



SOCIETY OF FINANCIAL EXAMINERS™

Supplemental Background Material

NAIC Examiner Project

Course AFE 4

Property and Liability Insurance Accounting

(Passing grade for this exam is 60)

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Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	1
Topic:	Introduction
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2004; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies; National Association of Insurance Commissioners, 2002
Objectives:	An introduction to the accounting for a property and liability insurance company.
Assigned Readings:	Troxel and Bouchie, pp. 1-26 AICPA Audit and Accounting Guide, 1.01-1.67. Accounting Practices and Procedures Manual - Preamble

Assignment One:

Introduction

- I. General Nature of the business
 - A. Purpose
 - B. Accumulation of investable assets
 - C. Kinds of insurance
 1. Personal
 2. Commercial

- D. Organizations
 - 1. Stock
 - 2. Mutual
 - 3. Reciprocal
 - 4. Public entity risk pools
 - 5. Private pools

- II. Major Transaction Cycles
 - A. Underwriting of risks
 - B. Processing and payment of claims
 - C. Investments

- III. Uses of Accounting Information
 - A. Resource allocation
 - B. Administrative control
 - C. Management stewardship

- IV. Statutory Insurance Accounting Principles
 - A. Objectives
 - 1. Preserve and enhance solvency
 - 2. Promote adequate and fair premium rates
 - 3. Ensure fairness, equity, and reasonableness in insurance markets
 - 4. Fulfill certain social goals

 - B. Valuation concepts
 - 1. Policyholders' surplus
 - a. Conservative statement
 - b. Prevent sharp fluctuations

 - 2. Effecting conservative measurement
 - a. Assets
 - (1) Classifications
 - (2) Measurement

 - b. Liabilities

- (1) Classifications
- (2) Measurement

- C. Continuity concept
- D. Realization concepts

- 1. Revenues
- 2. Expenses

V. Differences Between Statutory Accounting and Generally Accepted Accounting Principles

- A. Orientation of GAAP vs. SAP
- B. Origin and scope of GAAP
- C. Applying GAAP to property-liability insurers

- 1. “Adjusted earnings”
- 2. FASB statements

D. Seven areas of difference

- 1. Non-admitted assets
- 2. Unauthorized reinsurance
- 3. Excess loss reserves
- 4. Prepaid expenses
 - a. Effect on earnings and surplus
- 5. Deferred federal income taxes
- 6. Business combinations and consolidated financial statements
- 7. Premium deficiency
 - a. Cause
 - b. GAAP treatment

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 2
- Topic: Accounting Reports
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2002; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual for Property, National Association of Insurance Commissioners 2002.
- Objectives: To become familiar with the basic content of the accounting reports prepared by a property and liability insurance company.
- Assigned Readings: Troxel and Bouchie, pp. 26-52

Assignment Two:

Accounting Reports

- I. NAIC Annual Statement
- A. Who is required to file
 - B. Common name
 - C. Accounting Practices and Procedures Manual
 - D. Contents
 - 1. Summary financial statements
 - 2. Exhibits
 - 3. Supporting schedules
 - 4. Comprehensive questionnaire
 - E. Comprehensive working papers
 - F. Balance sheet
 - 1. Assets

- a. Invested assets
 - b. Resources of value that do not yield an investment return
 - 2. Liabilities
 - a. Definition
 - b. "Reserves"
 - c. General categories
 - 3. Capital and surplus
- G. Income statement
- 1. "Underwriting and Investment Exhibit Statement of Income"
 - 2. Sources of income
 - a. Underwriting income
 - b. Net investment income earned
 - c. Revenue and expenses from sources other than underwriting and investment operations
- H. Capital and surplus account reconciliation
- I. Statement of cash flows
- 1. Sources of cash
 - 2. Uses of cash
- J. Exhibits and schedules
- 1. Underwriting and investment exhibit
 - 2. Analysis of admitted and non-admitted assets
 - 3. Reconciliation of ledger assets
 - 4. Statistical detail by line of business
 - 5. General interrogatories
- K. Five-year historical data
- II. Insurance Expense Exhibit
- A. Information provided
 - B. NAIC's *Instructions for Uniform Classification of Expenses*
- III. Reports to Shareholders

- IV. Reports to Stock Exchanges
- V. Reports to SEC
- VI. Other accounting and statistical reports
 - A. Policyholder reports
 - B. Reports to statistical agencies
 - C. Federal income tax reports
 - D. Management information
 - 1. Contrasts to financial accounting
 - 2. Use
 - 3. Management reports

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	3
Topic:	Insurance Company Assets
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
Objectives:	To identify the types of assets commonly acquired by a property-liability insurance company and their categorizations.
Assigned Readings:	Troxel and Bouchie, pp. 55-70 Accounting Practices and Procedures Manual SSAPs 2,4,6,10,16,20,21,26,29,30,31,32,34,37,38,39,40,43,44,45,46, 53, and 86

Assignment Three

Insurance Company Assets

I. Introduction

- A. Statutory and administrative regulations
- B. Analysis of Assets
- C. Ledger Assets
- D. Non-admitted assets
- E. Admitted assets

II. Non-admitted assets

- A. Principal asset categories included

- B. Attributes
- III. Admitted Assets
- A. Bonds
 - 1. Categorization: taxable vs. nontaxable, by type of issues
 - 2. Limits on certain types of bonds
 - 3. Valued at amortized cost
 - 4. Interest income from bonds recorded on an accrual basis
 - B. Common stocks
 - 1. Schedule D
 - 2. Statutory rules and regulations limiting stock ownership
 - a. Types of rules/regulations
 - b. Purposes
 - 3. Valuation of Common Stock
 - C. Preferred stocks
 - 1. Classification
 - 2. Valuation
 - D. Mortgage loans
 - E. Real estate
 - F. Collateral loans
 - G. Cash
 - H. Short-term investments
 - I. Agents' balances
 - J. Funds held by or deposited with reinsured companies
 - K. Reinsurance recoverable on loss payments
 - L. Bills receivable taken for premium
 - M. Federal income tax recoverable
 - N. Electronic data processing equipment
 - O. Authorized investments in affiliates

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	4
Topic:	Asset Valuation and Investment Policy
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners,2002.
Objectives:	To identify asset valuation methods for common invested assets and to describe factors that impact investment policy
Assigned Readings:	Troxel and Bouchie, pp. 70-86 Accounting Practices and Procedures Manual SSAPs 2,4,6,10,16,20,21,26,29,30,31,32,34,37,38,39,40,43,44,45,46 , 53 and 86

Assignment Four

Asset Valuation and Investment Policy

- I. Valuation of Assets
 - A. Bonds
 - 1. Definition
 - a. Coupon
 - b. Par value
 - c. Premium
 - d. Discount
 - e. Current yield
 - f. Amortization
 - g. Amortized cost

- h. Yield-to-maturity
 - 2. Determining bond values
 - a. Sum of present values of two future cash flows
 - b. Amortization
 - 3. Principles of bond valuation
 - B. Common stock
 - C. Preferred stock
 - D. Stock-related valuation situations
 - 1. Dividends
 - 2. Loaned securities
- II. Investment policy
- A. Three important determinants
 - 1. Cash flow
 - 2. Insurance leverage
 - 3. Insurance exposure
 - B. Cash flow
 - 1. Cash inflows
 - 2. Cash outflows for expenses
 - 3. Cash outflows for loss and loss adjustment expenses
 - 4. Net underwriting cash flow
 - C. Insurance leverage and insurance exposure
 - 1. Financial leverage
 - 2. Operating leverage
 - 3. Insurance leverage
 - 4. Issues addressed by insurance leverage and exposure
 - 5. Product mix impacts insurance leverage
 - a. long-tail lines
 - b. short-tail lines
 - 6. Ratio of reserves to premiums written
 - 7. Relation between leverage and exposure
 - 8. Impact of product line mix

- D. Insurance company objectives
- E. Investment portfolio composition
- F. Returns

- 1. Total returns
- 2. Total rate of return on equity
- 3. Total underwriting return
- 4. Total investment return
- 5. Total pretax return from policyholder supplied funds
- 6. Increasing total return
- 7. Risk
 - a. Product
 - b. Investment

- G. Investment Policy

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 5
- Topic: Loss Reserves
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
- Objectives: To describe the types of reserves shown by a property-liability insurance company and how to estimate each.
- Assigned Readings: Troxel and Bouchie, pp. 89-117
 Accounting Practices and Procedures Manual SSAPs 5 and 55
 AICPA Audit and Accounting Guide, 4.32-4.113

Assignment Five:

Loss Reserves

- I. Introduction
 - A. Third party lines vs. first party lines
 - B. Importance of reserves
 - C. Types of loss reserves
 1. Claims that have been reported
 2. Incurred but not reported (IBNR) claims
- II. Cost Accumulation Periods
 - A. Three different cost accounting periods are used
 1. Calendar-year

2. Policy-year
3. Accident-year
4. Illustration of cost accumulation periods

B. Methods of estimating reserves for unpaid losses

1. Categories of loss reserves
2. Individual case estimate method
 - a. Description
 - b. When used
3. Average value method
 - a. Description
 - b. When used
4. Loss ratio method
 - a. Description
 - b. When used
5. Tabular value method
 - a. Description
 - b. When used

C. Estimating IBNR loss reserves

D. Evaluation of loss reserves

1. Interested parties
2. First-party claims
3. Third-party claims
4. Loss Reserve Development
5. Schedule P of annual statement

E. Loss adjustment expense reserves

1. Reserve for anticipated future expenses required to settle losses
2. Allocated vs. unallocated loss adjustment expenses
3. Allocated loss adjustment expense reserve
 - a. Case basis vs. formula basis
 - b. Calendar-year paid to paid generally results in an understatement

4. Unallocated loss adjustment expense reserves

F. Loss reserve opinion rule

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 6
- Topic: Unearned Premium Reserve and Policyholders' Surplus
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
- Objectives: To be able to describe unearned premium reserves and how they are calculated and their affects on performance. To describe the components of policyholders' surplus and the items that affect it.
- Assigned Readings: Troxel and Bouchie, pp. 117-131
 Accounting Practices and Procedures Manual SSAPs 41, 53, 65, 66 and 72

Assignment Six:

Unearned Premium Reserve and Policyholders' Surplus

- I. Unearned Premium Reserve
- A. Purpose
- B. Pro rata methods of calculating the unearned premium
1. Monthly pro rata method
2. Daily method
3. Special methods
- a. Retrospective premiums
- b. Installment premiums (treat as successive one-year policies)
- c. Audit premiums
- d. Advance premiums

4. Conservative statement of unearned premium reserve
 - a. Statutory underwriting loss
 - b. "Equity" in unearned premium reserve: GAAP statements adjust for this
 - c. Results if insurer were to stop writing new business
 - d. Length of policy period
- II. Liabilities for Reinsurance Transactions
- a. Credit for reinsurance ceded in reserves for losses, loss adjustment expenses, and unearned premiums
 - b. Provision for reinsurance
- III. Policyholders' Surplus
- A. Components of policyholders' surplus
1. Capital stock
 2. Gross paid-in and contributed surplus
 3. Unassigned funds (surplus)
 4. Special surplus funds
 5. Treasury stock
- B. Factors affecting policyholders' surplus
1. Underwriting results
 2. Investment performance
 3. Loss reserve developments
 4. Growth rate

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	7
Topic:	The Premium Cycle
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
Objectives:	To describe the steps in the premium cycle and the record keeping and accounting associated with these steps.
Assigned Readings:	Troxel and Bouchie, pp. 133-143 AICPA Audit and Accounting Guide, 3.01-3.44 Accounting Practices and Procedures Manual SSAPs 53, 65 and 66

Assignment Seven:

The Premium Cycle

I. Introduction

- A. When insurance placed in force, entries made to accounts
 - 1. Types of written premiums
 - a. Direct premiums
 - b. Assumed reinsurance premiums
 - c. Ceded reinsurance premiums
 - d. Return premiums
 - 2. Rating

- a. Based on experience by line
 - b. Based on industry loss experience compiled by rating organizations
- B. Net amount received after commissions and underwriting expenses invested consistent with
- 1. Current loss payment cash needs
 - 2. Investment objectives
 - 3. Regulatory constraints

II. Transaction Cycle

- A. Includes all phases of premium recognition
- B. Evaluating and accepting risks
 - 1. Objectives
 - 2. Activities following submission of an application by an agent or broker
 - 3. Underwriting function
 - 4. Risk coding for reports concerning premiums
 - 5. Accounting entries for insurance
 - 6. Premiums established by one of three methods
 - a. Class or manual rating
 - b. Individual or judgment rating
 - c. Merit rating
 - 7. Renewal
 - 8. Determining whether entire risk should be retained
- C. Issuing policies
- D. Billing and collecting premiums
 - 1. Direct billing vs. agency billing
- E. Paying commissions and other costs of acquiring business
- F. Adjusting premiums written and unearned premiums
 - 1. Cancellation
 - 2. Endorsements
 - 3. Audit premiums
 - 4. Retrospective premium adjustments
 - 5. Policyholder dividends
- G. Home office and branch office record keeping
- H. Premiums transaction flow

III. Accounting Principles

- A. Accounting principles specified in FASB Statement # 60
- B. Contract duration
 - 1. Short-duration contracts
 - 2. Long-duration contracts
- C. Revenue recognition
- D. Policy acquisition costs
- E. Premium deficiencies

IV. Special Audit Risk Considerations

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	8
Topic:	The Loss Cycle
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
Objectives:	To identify the functions of loss cycle and be able to describe each part
Assigned Readings:	Troxel and Bouchie, pp. 143-150 AICPA Audit and Accounting Guide, 4.01-4.64 Accounting Practices and Procedures Manual SSAP 55

Assignment Eight:

The Loss Cycle

- I. GAAP Accounting Practices
- II. Statutory Accounting Practices
 - A. Differences between SAP and GAAP
 1. Salvage or subrogation
 2. Minimum statutory reserve requirements
 3. Discounting of lifetime claims and accident and health long-term disability claims
- III. Introduction
 - A. Losses and loss adjustment expenses

- B. Property claims
- C. Liability claims
- D. Worker's compensation
- E. Surety or Fidelity claims

IV. The Loss Transaction Cycle

- A. Claim acceptance and processing
 - 1. Preparing claim file
 - 2. Loss recording
 - 3. Smaller and "one-shot" claims
- B. Claim adjustment and estimation
 - 1. Different methods of adjustment
 - a. Home or branch office adjusters
 - b. Independent adjusters
 - c. Adjustment bureaus
 - 2. Estimates made by adjuster
- C. Claim settlement
- D. Reinsurance recoverable
- E. Salvage and Subrogation

V. Claims Transaction Flow

VI. Loss reserve estimation

- A. Estimating methods
- B. Claim adjustment expenses
 - a. Allocated vs. unallocated expenses
 - b. Estimation methods
- C. Salvage and subrogation

VII. Special Risk Considerations

- A. Key indicators of deficiencies
- B. Current trends and conditions

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 9
- Topic: Expenses and Investment Income
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
- Objectives: To describe the accounting for insurance company expenses and presentation on the financial statements. To describe the types of investments and how income is determined. To identify items treated as changes in surplus.
- Assigned Readings: Troxel and Bouchie, pp. 150-174
 AICPA Audit and Accounting Guide, 5.01-5.65
 Accounting Practices and Procedures Manual SSAPs 29,34 and 70

Assignment Nine:

Expenses and Investment Income

- I. Introduction
 - A. Sources of incurred expenses
 - B. Part 4 of Underwriting and Investment Exhibit
 - C. Insurance Expense Exhibit

- II. Uniform Accounting Instructions
 - A. Uniform expense allocation rules
 - B. Allocation based upon four principles
 1. Direct expenses are to be allocated as incurred

2. Other expenses related to some direct expense
 3. General expenses not related to direct expenses
 4. Those general expenses not subject to allocation based on time and special studies
- III. Insurance Expense Exhibit
- A. Three main purposes
 - B. Part I – allocation to expense groups
 1. Investment expenses
 2. Loss adjustment expenses
 3. Other underwriting expenses
 - C. Part II – allocation to lines of business net of reinsurance
 - D. Part III – allocation to lines of direct business written
- IV. Investment income
- A. Net investment income
 - B. Calculation of interest or dividend income for current year
 - C. Amortization of premium or discount
 - D. Real estate income
 - E. Investment expenses
 - F. Part 1A of Underwriting and Investment Exhibit
 - G. Investment strategy and insurance business
 1. Cash invested to meet cash flow needs
 2. Short- and long-term investments
 3. Short-term investments
 - a. Commercial paper
 - b. Certificates of deposit
 - c. Treasury bills
 - d. Money market funds
 - e. Repurchase agreements
 - f. Securities lending
 - H. Investment transaction cycle
 - I. GAAP accounting principles
 1. Held to maturity
 2. Trading
 3. Available for sale
 - J. SAP accounting practices

1. Bonds
 2. Common and preferred stock
 3. First mortgages on real estate
 4. Changes in value between book and admitted asset value
 5. Investment income due and accrued
- K. Special risk considerations
1. Increased underwriting losses due to a less restrictive underwriting philosophy – may lead to greater investment risk
 2. Audit risks
 - a. Investment concentration
 - b. Investment liquidity
 - c. Investment valuation
 - d. Investment yield trend
 - e. Investment policy
 - f. Investment repurchase agreements
- V. Other Income
- VI. Gains and Losses in Surplus
- A. Gains and losses that under SAP do not flow through the income statement
 - B. Net unrealized capital gains and losses
 1. Sources
 2. Provision for federal income tax: SAP vs. GAAP
 - C. Changes in non-admitted assets
 - D. Change in provision for Reinsurance
 - E. Changes in foreign exchange adjustment when assets and liabilities are converted to US currency for financial statement presentation
 - F. Change in excess of statutory reserves over statement reserves
 - G. Capital changes segregated by source
 - H. Other changes in surplus
 1. Adjustment to prior years' income taxes
 2. Effects of changes in accounting methods
 3. Errors noted in prior years financial statements

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	10
Topic:	Reinsurance
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners, 2002.
Objectives:	To be able to describe the categories of reinsurance and transactions. To describe the accounting for reinsurance transactions and their effect on the ceding company.
Assigned Readings:	Troxel and Bouchie, pp. 174-179 AICPA Audit and Accounting Guide, 6.01-6.42 Accounting Practices and Procedures Manual SSAP 62

Assignment Ten:

Reinsurance

- I. Introduction
 - A. Three kinds of reinsurance companies
 1. Professional reinsurers – engage almost exclusively in reinsurance
 2. Reinsurance departments – units of primary insurers
 3. Reinsurance pools or associations – groups or syndicates of insurers organized to provide members reinsurance protection
 - B. Reasons for entering into reinsurance
 1. Reduce exposure on particular risk
 2. Protect against accumulation of losses from catastrophes

3. Reduce total liabilities
4. Provide financial capacity to accept risks involving large amounts
5. Help stabilize operating results
6. Obtain assistance with new products and lines
7. Limit liabilities of captive insurance companies
8. Balance risks and capital

C. Commissions

1. Basic ceding – reimburse for underwriting costs
2. Contingent – share in profits realized by assuming company

II. Kinds of Insurance

A. Categorization by method used to purchase reinsurance

1. Facultative
2. Treaty

B. Categorization by method of spreading loss

1. Pro rata reinsurance
2. Quota share reinsurance
3. Surplus share reinsurance
4. Excess reinsurance
5. Excess of loss per risk reinsurance
6. Excess of loss per occurrence reinsurance
7. Aggregate excess of loss reinsurance

III. Accounting Practices

- A. Accounting for reinsurance ceded is the opposite of accounting for direct business
- B. FASB Statement No. 113
- C. Statutory Accounting

1. Unauthorized reinsurer/non-admitted reinsurer
2. An unauthorized reinsurer

IV. Reinsurance Premiums and Commissions

- A. Cessions usually involve a 30 to 45 percent commission
- B. Premiums ceded
 1. Written basis – premium due reinsurer at inception
 2. Earned basis – premium due reinsurer as they are earned

3. Surplus aid

V. Reinsurance losses and recoveries

A. Two categories

1. Recoverable on paid losses – shown as admitted asset
2. Recoverable on pending losses – deduction from loss reserve

B. Amounts entered into claim file and data processing records

C. Annual statement reports gross unpaid losses, related reinsurance recoverable, and net unpaid losses

D. Amounts recoverable divided in amounts from authorized and unauthorized companies

VI. Risk considerations

A. Ability of assuming company to meet obligations

B. Absence of reinsurance

C. Accuracy and reliability of data received from ceding company

D. Internal controls of the ceding company

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	11
Topic:	Taxes
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners, 2002.
Objectives:	To describe the accounting for income taxes and other taxes.
Assigned Readings:	AICPA Audit and Accounting Guide, 7.01-7.68 Accounting Practices and Procedures Manual SSAP 10

Assignment Eleven:

Taxes

- I Federal Income Taxation
 - A. A property-liability insurance company is subject to the same federal income tax laws that apply to other commercial enterprises
 - B. Omnibus Budget Reform Act of 1990
 - 1. Anticipated Salvage and Subrogation
 - C. Tax Reform Act of 1986
 - 1. Discounting loss reserves
 - a. Loss and loss adjustment expense reserve are subject to discounting
 - b. Amount of discounted unpaid losses
 - c. Interest rate used to discount selected by Secretary of the Treasury

- d. Loss-payment pattern determined by Secretary of the Treasury
 - 2. Unearned premium reserve
 - a. Permits only 80% of annual change in unearned premium reserve to be used in determining taxable income
 - 3. Dividends and tax-exempt interest
 - 4. Small property-liability insurance companies
 - 5. Protection against loss account
 - 6. Alternative minimum tax (AMT)
- II. Statutory Accounting Practices and Taxable Income
- A. Underwriting and investment exhibit of the annual statement approved by NAIC is accepted by IRS as net income
 - B. Similarities between statutory and taxable income
 - 1. Commissions, premium taxes, and other costs of acquiring business are deductible in period incurred
 - 2. Direct charges or credits to surplus are not included in determining taxable income
 - a. Premiums past due from agents
 - b. Provision for unauthorized reinsurance
 - 3. Premiums included as they are earned
 - C. Items always excluded from taxable income
 - 1. Tax-exempt interest on certain bonds
 - 2. Dividends received deduction
 - D. Salvage and subrogation
 - E. Policyholder dividends
 - F. Deposit premiums
- III. Special Income Tax Provisions
- A. Capital losses
- IV. GAAP Accounting for Income Taxes
- V. State Taxation
- A. Many states differentiate between domestic and foreign insurers
 - B. Premium taxes

C. State income taxes

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 12
- Topic: SAP to GAAP Reconciliation
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual National Association of Insurance Commissioners, 2002.
- Objectives: To be able to describe the differences between statutory accounting practices and generally accepted accounting principles.
- Assigned Readings: AICPA Audit and Accounting Guide, 1.72 & Table 1.1

Assignment Twelve:

SAP to GAAP Reconciliation

- I. Introduction
 - A. SAP is oriented toward demonstrating the solvency of a property-liability insurance company
 - B. GAAP's focus is on a going-concern basis
 - C. Importance of differences
 - D. Property-liability insurance companies may prepare their GAAP financial statements by adjusting their SAP statements for the differences
- II. Differences between SAP and GAAP
 - A. Investments
 1. Bonds
 - a. Bonds are generally held to maturity

- b. Valued at amortized cost
 - c. Bonds whose values are permanently impaired
2. Stocks
- a. Under SAP carried at market value, except for preferreds with mandatory redemption feature
 - b. Under GAAP all equity securities accounted for in accordance with FASB Statement # 115
- B. Non-admitted assets
- C. Acquisition costs
- D. Premium deficiencies
- E. Policyholder dividends
- F. Contingent commissions
- G. Loss Reserves
- H. Reserves for unauthorized reinsurance
- I. Deferred taxes

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	13
Topic:	Insurance Company Financial Analysis
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners, 2002.
Objectives:	To be able to calculate the traditional financial ratios for a property-liability insurance company and describe their use.
Assigned Readings:	Troxel and Bouchie, pp. 181-200

Assignment Thirteen:

Insurance Company Financial Analysis

- I. Unique Characteristics of Insurance Operations
 - A. Establish prices before knowing costs
 - B. Insurance companies are financial intermediaries
 - C. Unusual capital structure
 - D. Regulatory accounting practices influence analysis
 - E. Basic measurement statistics developed to analyze property-liability insurance companies

- II. Capacity
 - A. Capacity statistics
 - B. Factors constraining ability to increase premium volume
 1. Statutory treatment of acquisition expenses
 2. Management imposed constraint

C. Kenny rules

1. Property (fire) ratio
 - a. Rationale
2. Casualty ratio

D. Cover ratios

1. Loss reserves and surplus
2. Worker's compensation
3. General cover ratio

E. Liquidity ratios

III. Profit

A. Combined ratio

1. Pure loss ratio
2. Expense ratio
 - a. Trade basis – Expenses Incurred/Premiums Written
 - b. Financial basis – Expenses Incurred/Premiums Earned
3. Combined ratio
 - a. Adds loss ratio and expense ratio
 - b. Rationale for using trade basis expense ratio
 - c. Use of combined ratio

B. Investment profit

1. Two relationships considered jointly
 - a. Degree of insurance exposure
 - b. Portion of assets invested in common stock

III. Profitability Ratios

A. Useful ratios are one that show profits in relation to

1. Premiums earned
2. Investment

3. Net worth
 4. Number of shares of common stock
- B. Underwriting profit ratio
- C. Insurance operating profit ratio
- D. Return on invested funds
1. Investment earnings ratio
 2. Investment profit ratio
 3. Return on net worth
 4. Adjusted return on net worth
- E. Earnings per share

Society of Financial Examiners
Property and Liability Insurance Accounting

Unit:	14
Topic:	Financial Ratings and Solvency
Text Required:	Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.) AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants) Accounting Practices and Procedures Manual National Association of Insurance Commissioners, 2002.
Objectives:	To be able to calculate the traditional financial ratios for a property-liability insurance company and describe their use.
Assigned Readings:	Troxel and Bouchie, pp. 200-244

Assignment Fourteen:

Financial Ratings and Solvency

- I. Financial Ratings
 - A. Best's evaluation procedures
 1. Evaluates factors that affect financial performance
 2. Goal to determine whether company has ability to meet obligations of its contracts
 3. Quantitative measures
 - a. Profitability tests – ability to provide attractive products and services
 - b. Leverage tests
 - c. Liquidity tests
 4. Qualitative measures
 - a. Spread of risk – analyzes the book of business on both a geographic and line-of-

- business basis
- b. Amount and soundness of reinsurance
- c. Quality and diversification of assets
- d. Adequacy of reserves
- e. Surplus adequacy and capital structure
- f. Management

B. Best's rating system

1. Rating modifications for performance
 - a. Qualified – might be adversely affected by pending state regulation or possibility of mandated payments from residual market programs in excess of surplus
 - b. Watch list – downward trend in profitability, leverage, or liquidity
 - c. Revised – rating revised during the year
2. Modifications based on affiliations
3. Not assigned rating
4. Financial size

II. Establishing Insurance Solvency

A. Meaning

1. Maintains ability to meet its obligations as they are due
2. Legal requirement that company maintain at least a prescribed level of net worth
3. Management purposes

B. Minimum net worth requirements

1. Initial net worth to obtain license governed by state insurance laws: stock vs. mutual
2. Continuing minimum net worth requirements are commonly lower than initial

C. Capital and surplus expansion

III. Methods of Maintaining Solvency

- A. Capital and surplus requirements
- B. Rate regulation
- C. Investment regulation
- D. Statutory accounting rules
- E. Financial reporting requirements
- F. Periodic examinations

1. Field examinations into financial affairs and market conduct of companies licensed to do

business in state

- a. Purposes
- b. Examinations Procedures
- c. NAIC zone examination

G. NAIC regulatory tests (Insurance Regulatory Information Systems – IRIS)

1. Purpose
2. Mechanics

H. Overall IRIS tests

1. Gross premium to surplus
2. Net premium to surplus
3. Change in writings
4. Surplus aid to surplus

I. Profitability tests

1. Two-year overall operating ratio
2. Investment yield
3. Change in surplus

J. Liquidity tests

1. Liabilities to liquid assets
2. Agents' balances to surplus

K. Reserve tests

1. One-year reserve development
2. Two-year reserve development
3. Estimated current reserve deficiency to surplus

IV. Insurance Guaranty Mechanisms

- A. Designed to provide reparations to policyholders and third party claimants of insolvent insurers
- B. State guaranty laws
 1. Operation
 2. Criticisms

V. Solvency Record

- A. Economic effect of insolvency
- B. Factors leading to insolvency
 - 1. Improper underwriting, reserving, and claims handling
 - 2. Financial condition of reinsurers
 - 3. Inadequate expense controls
 - 4. Questionable investment practices
 - 5. Management dishonesty
 - 6. Abnormal transactions with agents, brokers, or reinsurers
 - 7. Excessive commissions and management allowances

Society of Financial Examiners
Property and Liability Insurance Accounting

- Unit: 15
- Topic: Audit Considerations
- Text Required: Property-Liability Insurance Accounting and Finance; Terrie E. Troxel, George E. Bouchie; Fourth Edition, 1995; (American Institute for Property and Liability Underwriters, Inc.)
- AICPA Audit and Accounting Guide, Audits of Property and Liability Insurance Companies; with conforming changes as of May 1, 2003; (American Institute of Certified Public Accountants)
- Accounting Practices and Procedures Manual National Association of Insurance Commissioners 2002.
- Objectives: To describe considerations inherent to the planning of an audit of a property-liability insurance company
- Assigned Readings: AICPA Audit and Accounting guide, 2.01-2.50, Appendix A and B

Assignment Fifteen:

Audit Considerations

- I. Preliminary Audit Considerations
 - A. Overall risk factors
 1. Conditions specific to insurance industry
 2. Profitability generally gauged by combined ratio and operating ratio
 - B. NAIC Insurance Regulatory Information System
 - C. NAIC profitability reports
 1. Description
 2. Purpose
 - D. Special audit risk factors
 - E. Internal control structure

1. Consists of five elements
 - a. Control environment
 - b. Risk assessment
 - c. Control activities
 - d. Information & communication
 - e. Monitoring
 2. Planning an audit requires sufficient understanding of each of five elements
 3. Assessing control risk for the account balance, transaction class, and disclosure component of the financial statements
 4. Using knowledge provided by understanding of control structure in nature, timing and extent of substantive tests
- II. Electronic Data Processing
- A. Relationship between EDP and control risk
 - B. General controls
 1. Organization and operations controls
 2. System development and documentation controls
 3. Hardware and software controls
 4. Access controls
 5. Data and procedural controls
- III. Consideration of the work of internal auditors
- IV. Consideration of state regulatory examination
- V. Permitted Statutory Accounting Practices
- VI. Risk-based capital