

# The Importance of Financial Statements

*August 13, 2024*

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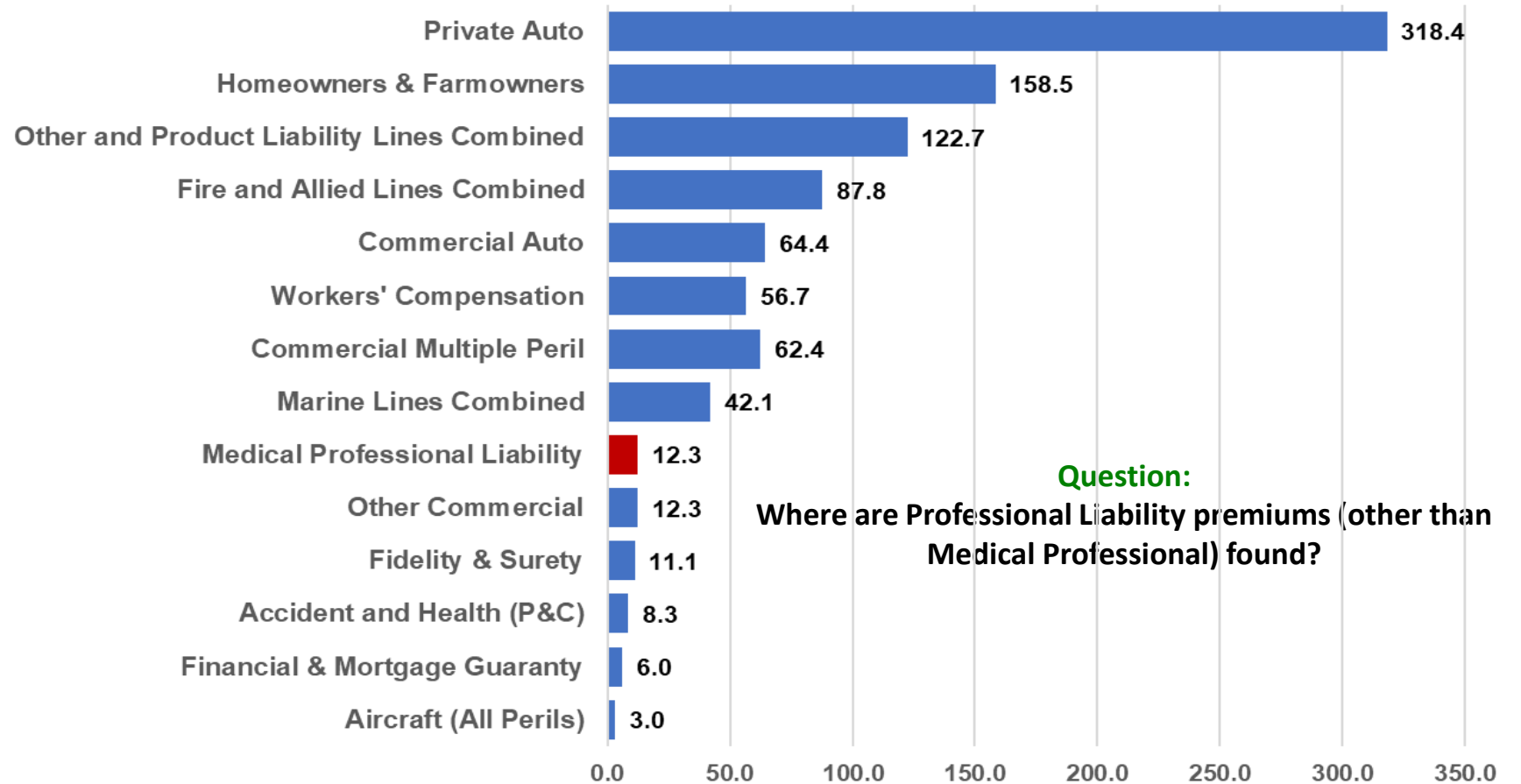
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# Before We Begin

2023 U.S. Direct Premiums Written by Class  
(\$ billions)



2023 Annual Statement		
By Segment	DPW (\$B)	%
Personal Lines	477.0	49
Commercial Lines	480.6	50
A&H	8.4	1
<b>Total</b>	<b>965.9</b>	<b>100</b>
<b>Capital &amp; Surplus</b>	<b>\$ 1,042.3</b>	
SNL Financial Aug. 2023		

Source: SNL Financial

08/13/2024

# Before We Begin...PL Markets

## US MPL – Top 20 Writers, 2023

Ranked by MPL DPW  
(\$ millions)

Rank	2022	2023	Group/Company	DPW	YoY % Change	2023 MPL Market Share
1	1		Berkshire Hathaway Insurance Group	2,175	1.8	18.2
2	2		Doctors Company Insurance Group	1,207	7.1	10.1
4	3		CNA Insurance Companies	698	9.7	5.8
3	4		ProAssurance Group	692	-3.5	5.8
6	5		MAG Mutual Companies	581	21.0	4.9
5	6		Coverys Companies	508	-3.5	4.2
7	7		MCIC Vermont (A RRRG)	459	-0.2	3.8
14	8		Curi Insurance Group <sup>1</sup>	395	-0.2	3.3
8	9		Liberty Mutual Insurance Companies	383	16.2	3.2
10	10		Chubb INA Group	224	7.2	1.9
12	11		ISMIE Mutual Group	216	7.2	1.8
11	12		W. R. Berkley Insurance Group	204	1.3	1.7
15	13		Controlled Risk Insurance Co of VT, Inc	183	4.3	1.5
13	14		PRI Group	176	0.2	1.5
18	15		COPIC Insurance Group	166	23.1	1.4
19	16		Fairfax Financial (USA) Group	150	15.0	1.3
17	17		State Volunteer Mutual Insurance Company	146	6.1	1.2
20	18		Physicians Insurance Mutual Group	145	14.5	1.2
23	19		American International Group	106	8.3	0.9
21	20		National Group	106	5.9	0.9

Top 5 ~ 46%  
Top 10 ~ 63%

<sup>1</sup> Constellation Insurance Group and all of its subsidiaries merged with Curi Holdings Group and all of its subsidiaries (closed on October 3, 2023). The combined company now operates under the name Curi. In 2022, Constellation was ranked #9 in US MPL DPW, and Curi, #14.

Source: 

Ranked by Monoline D&O DPW

## US D&O Liability – Top 20

Company Name	2023 DPW	
	\$ millions	% Change from 2022
XL America Cos	1,101	-40.2
Chubb INA Grp	1,088	-11.4
Berkshire Hathaway Insurance Grp	937	-13.3
American International Grp	894	-16.5
Tokio Marine US PC Grp	856	-6.4
Fairfax Financial (USA) Grp	595	-24.5
CNA Insurance Cos	496	-2.9
Travelers Grp	455	-4.6
W. R. Berkley Insurance Grp	409	-28.6
Sompo Holdings US Grp	401	-12.1
Zurich Insurance US PC Grp	393	-19.8
Arch Insurance Grp	372	-13.3
Nationwide Property & Casualty Grp	357	32.5
Markel Insurance Grp	308	61.5
Great American P & C Insurance Grp	280	-4.7
AXIS US Operations	233	-20.2
Old Republic Insurance Grp	208	-21.4
Hartford Insurance Grp	200	-12.3
Allianz US PC Insurance Cos	182	-4.7
Everest Re U.S. Grp	164	-10.7
<b>Industry Total</b>	<b>11,485</b>	<b>-15.3</b>

Top 5 ~ 42%  
Top 10 ~ 63%

Source: 

# Financial Statements - Learning Objectives

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- Identify the purpose, structure and types of key financial reports
- Identify and examine important elements of the balance sheet, income and cash flow statements
- Explain the basic features of each type of statement

# Why Are Financial Statements Important?

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## Financial Analysis

- Valuation
- Profitability
- Effective / Efficiency
- Financial Strength / Solvency



# How? Generally Accepted Accounting Principles

<b>GAAP</b>	<b>Criteria</b>
<b>What is it?</b>	Set of rules and standards for reporting a company's financial data (used by CPAs)
<b>Purpose</b>	A means to understand and compare financial information
<b>Sources</b>	Historical principles and rules/standards developed by regulators and industry
<b>International Financial Reporting</b>	US & international accounting regulators have been working to coordinate standards

# Primary GAAP Concepts

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## GAAP Assumptions

- Separate entity
- Stable monetary unit
- Fixed time period(s)
- ***Going concern***

# Additional GAAP Concepts

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## GAAP Characteristics

- Historical cost basis
- Full disclosure
- Revenue Recognition
- Matching Principle (accrual vs. cash accounting)

# GAAP Constraints

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## **Additional Characteristics & Limitations**

- Cost-benefit
- Conservatism
- Industry practices
- Materiality

# Auditor's Opinion

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## Audit Reports – Objectives

- Are financial statements fairly stated?
- Is management's assessment of internal control effectiveness over financial reporting accurate?
- Are internal controls over financial reporting process *actually* effective?

# Public Accounting Firms

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## Types of Audit Reports

- **Opinion**
  - *Unqualified*
  - *Qualified*
  - *Adverse*
  - *Disclaimer*
- **Review**
- **Compilation**

# Financial Reporting Issues

## Public Companies and Oversight

- What is a public company?
- Oversight and regulation
  - Securities and Exchange Commission (SEC)
  - Financial Accounting Standards Board (FASB)
  - Public Company Accounting Oversight Board (PCAOB)
  - American Institute for Certified Public Accounts (AICPA)

# Financial Reporting Requirements

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## **Laws Governing the Securities Industry**

- Securities Act of 1933
- Securities Exchange Act of 1934
- Public Securities Litigation Reform Act (PSLRA) of 1995
- Sarbanes Oxley Act of 2002 (SOX) – PCAOB established
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010



# CEO and CFO Certification

## **Sarbanes-Oxley Act (2002): Strict Requirements**

- SOX requires CEO & CFO to certify that:
  1. Internal controls over financial reporting are effective  
*and*
  2. The financial statements are accurate
- Pleading ignorance not acceptable
- Criminal Penalties

# Financial Reporting Requirements

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## **SEC Filings for Public Companies**

- **10-K**
- **10-Q**
- **8-K**

# Financial Information

## Obtaining Information on Public Companies

- **Sources**
  - Financial databases (Edgar, Bloomberg, etc.)
  - Internet /Web sources (Yahoo, CNBC, etc.)
  - Rating organizations
  - SEC / Government
- **Fundamental Quality**
  - Relevance
  - Reliability
  - Comparability
  - Consistency

# Financial Analysis

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## The Annual Report

- What *is* it?
- What *purpose* does it serve?
- What *information* does it contain?

# Financial Statements

<b>Formal Statement</b>	<b>Disclosure Requirements</b>
<b>Balance Sheet</b>	Financial position as of a specific point in time
<b>Income Statement</b>	Earnings for a period (Year ending, Quarter, etc.)
<b>Cash Flow Statement</b>	Cash flows during a period
<b>Statement of changes in Owners' Equity</b>	Investments by/distributions to owners during a period
<b>Management's Discussion and Analysis (MD&amp;A)</b>	Notes or explanations of accounting policies used & additional details

# The Balance Sheet

## Fundamentals - Purpose

- Reveals the financial position of the company **at** a specific point in time (e.g., “as of” December 31)
- Presents a “snapshot” of all:
  - Assets owned
  - Liabilities owed
  - Shareholders’ Equity

# Balance Sheet Concepts

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## General Accounting Equation

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}^*$$

\* Other terms may be used for public or private companies

NOTE:

Subtracting Liabilities from both sides of the equation yields:

$$\text{Shareholders' Equity} = \text{Assets} - \text{Liabilities}$$

# Balance Sheet Concepts

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<b>Assets</b>
<ul style="list-style-type: none"><li>• Current Assets</li><li>• Long-term Assets</li></ul>
<b>Liabilities</b>
<ul style="list-style-type: none"><li>• Current Liabilities</li><li>• Long-term Liabilities</li></ul>



# Balance Sheet Elements

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## Shareholders' Equity

- Preferred stock
- Common stock
- Retained earnings
- Treasury stock
- Capital surplus
- Other

# Balance Sheet Analysis

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## ***Careful Attention to Certain Items***

- Off Balance Sheet liabilities
- Intangible Assets
- Account Receivables

## ***Important Question***

- Can the company cover its liabilities?

# The Income Statement

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## Purpose and Fundamentals

- Measures profitability of a company **over a specified period of time**  
(e.g., “period ending” December 31)

**Net Income (Loss) = Revenues – Expenses**

# Income Statement Elements

## Typical Components

- Revenue (Gross/Net Operating)
- Cost of goods sold
- Gross profit
- Operating expenses
- Research & Development (R&D) expenses
- Selling, General & Advertising (SG&A) expenses
- Net income (continuing/discontinued operations)
- Other gains/losses

# Income Statement Analysis

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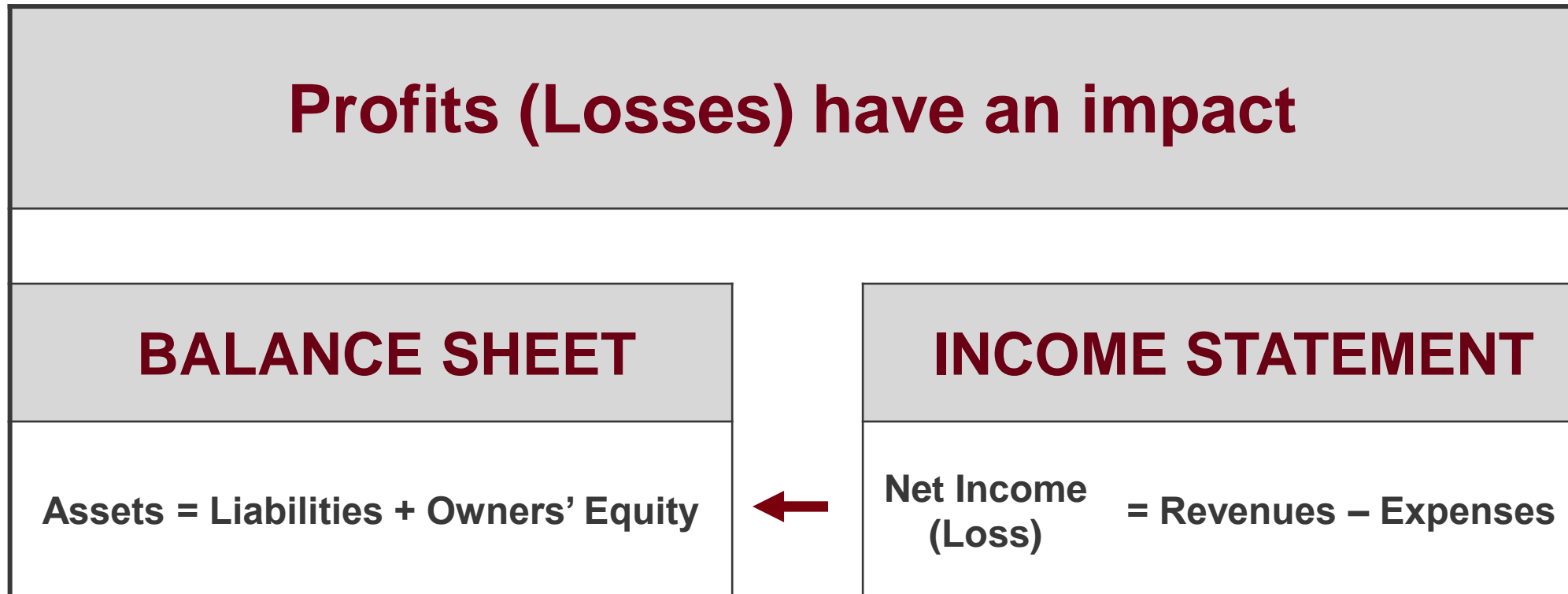
## ***Important Question***

- Is the company ***making*** or ***losing money***?

## ***Careful Attention***

- Recognizing revenue too early
- Delayed or premature recognition of expenses

# BS and IS Relationship



# Earnings: Stock Shares

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## Reporting Earnings Per Share (EPS)

- **Basic**
- **Diluted**

# Cash Flow Statement (1988)

## Fundamentals – Purpose

- Identifies *sources & uses* of cash during a defined period of time
- Records cash flow by *significant activity*:
  - Operating
  - Investing
  - Financing

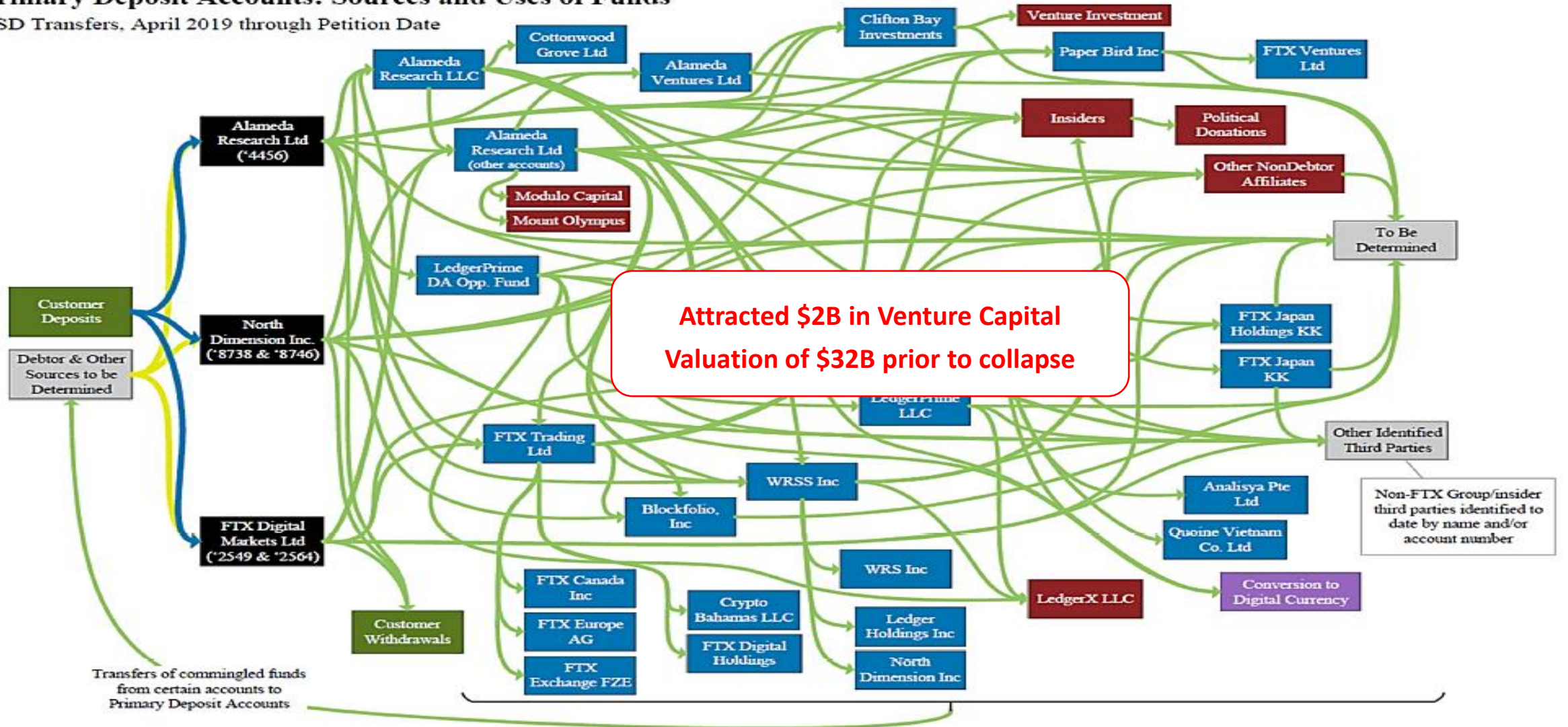
## Things to Remember

- Income (statement) **does not** equal cash flow
- Cash basis and Accrual basis very different



## Primary Deposit Accounts: Sources and Uses of Funds

USD Transfers, April 2019 through Petition Date



**Attracted \$2B in Venture Capital  
Valuation of \$32B prior to collapse**

<p>Customer Deposits <span style="color: blue;">—</span></p> <p>Debtor &amp; Other Sources to be Determined <span style="color: yellow;">—</span></p> <p>Transfers of Commingled Funds <span style="color: green;">—</span></p>	<p style="background-color: #0070C0; color: white; padding: 2px;">Debtor Accounts (grouped by Entity)</p> <p style="background-color: #9933CC; color: white; padding: 2px;">Third Parties Facilitating Conversion to USDC</p>	<p style="background-color: #800000; color: white; padding: 2px;">NonDebtor &amp; Insider Accounts</p> <p style="background-color: #808080; color: white; padding: 2px;">Identified Third Parties &amp; to be Determined</p>	<ul style="list-style-type: none"> <li>Diagram depicts direct and indirect transfers &gt; \$500,000 into and from the Primary Deposit Accounts. Recipients also received funds from many other sources not shown.</li> <li>Diagram does not reflect the sequence, volume, or frequency of transfers.</li> <li>Diagram is subject to change as analysis is ongoing.</li> </ul>
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# Financial Analysis

## A Number of Ratios Used For Evaluation

- Often used as a way to quickly assess health of a company prior to in-depth analysis
- Frequently identified in six main groups:
  1. **Liquidity** – ability to pay short-term debts
  2. **Solvency** – ability to pay long-term debt & interest
  3. **Profitability** – ability to generate profits from operations
  4. **Efficiency** – use of A & L to generate sales/max. profits
  5. **Coverage** – ability to pay interest/meet debt obligations
  6. **Market Prospect** – most common; identify earnings

# Financial Analysis

<b>Public Company Examples (Vary by Industry)</b>	
<b>TYPE(S)</b>	<b>EXAMPLE</b>
<b>Valuation</b>	$\text{Market Capitalization} = \text{No. of outstanding shares} \times \text{Market value per share}$
<b>Profitability</b>	$\text{Profit Margin} = \text{Net Income} / \text{Revenue}$
<b>Efficiency (Effectiveness)</b>	$\text{Return on Equity} = \frac{\text{Net Income (Loss)}}{\text{Total Shareholders' Equity}}$
<b>Solvency (Strength)</b>	$\text{Total Debt to Equity} = \frac{\text{Total Liabilities}}{\text{Total Shareholders' Equity}}$

# Rating Agencies – What Role?

## Nationally Recognized Statistical Rating Organizations



**Standard & Poors**

- Largest; focus on default probability



**Moody's**

- Focus on fixed income securities



**Fitch**

- Focus on yield; company debt



**A.M. Best**

- Focus on insurers and reinsurers

# Financial Analysis Wisdom

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## Words of Caution

- Financial statements primarily report ***quantitative*** data
- Do not reflect ***qualitative*** factors such as the value of management or employees, reputation, etc.

# Session Recap

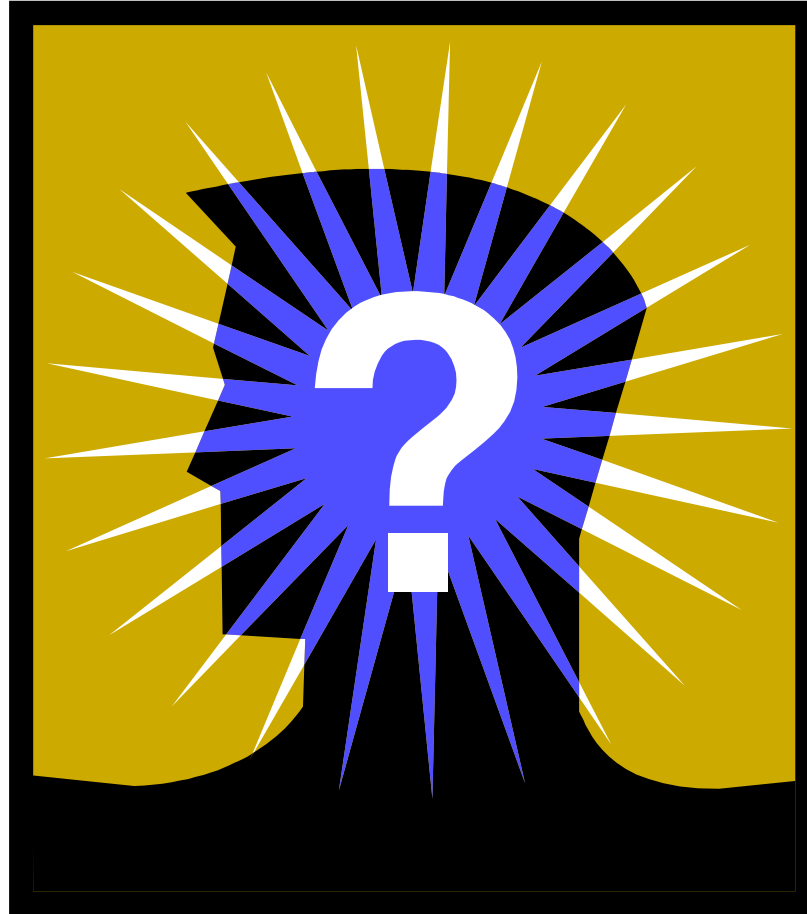
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# Questions?

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Thank you!