



Department of Insurance
State of Arizona
Captive Insurance Division
Telephone: (602) 364-4490
Facsimile: (602) 364-3989

JANET NAPOLITANO
Governor

2910 North 44th Street, Suite 210
Phoenix, Arizona 85018-7269
www.id.state.az.us

CHRISTINA URIAS
Director of Insurance

Date: October 9, 2008

To: Arizona Captive Community

From: Stephanie Lefkowski, Chief Analyst

Re: Note 1 to the NAIC Quarterly and Annual Statement Filings for Risk Retention Groups

The NAIC *Annual Statement Instructions* require all companies to file a reconciliation of net income and statutory surplus if a company is using an accounting basis that differs from that prescribed in the NAIC *Accounting Practices and Procedures Manual*, commonly referred to as statutory accounting (SAP). This reconciliation must be included in Note 1 to the NAIC Annual Statement.

Risk retention groups organized as captives are generally preparing their financial statements in accordance with generally accepted accounting basis (GAAP). RRGs should be including a GAAP-to-SAP reconciliation in their annual and quarterly statements. Attached is specific information extracted from the NAIC *Annual Statement Instructions*, along with the suggested format for the reconciliation. Please ensure that this reconciliation is included in all future filings.

This reconciliation is required in all RRG financial statement filings, regardless of whether there has been a material change from the preceding period.

Thank you for your cooperation.

Information from the NAIC *Annual Statement Instructions*:

This note is required to be completed, even if there are no prescribed practices or permitted practices to report. Indicate that the statement has been completed in accordance with the NAIC *Accounting Practices and Procedures Manual* except to the extent that state law differs. If a reporting entity employs accounting practices that depart from the NAIC *Accounting Practices and Procedures Manual* including different practices required by state law, disclose the following information about those accounting practices that affect net income, statutory surplus or risk-based capital.

Include:

- (1) A description of the accounting practice;
- (2) A statement that the accounting practice differs from NAIC statutory accounting practices and procedures (NAIC SAP);
- (3) The monetary effect on net income and statutory surplus of using an accounting practice that differs from NAIC statutory accounting practices and procedures; and
- (4) If an Insurance enterprise's risk-based capital would have triggered a regulatory event had it not used a prescribed or permitted practice, that fact should be disclosed in the financial statements.

Suggested Format for the Reconciliation:

If a company is using an accounting practice that differs from NAIC statutory accounting, the reconciliation of net income and statutory surplus should closely resemble the following format:

| | Current YTD | Prior Year End |
|---|----------------|-------------------|
| <u>Net Income, Arizona basis:</u> | | |
| Change in Deferred Policy Acquisition Costs | \$XX | \$XX |
| Change in Deferred Tax Asset | XX | XX |
| Change in Prepaid Expenses | XX | XX |
| Change in Unrealized Gain/Loss | XX | XX |
| Change in Non-Tabular Loss & LAE Reserve | | |
| Discounting | XX | XX |
| Change in Deferred Commission Income | XX | XX |
| | XX | XX |
| | XX | XX |
| <u>Net Income, NAIC SAP:</u> | <u>\$XX</u> | <u>\$XX</u> |

| | | |
|---|-------------|-------------|
| <u>Statutory Surplus, Arizona basis:</u> | | |
| Letters of Credit Approved for Capitalization | \$XX | \$XX |
| Deferred Policy Acquisition Costs | XX | XX |
| Deferred Tax Asset-Non-admitted Portion | XX | XX |
| Prepaid Expenses | XX | XX |
| Unrealized Gain/Loss | XX | XX |
| Non-Tabular Loss & LAE Reserve | | |
| Discounting | XX | XX |
| Deferred Commission Income | XX | XX |
| | XX | XX |
| | XX | XX |
| <u>Statutory Surplus, NAIC SAP:</u> | <u>\$XX</u> | <u>\$XX</u> |