

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Conceptual Framework – Updates

Check (applicable entity):

	P/C	Life	Health
Modification of Existing SSAP	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interpretation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Description of Issue: In December 2021, the Financial Accounting Standards Board (FASB) issued two new chapters of its conceptual framework. The conceptual framework is a body of interrelated objectives and fundamentals that provides the FASB with a foundation for setting standards and concepts to consider when it resolves questions or develops/modifies accounting and reporting guidance.

It is important to note that the Statements of Financial Accounting Concepts are not authoritative and do not establish new or change existing U.S. GAAP. Per the FASB chair, these concepts are “a tool for the Board to use in setting standards that improve the understandability of information entities provide to existing and potential investors, lenders, donors, and other resource providers.”

This agenda item reviews and summarizes each of the two newly issued concept chapters and reviews their potential impact on statutory accounting. Again, while the conceptual framework statements are not authoritative, they are the guiding principles for standard setting and these new updates have superseded chapters currently referenced in the *Accounting Practices and Procedures Manual (AP&P Manual)*. In addition, and most notably, in the case of one of these chapters, FASB changed certain key fundamental definitions, specifically the definition of an asset and a liability, which have historically been mirrored by statutory accounting.

Update 1:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements* introduced updated definitions of certain key elements used in financial reporting – the definition of an asset and liability. The chapter states that assets and liabilities have conceptual and definitional primacy because assets and liabilities (and changes in those elements) are foundational to all the other items reported in the financial statements. To correctly identify and represent an asset or liability is the beginning basis for all financial reporting and due to their importance, updates to both financial statement elements have been adopted. A summary of each, comparing the historical and current definitions, is provided below:

Changes regarding the definition of an ASSET:

- **Historical definition:** a probable future economic benefit obtained or controlled by a particular entity as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,
 2. a particular enterprise can obtain the benefit and control others' access to it, and
 3. the transaction or other event giving rise to the enterprise's right to or control of the benefit has already occurred.
- **New Definition:** a present right of an entity to an economic benefit.
- **Current Characteristics: Two essential characteristics:**

1. it is a present right, and
2. the right is to an economic benefit.

The combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. For clarity, an "economic benefit" represents services or other items of economic value and generally result in net cash inflows to the entity.

Commentary regarding definitional changes:

The current definition of an asset no longer includes the term *probable* or the phrases *future economic benefit* and *past transactions or events*. The FASB concluded that the term *probable* has historically been misunderstood as implying that a future benefit must be probable to a certain threshold before the definition of an asset was met. Thus, if the probability of a future benefit was low, an asset could not be recognized. FASB also struck the phrase *future economic benefit* as this phrase often was interpreted that the asset must represent a certain future economic benefit (such as eventual cash inflows), however with this update, FASB clarified that the asset represents the rights to the benefit, not the actual benefit itself – nor the probability of realization.

Finally, FASB struck the phrase as the result of *past transactions or events*. It was concluded that if the asset represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Changes regarding the definition of a LIABILITY:

- **Historical definition:** are [certain or] probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
- **Historical Characteristics: Three essential characteristics:**
 1. it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
 2. the duty or responsibility obligates a particular enterprise, leaving it little or no discretion to avoid the future sacrifice, and
 3. the transaction or other event obligating the enterprise has already happened.
- **New Definition:** a present obligation of an entity to transfer an economic benefit.
- **Current Characteristics: Two essential characteristics:**
 1. it is a present obligation, and
 2. the obligation requires an entity to transfer or otherwise provide economic benefit to others. (For the purposes of this characteristic, *transfer* is typically used to describe obligations to pay cash or convey assets, while the term *provide* is used to describe obligations to provide services or stand by to do so).

Commentary regarding definitional changes:

The current definition of a liability no longer includes the term *probable* or the phrase *in the future as a result of past transactions or events*. The FASB concluded that the term *probable* has historically been understood as implying that a future obligation must meet a probability to a certain threshold before the definition of a liability was met. Thus, if the probability of a future transfer of an asset (or the requirement to provide a service) was low, a liability would likely not be recognized. In removing the term *probable* (and replacing it with "present obligation"), FASB concluded that in almost all situations, the presence of an obligation will be apparent. It stated

that most present obligations are legally enforceable, including obligations arising from binding contracts, agreements, statutes, or other legal or contractual means. Chapter 4 also discusses the prevalence of certain business risks and how to assess if they result in the recognition of a liability. It concluded that while certain businesses pose risk of future events occurring that will cause them to transfer an economic benefit (an asset), the risk itself does not represent a present obligation because exposure to a potential negative consequence does not constitute a present obligation.

However, FASB also stated situations lacking clear legal or contractual evidence of a present obligation may pose particular challenges that may make it difficult to discern whether a present obligation exists. In these settings, the FASB stated that constructive obligations or other noncontractual obligations are created by circumstance rather than by explicit agreement. In the absence of an explicit agreement, sufficient information to distinguish a present obligation is likely only available at the specific standards level. Thus, the FASB concluded that the specific facts and circumstances at the standards level (or in the case of statutory accounting, at the SAP level) must be utilized to determine whether the entity has created a constructive obligation and must recognize a liability.

FASB also struck the phrase as the result of *past transactions or events*. It was concluded that if the liability represents a *present right*, by default, the right must have occurred as the result of a past transaction or event and thus this phraseology was deemed redundant and unnecessary.

Update 2:

FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* identifies factors that the FASB will consider when deciding **how** items should be displayed on the financial statements. Chapter 7 describes the information to be included in the financial statements and how appropriate presentation can contribute to the objective of financial reporting – to communicate financial information about an entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources (goods and services) to the entity. These decisions typically involve buying or selling of goods/services or holding equity and debt instruments as well as providing or settling loans or other forms of credit. This chapter articulates that the financial statements meet a “general purpose” and should not be considered to meet all purposes for possible users – and thus a common set of conceptual standards is appropriate.

Chapter 7 also describes the importance of financial statement notes, or supplementary information so that financial statement users are provided with a more complete picture of an entity’s accounting policy or any particular unique circumstance or event. In terms of general reporting, the conceptual statement relays that a distinction between nonhomogeneous items should be depicted in the financial statements with different reporting line items and subtotals and that the information should be provided based on recognition and measurement standards. In essence, reporting should be sufficiently aggregated, but not aggregated to a level in which the information is too consolidated for general use and understanding. Once reported, then any significant accounting policy or circumstance would further be defined with accompanying notes.

The chapter broadly states that to meet the objectives of financial reporting, line items should be distinct based on the information being provided – as the information should distinguish between various types of transactions/events and should assist users in their estimates in the amounts and timing of future cash flows or the entity’s ability to provide other economic value. The financial statements should depict the results of different types of transactions, including changes in events or other circumstances that may vary the frequency or predictability of performance based on many items, including changes in economic conditions.

In summary, while Chapter 7 does supersede sections of *Statement of Financial Accounting Concept 5*, it did not result in fundamental changes to the principal concepts of financial reporting. The chapter articulates the need for complete financial reporting, describes the interconnectedness of a ‘complete set of financial statements’ and relays the importance of these documents as the information in the financial statements is the primary (and typically the sole) source for analyzing current and potential future performance of an organization and its ability to meet its long-term financial objectives. At a high level, the chapter discusses what information should broadly be categorized

as revenues, expenses, gains, and losses and to the extent equity is impacted by operations as well as changes in owners' equity through investments or distributions.

In terms of the impact to statutory accounting, the updated concepts in this chapter are not expected to modify current guidance, other than to update references to superseded accounting concepts.

Existing Authoritative Literature:

NAIC Staff Note – the Preamble contains reference to certain concept statements in footnotes 2 and 4 and have been bolded below for ease of identification. It is important to note that while these footnotes currently reference superseded conceptual statements, the conceptual statements noted do not represent adopted guidance - they are noted as reference for overarching guiding principles regarding financial reporting.

Preamble

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting principles ("SAP" or "statutory basis") and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC's guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts One, Two, Five, and Six*. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1

SSAPs, including U.S. GAAP reference material to the extent adopted by the NAIC from the FASB Accounting Standards Codification (FASB Codification or GAAP guidance)

Level 2

Consensus positions of the Emerging Accounting Issues (E) Working Group as adopted by the NAIC (INTs adopted before 2016)

Interpretations of existing SSAPs as adopted by the Statutory Accounting Principles (E) Working Group (INTs adopted in 2016 or beyond)

Level 3

NAIC Annual Statement Instructions

Purposes and Procedures Manual of the NAIC Investment Analysis Office

Level 4

*Statutory Accounting Principles Preamble and Statement of Concepts **FN4***

Level 5

Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

43. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3. Revisions to guidance in accordance with additions or revisions to the NAIC statutory hierarchy should be accounted for as a change in accounting principle in accordance with SSAP No. 3—*Accounting Changes and Corrections of Errors*.

44. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature identified in Level 5. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources of nonauthoritative GAAP pronouncements.

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

SSAP No. 4—Assets and Nonadmitted Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of an **Asset**. Relevant items have been bolded below for ease of identification.

2. For purposes of statutory accounting, **an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.** These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets

NAIC Staff Note – this SAP contains the definition of the financial statement element of a **Liability**. Relevant items have been bolded below for ease of identification.

2. A liability is defined as certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

FN1 - FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

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): While slightly different, the updated FASB asset & liability definitions do closer align with IFRS definitions. While IFRS retains the phrase “as a result of past events,” it also explicitly retains the term “control,” which is now implicit with the FASB updates. The elimination of the explicit term “control” was a deliberate action of the FASB as they noted that the notion of control has been historically misunderstood (control is to the right that gives rise to the economic benefit rather than to the economic benefits themselves). For reference *IFRS Chapter 4 – The Elements of Financial Statements*, defines an *asset* as a present economic resource controlled by the entity as a result of past events; with the economic resource representing a right that has the potential to produce economic benefits. Additionally, the chapter defines a *liability* as a present obligation of an entity to transfer an economic resource as a result of past events.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated below and in the issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting*.

Proposed edits to the Preamble: proposed modifications reflect updates for superseded FASB Financial Accounting Concepts.

IV. Statutory Accounting Principles Statement of Concepts

25. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (NAIC) in the continued development and maintenance of statutory accounting

principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.

26. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

27. SAP utilizes the framework established by GAAP. **FN2** This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC must specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

28. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

29. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

FN 2 - The GAAP framework applicable to insurance accounting is set forth in *Statements of Financial Accounting Concepts* ~~One, Two, Five, and Six~~Eight. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.

V. Statutory Hierarchy

42. The following Hierarchy is not intended to preempt state legislative and regulatory authority.

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*Statutory Accounting Principles Preamble and Statement of Concepts **FN4***

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Sources of nonauthoritative GAAP accounting guidance and literature, including: (a) practices that are widely recognized and prevalent either generally or in the industry, (b) FASB Concept Statements, (c) AICPA guidance not included in FASB Codification, (d) International Financial Reporting Standards, (e) Pronouncements of professional associations or regulatory agencies, (f) Technical Information Service Inquiries and Replies included in the AICPA Technical Practice Aids, and (g) Accounting textbooks, handbooks and articles

FN 4 - The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements ~~One, Two,~~ Five and ~~Six~~Eight to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.

Proposed edits SSAP No. 4—Assets and Nonadmitted Assets: proposed modifications reflect an updated definition of the term **Asset** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. For purposes of statutory accounting, an asset shall be defined as: a present right of an entity to an economic benefit. ~~probable FN1 future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.~~ An asset has ~~two~~three essential characteristics: (a) it is a present right ~~embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,~~ and (b) the right is to an economic benefit. ~~a particular entity can obtain the benefit and control others' access to it FN1 FN2, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.~~ These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph 3.

3. As stated in the Statement of Concepts, "The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third-party interests should not be recognized on the balance sheet," and are, therefore, considered nonadmitted. For purposes of statutory accounting principles, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2, which is accorded limited or no value in statutory reporting, and is one which is:

- a. Specifically identified within the *Accounting Practices and Procedures Manual* as a nonadmitted asset; or
- b. Not specifically identified as an admitted asset within the *Accounting Practices and Procedures Manual*.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the *Accounting Practices and Procedures Manual*. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the *Accounting Practices and Procedures Manual* as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

5. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

FN1 - *FASB Statement of Financial Accounting Concepts No. 86, Elements of Financial Statements*, states that the combination of these two characteristics allows an entity to obtain the economic benefit and control others' access to the benefit. A present right of an entity to an economic benefit entitles the entity to the economic benefit and the ability to restrict others' access to the benefit to which the entity is entitled. ~~Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

FN2 - If assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are not under the exclusive control of the insurance entity and are not available to satisfy policyholder obligations due to these encumbrances or other third-party interests. Thus, pursuant to paragraph 2(c), such assets shall not be recognized as an admitted asset on the balance sheet. Additional guidance for assets pledged as collateral is included in INT 01-31.

Relevant Literature

9. This statement incorporates the definition of an asset from ~~adopts~~ *FASB Statement of Financial Accounting Concepts No. 86, Chapter 4, Elements of Financial Statements*, paragraphs E16-E18~~25-33~~.

References

Relevant Issue Papers

Issue Paper No. 4—Definition of Assets and Nonadmitted Assets

Issue Paper No. 119—Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

Issue Paper No. 16X -Updates to the Definition of an Asset

SSAP No. 5—Liabilities, Contingencies and Impairments of Assets: proposed modifications reflect an updated definition of the term **Liability** – to match the newly issued definition in FASB Statement of Financial Accounting Concepts No. 8

2. A liability is defined as a present obligation of an entity to transfer an economic benefit. ~~certain or probable FN1 future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).~~

3. A liability has ~~three~~two essential characteristics: (a) it is a present obligation ~~embodies a present duty or responsibility to one or more other entities that entails settlement by probable FN1 future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, and~~ (b) the obligation requires an entity to transfer or otherwise provide economic benefit to others ~~duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.~~ This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity's financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

~~FN1—FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense~~

~~(such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.~~

Relevant Literature

39. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 ~~and paragraphs 35 and 36 of FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements~~. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement adopts with modification *ASU 2013-04, Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* with the same statutory modification adopted for FIN 14. [This statement incorporates the definition of a liability from FASB Statement of Financial Accounting Concepts No. 8, Chapter 4, Elements of Financial Statements, paragraphs E37 and E38.](#)

References

Relevant Issue Papers

Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets

Issue Paper No. 20—Gain Contingencies

Issue Paper No. 135—Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

[*Issue Paper No. 16X – Updates to the Definition of a Liability*](#)

Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as a SAP clarification, and expose revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets*, as illustrated in the agenda item and in the draft issue papers, to incorporate updates from *Chapter 4, Elements of Financial Statements* and *Chapter 7, Presentation of the FASB’s Conceptual Framework for Financial Reporting*.

Staff Review Completed by: Jim Pinegar– NAIC Staff, January – 2022

Status:

On April 4, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a SAP clarification, and exposed revisions to the Preamble, *SSAP No. 4—Assets and Nonadmitted Assets* and *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* to incorporate 1) updates from FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7, Presentation* which identifies factors to consider when deciding how items should be displayed on the financial statements, and 2) Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements*, which updates the definitions of an asset and a liability. The Working Group also exposed two draft issue papers for historical documentation of these SAP clarifications.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2022/4-SpringNM/Exposures/22-01ConceptualFramework.docx>