Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** Clarification of Prescribed Practices

**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 intends to clarify the definition and application of prescribed practices. This issue has been presented in response to questions received on existing references in the NAIC *Accounting Practices & Procedures Manual* (AP&P)*.* In summary:

* Each state insurance department has the authority to regulate any insurance company that is licensed in their state. The AP&P Manual is not intended to preempt states’ legislative and regulatory authority.
* The financial statements filed with the NAIC and subject to independent audit, pursuant to *Model Law 205: Annual Financial Reporting Model Regulation* shall be in accordance with practices prescribed or permitted by the domiciliary state.
* However, a non-domiciliary state in which the company is licensed may require or allow different accounting practices in the financial statements filed in that state. Ideally, to prevent reporting entities from having to file different financial statements or reports with differing states, the practices permitted or prescribed by a domiciliary state will be accepted in all states in which a company is licensed. However, as noted above, the provisions of the AP&P Manual are not intended to preempt states’ legislative or regulatory authority. Accordingly, each state in which a company is licensed could allow or require differing financial reports. If a non-domiciliary state in which the company is licensed requires or allows a practice by state statute / bulletin (or other state-wide provision) that is different from NAIC SAP, this provision is also considered a prescribed practice. If the company files financial statements that reflect this practice, even if the financial statements are filed only in the non-domiciliary state, then the prescribed practice disclosure of Note 1 shall apply.

Examples of two possible situations:

Scenario 1: Non-domiciliary State A issues a state statute / bulletin that requires an accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

Scenario 1 Conclusion: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity also shall file separate financial statements with State A in accordance with the accounting practice mandated by that non-domiciliary state.

Scenario 2: Non-domiciliary State A issues a state statute / bulletin that allows an accounting practice for all companies that are licensed and doing business within State A. Domiciliary State B does not issue a comparable state statute / bulletin.

Scenario 2 Conclusion: The reporting entity shall file statutory financial statements with their domiciliary state and the NAIC in accordance with the statutory accounting practices permitted or prescribed by the domiciliary state (State B). (These financial statements would be subject to the independent audit requirements per Model 205.) The reporting entity then has the ability, but is not required, to file financial statements in State A that reflects the accounting practice prescribed by that non-domiciliary state.

Existing Authoritative Literature:

*Preamble*

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state’s statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state’s insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA’s Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile.

*Preamble Questions and Answers*

*Permitted Practices Advance Notification Requirement – Implementation Questions and Answers*

1. **Q: What is the difference between a permitted accounting practice and a prescribed practice?**

 A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer’s domiciliary state regulatory authority.

 **Prescribed** accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled in a particular state. The NAIC AP&P Manual is not intended to preempt states’ legislative and regulatory authority.

 If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

The NAIC Model laws do not contain a definition of “prescribed practice,” but references to prescribed practices are noted in the Model laws below. These are provided as reference. There are no revisions proposed to the Model Laws:

Model 205 – Annual Financial Reporting Model Regulation

Section 6 - Designation of Independent Certified Public Accountant

B. The insurer shall obtain a letter from the accountant, and file a copy with the commissioner stating that the accountant is aware of the provisions of the insurance code and the regulations of the Insurance Department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that Insurance Department, specifying such exceptions as he or she may believe appropriate.

Model 450 – Insurance Holding Company System Model Regulation with Reporting Forms and Instructions

Item 12. Financial Statements and Exhibits

The annual financial statements of the applicant shall be accompanied by the certificate of an independent public accountant to the effect that such statements present fairly the financial position of the applicant and the results of its operations for the year then ended, in conformity with generally accepted accounting principles or with requirements of insurance or other accounting principles prescribed or permitted under law. If the applicant is an insurer which is actively engaged in the business of insurance, the financial statements need not be certified, provided they are based on the Annual Statement of the person filed with the insurance department of the person’s domiciliary state and are in accordance with the requirements of insurance or other accounting principles prescribed or permitted under the law and regulations of the state.

Model 785 – Credit for Reinsurance Model Law

Section 4. Qualified U.S. Financial Institutions

4.c. Maintains at least $250 million in capital and surplus when determined in accordance with the NAIC Accounting Practices and Procedures Manual, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices; and is

Model 787 – Term and Universal Life Insurance Reserve Financing Model Regulation

Section 6. The Actuarial Method

B. Valuation used for Purposes of Calculations

For the purposes of both calculating the Required Level of Primary Security pursuant to the Actuarial Method and determining the amount of Primary Security and Other Security, as applicable, held by or on behalf of the ceding insurer, the following shall apply: (1) For assets, including any such assets held in trust, that would be admitted under the NAIC Accounting Practices and Procedures Manual if they were held by the ceding insurer, the valuations are to be determined according to statutory accounting procedures as if such assets were held in the ceding insurer’s general account and without taking into consideration the effect of any prescribed or permitted practices; and

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 expose proposed revisions to the Preamble Implementation Questions and Answers to clarify prescribed practices. These revisions clarify that while any state in which a company is licensed can issue prescribed practices, the prescribed practices directed by the domiciliary state shall be reflected in the financial statements filed with the NAIC and are the financial statements subject to the independent auditor requirements. (NAIC staff do not believe revisions are necessary to paragraph 12 of the Preamble as that guidance does not limit practices to the domiciliary state and already confirms that the domiciliary state practices shall be reflected in the financial statements subject to audit. For reference paragraph 12 is below.)

12. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state’s statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state’s insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA’s Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. **Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile**.

Proposed Revisions to the Preamble Questions and Answers:

1. **Q: What is the difference between a permitted accounting practice and a prescribed practice?**

 A: **Permitted** accounting practices include practices specifically requested by an insurer that depart from NAIC Statutory Accounting Principles (SAP) and state prescribed accounting practices, as described below, and have received approval from the insurer’s domiciliary state regulatory authority.

 **Prescribed** accounting practices are those practices that are incorporated directly or by reference by state laws, regulations and general administrative rules applicable to all insurance enterprises domiciled and/or licensed in a particular state. The NAIC AP&P Manual is not intended to preempt states’ legislative and regulatory authority. Prescribed accounting practices of the domiciliary state shall be reflected in the statutory financial statements filed with the NAIC. Non-domiciliary states may additionally require insurance entities licensed in their state to file financial statements in accordance with the prescribed accounting practices of that particular non-domiciliary state.

 If a reporting entity requests an accounting practice that differs from state prescribed accounting practices, but is in accordance with NAIC SAP, advance notice of approval is not required.

Staff Review Completed by:

Julie Gann - NAIC Staff

July 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 proposed revisions to the Preamble Implementation Questions and Answers to clarify prescribed practices, as illustrated above. These revisions clarify that while any state in which a company is licensed can issue prescribed practices, the prescribed practices directed by the domiciliary state shall be reflected in the financial statements filed with the NAIC and are the financial statements subject to the independent audit requirements.

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