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September 16, 2002

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London EC4M 6XH United Kingdom

Dear Sir David:

Thank you for the opportunity to comment on the Exposure Draft of the International Accounting Standards Board Improvements Project (Exposure Draft). On behalf of the International Accounting Standards Working Group (IASWG) of the National Association of Insurance Commissioners (NAIC), I am pleased to provide you with comments on the International Accounting Standards (IAS) in response to your Invitation to Comment.

Formed in 1871, the NAIC is a voluntary organization of the chief insurance regulatory officials of the 50 states of the United States of America, the District of Columbia, American Somoa, Guam, Puerto Rico and the Virgin Islands. The mission of the NAIC is to assist state insurance regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsive, efficient and cost-effective manner, consistent with the wishes of its members:

1. Protect the public interest, promote competitive markets and facilitate the fair and equitable treatment of insurance consumers.
2. Promote the reliability, solvency and financial solidity of insurance institutions; and
3. Support and improve state regulation of insurance.

In fulfilling this mission, the NAIC has developed significant experience and expertise in the development of meaningful accounting principles for use in the financial statements of insurance enterprises. In 1998, the NAIC completed the base portion of the Codification of Statutory Accounting Principles project whose purpose was to produce a comprehensive guide to statutory accounting principles. This guide, called the Accounting Practices & Procedures Manual, Effective January 1, 2001 (NAIC SAP), is to be used by every insurance company in the United States in preparing financial statements for use by insurance regulators and is the result of over nine years of hard work and dedication by regulators and members of the U.S. Insurance Industry.

The fundamental concepts upon which these principles were promulgated are conservatism, consistency and recognition. These principles are materially different than the framework used by the International Accounting Standards Board (IASB). For this reason, the NAIC has taken a significant interest in the International Accounting Standards of the IASB. Additionally, the NAIC would note that our opinions and recommendations regarding this guidance might change as other subsequent projects are completed at the IASB such as the insurance contracts project and the financial instruments project.

The NAIC's interest in the IASB's Exposure Draft: *International Accounting Standards Improvements Project*, as with all standards developed by the IASB, is to assist the IASB in developing high quality standards to be used uniformly across all countries. The objective of the

IASB Improvements Project is to update the twelve standards included in the project for the elimination of inconsistencies, redundancies, and conflicts with other international accounting standards and with the international accounting standards framework. A second tier objective was that of convergence with other national standard setters if such convergence could be obtained quickly and with minimum effort. For these reasons, the NAIC has reviewed and prepared comments on this Exposure Draft and is supportive of the IASB's objectives.

The NAIC has performed a comparative analysis of the International Accounting Standards contained in the Improvements Project to U.S. GAAP and NAIC SAP. The NAIC performed this analysis with the understanding that the statutory principles underlying the financial statements prepared for regulatory use are sometimes different than those principles underlying financial statements prepared for general purposes. Based on this understanding, the NAIC comments provide some discussion of statutory accounting principles, but most importantly, they provide final recommendations based upon a general-purpose financial statement framework.

These comments have been prepared by the IASWG of the NAIC and are organized in a manner consistent with the questions outlined in the IASB's Invitation to Comment. As part of the NAIC's due process procedures, these comments have also been shared with interested parties to the IASWG, all of whom were given an opportunity to contribute to these comments.

Comments

IAS 1: Presentation of Financial Statements

Q1) Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standards to achieve a fair presentation?

- **Response: Agree**

The NAIC SAP is the standard upon which departures are measured in U.S. insurers. Differences in SAP do not necessarily occur in order to achieve a fair presentation as questioned in the IAS, but may be caused by varying state statutes. If a reporting entity employs accounting practices that depart from NAIC SAP, disclosures about those accounting practices that affect statutory surplus or risk-based capital shall be made as follows:

- A description of the accounting practice;
- A statement that the accounting practice differs from the NAIC statutory accounting practices and procedures; and
- The monetary effect on net income and statutory surplus of using an accounting practice, which differs from NAIC statutory accounting practices and procedures.

Q2) Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes?

- **Response: Agree**

The NAIC SAP requires that extraordinary items should be reported in the entity's continuing operations and should not be reported separately in the statement of operations.

Extraordinary items are items, which result from transactions or events that have all of the following characteristics:

- they are not expected to occur frequently over several years;
- they do not typify the normal business activities of the entity; and
- they do not depend primarily on decisions or determinations by management or owners.

NAIC SAP does require disclosure of the nature of the extraordinary items in the financial statements. Such disclosure allows the users of the financial statements to understand the nature of the transactions or events giving rise to the extraordinary items and the extent to which income has been affected. Users of financial statements need to have access to this information in order to make a good evaluation of the future financial performance of an entity. This is of key importance for investors and also for regulators who evaluate the insurer's future ability to meet policyholders' obligations.

Q3) Do you agree that long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorized for issue?

- **Response: Agree**

In accordance with NAIC SAP, accounting liabilities are not differentiated between current and long-term. Accounting liabilities are included in the financial statements using a liquidity presentation.

With regards to the above question, for conditions that existed at the balance sheet date, NAIC SAP requires that material subsequent event information which becomes available prior to the issuance of the financial statements be reflected in the financial statements unless specifically prohibited. For material subsequent events that arise after the balance sheet date, NAIC SAP only requires disclosure in the notes to the financial statements.

Note: The IASWG has chosen not to comment on IAS 1 Question 4.

Q5) Do you agree that an entity should disclose the judgments made by management in applying the accounting policies that have the most significant effect on the amounts of items recognized in the financial statements (see proposed paragraphs 108 and 109)?

- **Response: Disagree**

NAIC SAP requires that estimates be made by management. Statement of Statutory Accounting Principle No. 1 requires the financial statements to include an explanation on the use of management's estimates. Disclosure of the uncertainly of the estimate and that it is reasonably possible that the estimate will change in the near term is also required. Disclosures of estimates are required when it is at least reasonably possible that the estimate will change in the near term, which is generally a period of less than one year, and such change would be material to the financial statements. NAIC SAP does not utilize the terminology of "most significant effect" on the amounts of items recognized in the financial statements regarding disclosures of estimates. As this terminology is subjective, interpretations on this language may differ.

Q6) Do you agree that an entity should disclose key assumptions about the future and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

- **Response: Disagree**

  In accordance with NAIC SAP, risks and uncertainties regarding the company's operations, estimates, and vulnerability to concentrations are required to be disclosed. However, key assumption about the future and other sources of measurement uncertainty would be more appropriately disclosed in the company's Management, Discussion, and Analysis.

General Comments Regarding IAS 1: The words " undue cost or effort" appear in paragraph 35 and elsewhere in the Exposure Draft of Proposed Improvements to International Accounting Standards document. While we agree that all standards must consider the cost and benefits associated with the guidance, we do not believe it is necessary to include the words "undue cost or effort" within the standards. Often, management has assessed the cost and undertaken the steps necessary to effect the changes rendering the words superfluous. For example, paragraph 35 could be modified eliminating the third line so that it reads as follows:

"When the presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified. When comparative amounts are reclassified, an entity shall disclose:"

Additionally, new standards requiring a change in presentation should provide sufficient time to comply with the required changes. Failure to comply would require a disclosure of the reasons why the entity failed to comply and, if material, might require an auditor's comment.

Finally, we recommend that additional language be added to paragraph 49 to enhance its understanding as follows:

"An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet in accordance with paragraphs 56-64 except when a standard specifically describes a different presentation or when a liquidity presentation provides more relevant and reliable information."

IAS 8: Accounting Policies, Changes in Accounting, Estimates and Errors

Q1) Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred?

- **Response: Agree**

  According to NAIC SAP the cumulative effect of changes in accounting principles and correction of errors should be reported as if they had been applied retroactively for all prior periods. It also states that the effect of these changes should not be included in the determination of net income or loss. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. However, NAIC SAP states that the corrections of errors in previously issued financial statements shall be reported as adjustments to unassigned funds (surplus) in the period an error is detected.

Q2) Do you agree with eliminating the distinction between fundamental errors and other material errors?

- **Response: Agree.**

IAS 21: The Effects of Changes in Foreign Exchange Rates

Q1) Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

- **Response: Agree**

The scope of this international standard includes consolidation, which is not applicable to NAIC SAP. This standard also specifically excludes foreign currency derivatives addressed in IAS 39, which for statutory accounting purposes are specifically addressed in NAIC Statement on Statutory Accounting Principle No. 86. In the NAIC Statement on Statutory Accounting Principle No. 23 Foreign Currency Transactions, translations are functional currency, which is the same definition stated in IAS 21.

Fair value is also defined in IAS 21 as the amount for which an asset could be exchanged, or a liability that is settled between knowledgeable, willing parties in an arm's length transaction. The definition of fair value in NAIC SAP states the following:

The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets is the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.

If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option adjusted spread modes, and fundamental analysis. Valuation techniques for measuring financial assets/liabilities and servicing assets/liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm's length transaction.

Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

Q2) Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

- **Response: Disagree**

The guidance in paragraphs 18-20 is consistent with the NAIC Statement on Statutory Accounting Principle No. 23.

However, the following difference between IAS and NAIC SAP regarding reporting at subsequent balance sheet dates and reporting of exchange differences was noted.

While this section seems internally consistent with the international accounting model, this section of the standard does have several differences from the accounting guidance prescribed in SSAP No. 23. The standard states that at each balance sheet date: 1) foreign currency monetary items shall be translated using the closing rate; 2) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and 3) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the value was determined.

- In part, this differs because NAIC SAP currently allows for non-invested assets to be carried at fair value.
- Additionally, SAP requires translation of the balance sheet at the current exchange rate at the date of the financial statements.
- For statutory purposes, translation adjustments are included in unrealized gains/losses.

Q3) Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements?

- **Response: Please refer to Q2. In accordance with the response provided for the previous question, this question is no longer considered applicable.**

Q4) Do you agree that the allowed alternative to capitalize certain exchange differences in paragraph 21 or IAS 21 should be removed?

- **Response: Disagree**

NAIC SAP indicates that asset and liability fluctuations from foreign currency transactions shall be classified as unrealized gains and losses until the asset is sold or the liability is settled. Statement of Statutory Accounting Principle No. 23 indicates that when settlement occurs, unrealized gains and losses previously recorded shall be reversed and the foreign exchange profit or loss for the entire period shall be recorded as a realized capital gain or loss.

Q5) Do you agree that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

- **Response: Not Applicable**

Disposal on a foreign currency is not specifically addressed in NAIC SAP. Statement on Statutory Accounting Principle No. 23 states that unrealized gains/losses would be released and realized gains/losses recognized.

We do not have a comment on the tax effect exchange differences as noted in IAS 12. However, currently there are no disclosures required by NAIC SAP related to this issue. NAIC SAP does limit the positive goodwill that can be admitted on the company's financial statements. Statement of Statutory Accounting Principle No. 68 indicates that positive goodwill is limited to 10% of the entity's capital and surplus. Negative goodwill is required to be recorded as a contra-asset.

NAIC SAP does limit the positive goodwill that can be admitted on the company's financial statements. Statement of Statutory Accounting Principle No. 68 indicates that positive goodwill is limited to 10% of the entity's capital and surplus. Negative goodwill is required to be recorded as a contra-asset.

IAS 24: Related Party Disclosures

Q1) Do you agree that this standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations? 'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required.

- **Response: Agree**

NAIC SAP does require disclosure of the management compensation, expense allowances and other similar items paid in the ordinary course of an entity's operations. Although NAIC SAP does not require specific disclosure of management compensation, there are several states that do require this to be disclosed in a supplemental filing.

Q2) Do you agree that the standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs?

- **Response: Agree**

According to NAIC SAP, majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

IAS 27: Consolidated Financial Statements and Accounting for Investments in Subsidiaries

Q1) Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

- **Response: Not Applicable**

NAIC SAP does not permit consolidated statements.

Q2) Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity?

- **Response**: **Not Applicable**

NAIC SAP does not permit consolidated statements.

Q3) Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements?

- **Response**: **Not Applicable**

NAIC SAP does not permit consolidated statements.

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements?

- **Response**: **Not Applicable**

NAIC SAP does not permit consolidated statements.

IAS 40: Investment Property

Q1) Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:

i. the rest of the definition of investment property is met; and

ii. the lessee uses the fair value model set out in IAS 40, paragraphs 27–49?

- **Response: Agree i; Disagree ii**

According to NAIC SAP, property interest held under an operating lease is defined as investment property. All leases except leveraged leases as defined in Statement of Statutory Accounting Principle No. 22 shall be considered operating leases. The leased property should be accounted for by the lessor as it would have if the property had not been leased. The property shall be depreciated following the lessor's normal depreciation policies for such assets. Additionally, Statement of Statutory Accounting Principle No. 40 states that real estate investments shall be reported net of encumbrances in the following balance sheet categories, with parenthetical disclosure of the amount of related encumbrance such as properties occupied by the company, properties held for the product of income, and properties held for sale.

NAIC SAP does not recognize fair value accounting.

Q2) Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?

- **Response: Disagree**

Statement of Statutory Accounting Principle No. 22 indicates that all leases shall be accounted for as operating leases.

Q3) Do you agree that the IASB should not eliminate the choice between the cost model and the fair value model in the Improvements Project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

- **Response: Agree**

NAIC SAP does not recognize fair value accounting. Therefore, the NAIC strongly recommends that the IASB keep the cost valuation model as an option in future discussions regarding this topic.

We appreciate the opportunity to comment on this IASB initiative. Should you have any questions, please contact me at 501-371-2667, Annette Knief (NAIC Staff) at 816-783-8006 or Julie Gann (NAIC Staff) at 816-783-8125.

Sincerely,

Mel Anderson
NAIC IASWG Chair