

November 8,
2002

To: All Farm Mutual Insurance Companies
 From: Nathaniel S. Shapo, Director
 Re: (CB #2002-06) Depreciation of Home Office Building
 Reply To: Tom Lurkins, Property and Casualty Financial Analysis Unit Person: (217) 524-5942;
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Currently, Farm Mutual Insurance Companies have the option of depreciating their home office building. Starting with the 2002 Annual Statement that is due on January 31, 2003, the Illinois Department of Insurance will require all farm mutual insurance companies with a home office building to depreciate their home office building and the improvements thereto over the useful life of the building and improvements. The companies must use the straight-line method of depreciation or a method that is more accelerated.

For those companies, which had not previously depreciated their home office buildings, the home office building and the improvements must be depreciated over the remaining useful life of the building and improvements as of December 31, 2002. Since the building and some improvements may have different useful lives, the depreciation of the improvements may need to be calculated separately from the building. Improvements, such as replacement of the roof, heating and air conditioning and land improvements (landscaping, parking lot improvements, etc.) should be depreciated separately from the home office building over their estimated useful life. However, other improvements, such as replacement of doors, windows, etc. should be depreciated over the remaining useful life of the building. Those companies already depreciating their home office building should not make any adjustments to their method of depreciation or the useful life of the home office building and its improvements.

A company will not be allowed to capitalize the cost of maintenance and repairs to the home office building. These costs must be expensed in the year that the costs are incurred.

Attached is the formula for the straight-line method of depreciation along with an example. For future reference, this bulletin can soon be viewed on our internet web site under Company Information.

Straight-line Method of Depreciation

Actual Cost of Building less the Value of the Land on the Date of Purchase

Useful Life of Building = Depreciation on Building

Actual Cost of Improvement to Building

Useful Life of Improvement = Depreciation on Improvement

Example:

The company purchased a 10 year-old home office building with a remaining useful life of 30 years on January 1, 1991 at a cost of \$100,000. The land had a value of \$19,000 at the time of purchase. The company made \$10,000 of improvements to the home office building (new air conditioner and furnace) on January 1, 1998, which had a useful life of 10 years in 1998. The company had not previously recognized in its financial statements the depreciation of these assets. Below is the calculation of the depreciation at December 31, 2002:

$$\begin{array}{r} \text{Depreciation on Building: } \mathbf{100,000 - 19,000} \quad \mathbf{\$81,000} \\ \qquad \qquad \qquad 30 - 12 \qquad \qquad \qquad = 18 \qquad \qquad = \$4,500 \text{ (1)} \end{array}$$

$$\begin{array}{r} \text{Depreciation on Improvements: } \mathbf{10,000} \\ \qquad \qquad \qquad 10 - 5 \quad = \$2,000 \end{array}$$

(1) Depreciation in this amount is to be shown as an expense on Page 2, Line 28 of the annual statement in each of the following years so long as the building and improvements remain in service. The carrying value of the asset will be reduced each year by the amount of depreciation recognized.