

FA Module 20: Insurance contracts: GAAP – homework assignment

(The attached PDF file has better formatting.)

*Homework assignment:* Insurance contracts with premium deficiency: GAAP

On July 1, 20X1, an insurer writes a motor insurance contract with a one year term and collects a premium of 500. The cash received is held in a non-interest bearing checking account. The estimated claims for the policy year are 400. To compute the percentage of the policy term that has been earned, assume six months is half a year.

Expenses paid at policy inception are

- Agents' commission = 10% of premium
- Underwriting costs = 40
- Modifications to a web site = 20 (not deferrable)

On November 15, 20X1, a claim of 60 is paid. At December 31, 20X1,

- the estimated costs for other incurred claims is 80 (nominal value) and 70 (present value).
- the estimated claims for the unexpired portion of the policy are re-estimated as 275 (nominal value) and 225 (present value)

For this insurance contract:

- A. What are the assets at policy inception?
- B. What are the liabilities at policy inception?
- C. What is the revenue at policy inception?
- D. What are the expenses at policy inception?
- E. What are the assets at December 31, 20X1?
- F. What are the liabilities at December 31, 20X1?
- G. What is the revenue for 20X1?
- H. What are the expenses for 20X1?
- I. What is pre-tax income for 20X1?

(The assets, liabilities, revenue, and expenses are those stemming from the insurance contract.)

*Compare your solution with the practice problems on the discussion forum. The figures differ, but the relations are the same.*