US GAAP versus IASC Insurance Accounting

IACA Meeting, Hershey, PA
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7 June 2000

Key Topics

Comparisons of US GAAP and IASC Issues
Paper - Insurance
SEC Concept Release - IAS
Comparison of Measurement Methods

† IASC Steering Committee Proposals
  - Asset / Liability Measurement
  - Fair Value and Non-Fair Value Approaches
† US GAAP
  - Deferral and Matching Approach

Objectives of Methods

† IASC - Asset / Liability
  - Measure assets and liabilities that arise from insurance contracts
† US GAAP - Deferral & Matching
  - Defer income and expense so that they can be matched with each other
### Emergence of Income from Long-Term Contracts

<table>
<thead>
<tr>
<th>US GAAP</th>
<th>IASC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deferral and Matching</strong></td>
<td><strong>Asset / Liability</strong></td>
</tr>
<tr>
<td>✓ Based on predetermined attribution pattern</td>
<td>✓ Some income or loss emerges at point of sale</td>
</tr>
<tr>
<td>✓ May or may not be subject to dynamic unlocking as actual experience differs from expected</td>
<td>✓ Rest emerges as insurer is released from risk and as actual experience differs from expected</td>
</tr>
<tr>
<td>✓ Subject to recoverability testing</td>
<td></td>
</tr>
</tbody>
</table>

### Treatment of Acquisition Costs

<table>
<thead>
<tr>
<th>US GAAP</th>
<th>IASC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deferral and Matching</strong></td>
<td><strong>Asset / Liability</strong></td>
</tr>
<tr>
<td>✓ Generally deferred, subject to recoverability testing</td>
<td>✓ Not deferred, recognized as an expense immediately</td>
</tr>
</tbody>
</table>
Assumption-Setting Process

<table>
<thead>
<tr>
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<th>IASC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferral and Matching</td>
<td>Asset / Liability</td>
</tr>
<tr>
<td>Various. May be:</td>
<td>Current best estimate of all future events with some provision for risk</td>
</tr>
<tr>
<td>locked-in at inception with provision for risk, but subject to recoverability testing</td>
<td>Market expectations, not entity-specific (unless no market available)</td>
</tr>
<tr>
<td>current best estimate</td>
<td>Market based on price expected for an arms-length transaction between knowledgeable, willing parties</td>
</tr>
<tr>
<td>best estimate of long-term trends</td>
<td></td>
</tr>
<tr>
<td>mandated by supervisor</td>
<td></td>
</tr>
<tr>
<td>some combination of the above</td>
<td></td>
</tr>
</tbody>
</table>

Recognition of Assumption Changes

“A fresh start approach should be used to report changes in accounting estimates.

The effect of differences between actual experience and earlier assumptions should be recognized immediately.”
Discount Rate Assumption

**US GAAP**

Deferral and Matching

- Often based on expected long-term earnings on actual or notional investments backing liabilities

**IASC**

Asset / Liability

- Risk-free rate, adjusted for any risk not already reflected in the cash flows
- Risk adjustment based on price of an arm's length transaction
- Task force to discuss whether or not based on insurer's assets

Reinsurance

**US GAAP** defines the criteria for risk transfer within FAS 113.

**IASC** issues paper uses slightly different words but it is...

*unclear if the definitions are truly different.*
SEC Concept Release on IAS

- Release date March 2000
- Seeks feedback from domestic and foreign parties by end May 2000
- Poses 26 questions on IAS
- Full text of release and remarks by SEC chairman Arthur Levitt, SEC website


SEC Release - 26 Questions
Concentrate on 3 Major Areas

- Interpretation and Application of Standards
- Standards and Practices
- Standards and Financial Reporting
- Standards and International Financial Reporting

iaca 2000
Quality of Standards

"A critical issue in assessing quality of the IASC Standard will be whether they would produce the same level of transparency and comparability that generally is provided to U.S. investors under US GAAP."

Interpretation of Standards

- Can IAS be rigorously interpreted and applied?
- Interpretative role of the standard-setter
- Role of the auditor
- Role of regulators

Want to reduce the development of diverging interpretations of the IASC standards
Possible Approaches to Recognition

"The goal of the core standards project has been to
develop a high quality set of generally accepted international accounting standards
that would ultimately reduce or eliminate the need for reconciliation to national standards."