed, this would require auditor certification that the departure from U.S. GAAP results in a more conservative position. From a situation shared in which an 8.b.iii SCA (U.S. GAAP entity) was following provisions similar to the insurer with regards to revenue recognition, the auditor noted that the U.S. GAAP revenue recognition provisions (which requires consideration of future, expected activity) warranted a qualified opinion. Under the existing guidance, this qualified opinion results in nonadmittance of the SCA because it could not be quantified, which was material to the reporting entity. This nonadmittance treatment was noted to be punitive as the SCA was following processes that were consistent with SAP accounting that resulted in a more conservative financial statement representation of the SCA.

Existing Authoritative Literature: The entity types (8.b.i, 8.b.ii, etc.) referenced in the ‘Description of Issue,’ the audit opinion requirements and the permitted exceptions to the unqualified opinion requirements within SSAP No. 97 are below. Relevant guidance has been bolded for emphasis.

*SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*

### Applying the Market Valuation, Audited Statutory Equity and Audited GAAP Equity Methods

1. The admitted investments in SCA entities shall be valued using either the market valuation approach (as described in paragraph 8.a.), or one of the equity methods (as described in paragraph 8.b.) adjusted as appropriate in accordance with the guidance in *SSAP No. 25—Affiliates and Other Related Parties*, paragraph 17.d.
2. In order to use the market valuation approach for SCA entities, the following requirements apply:
3. The subsidiary must be traded on one of the following major exchanges: (1) the New York Stock Exchange, (2) the NASDAQ, or (3) the Japan Exchange Group;
4. The reporting entity must submit subsidiary information to the NAIC SCA analysts for calculation of the subsidiary’s market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;
5. Ownership percentages for determining the discount rate shall be measured at the holding company level;
6. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;
7. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;
8. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required.
9. Further, the SCA must have at least two million shares outstanding, with a total market value of at least $50 million in the public’s control; and
10. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.
11. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 8.a. or, if the requirements are met, but a reporting entity elects not to use that approach, the reporting entity’s proportionate share of its investments in SCAs shall be recorded as follows:
12. **Investments in U.S. insurance SCA entities shall be recorded based on either** 1) the underlying audited statutory equity of the respective entity’s financial statements, adjusted for any unamortized goodwill as provided for in *SSAP No. 68—Business Combinations and Goodwill* or 2) **the underlying audited statutory equity of the respective entity’s financial statements**, adjusted for any unamortized goodwill, modified to remove the impact of any permitted or prescribed accounting practices that depart from the NAIC *Accounting Practices and Procedures Manual*. Reporting entities shall record investments in U.S. insurance SCA entities on at least a quarterly basis, and shall base the investment value on the most recent quarterly information available from the SCA. Entities may recognize their investment in U.S. insurance SCA entities based on the unaudited statutory equity in the SCAs year-end annual statement if the annual SCA audited financial statements are not complete as of the filing deadline. The recorded statutory equity shall be adjusted for audit adjustments, if any, as soon as the annual audited financial statements have been completed. Annual consolidated or combined audits are allowed if completed in accordance with the Model Regulation Requiring Annual Audited Financial Reports as adopted by the SCA’s domiciliary state;
13. **Investments in both U.S. and foreign noninsurance SCA entities that do not qualify under paragraph 8.b.ii., shall be recorded based on the audited U.S. GAAP equity of the investee.** Foreign SCA entities are defined as those entities incorporated or otherwise legally formed under the laws of a foreign country. Additional guidance on investments in downstream holding companies is included in paragraphs 22-27. Additional guidance on the use of audited foreign GAAP basis financial statements for the U.S. GAAP equity valuation amount is included in paragraph 23.b.

### Qualified Versus Unqualified Opinions

1. Various opinions can be issued in which an entity can record certain investments under the GAAP Equity method of accounting. The reporting entity shall record investments that require audited GAAP equity in the manner described below when the audit opinion on the GAAP financial statements contains the following language:
2. The investment shall be nonadmitted if the audit opinion contains a disclaimer of opinion for the most recent statement of financial position presented in the financial statements.
3. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a scope limitation that impacts the most recent statement of financial position presented in the financial statements and the impact of the scope limitation cannot be quantified. However, if the impact of the scope limitation is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified scope limitation.
4. **The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a departure from GAAP** that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. **EXCEPTION: 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.**
5. **The investment shall be nonadmitted if the audit opinion contains an adverse opinion due to a departure from GAAP** that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements (see quantification exception related to the valuation of a U.S. insurance entity on the basis of U.S. statutory accounting principles discussed below). However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP. **EXCEPTION: 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 an adverse 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.**
6. 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.

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):** Not Applicable

**Staff Recommendation:** **NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and request comments on the extent to which situations exist that hinder admittance of 8.b.iii entities due to the departure of U.S. GAAP as a result of the inability to quantify the departure.**

Staff Review Completed by: Jim Pinegar - NAIC Staff – September 2020

**Status:**

On November 12, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on the extent in which situations exist that hinder admittance of 8.b.iii. entities due to the inability to quantify a departure from U.S. GAAP.

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