New Accounting Framework in Insurance Industry

R.C. Guria

< EXECUTIVE SUMMARY >

With the opening of the insurance sector in India to the private and the global giants, the entire scenario of the industry has undergone a sea-change. The insurance operations in India are in the phase of getting more structured and increasingly more complex. With this the expectations from the professionals have also increased. The financial statements and audit reports of the insurance companies are also required to be strictly in accordance with IRDA. The article deals with the requirements of Schedule B to the IRDA Regulations, 2002.

4. IRDA (Insurance Brokers) Regulations’02 & (Corporate Agents) Regulations 2002
6. Statutory Status to Institute of Surveyors and Adjusters.
7. IRDA (Investment Regulations) 2000
10. IRDA (Protection of Policyholder’s Interests)(Amendment) Regulations 2002

With the last four IRDA regulations, insurance accounting and the audit thereof have witnessed new framework and directions. Now the Financial Statements and Audit Reports of insurance companies are to be prepared strictly in accordance with IRDA (Preparation of Financial Statements and Auditor’s...
PART-I-Accounting Principles for preparing Financial Statements

1. Accounting Standard: Financial Statements comprising i) Balance Sheet, ii) Receipts and Payments Account (Cash Flow Statement) Profit & Loss Account (Shareholders’ Account) and Revenue Account (Policyholders Account) shall be in conformity with the Accounting Standards (AS) issued by the Institute Of Chartered Accountants of India to the extent applicable to the insurer carrying on general insurance business except that:

- Accounting Standard 3 —Cash-flow Statement shall be only under Direct Method
- Accounting Standard 13—Accounting for Investment shall not be applicable
- Accounting Standard 17-Segment reporting shall apply to all insurers irrespective of the requirements for listing and turnover mentioned therein.

Note-1. AS-3, Cash Flow Statement is the widely accepted model for preparation of Cash Flow Statements. It classifies Cash Flow in the following categories

- Cash Flow from Operating activities.
- Cash Flow from Investing activities
- Cash Flow from Financing activities.

Cash Flow from Operating activities cover cash flows derived from the principal revenue-producing activities. Cash Flows from Investing activities are related to acquisition and disposal of fixed assets and investments and Cash Flows from Financing activities refer to cash flows from and to providers of equity and loan funds to the organization. The method discussed above and shown in the format hereinafter is known as Indirect method of reporting Cash Flow from operating activities as required by SEBI. But AS 3 also stipulates alternative method known as Direct Method of reporting Cash Flows where major classes of gross cash receipts and payments from Operation activities are disclosed and reported IRDA stipulates only the direct method of Cash Flow, which has not yet been formatted by IRDA. So Cash flow statement is shown here

As per AAS-28-The Auditor’s Report on Financial Statements, Auditors are required to review and report whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity. It is also necessary to review and report whether the financial statements give a true and fair view in accordance with that financial reporting framework. Precisely AAS-28 requires auditors to be thorough with the Financial Statements and Reporting Framework as laid down by Regulatory Authority. AAS28 provides (Para 29) that financial statements comply with relevant statutory requirements and regulations.
under Indirect Method for ready reference here.

Note-2: AS.17 vis-a-vis IRDA guidelines on Segment Reporting: AS 17-Segment Reporting requires identification of different segments of an enterprise and furnishing information on performance risks and returns of the segments enabling the informed judgments about the enterprise as a whole as well as the segments defined. AS 17 provides guidance on how to identify segments. AS 17 defines a segment as a distinguishable area or component of an enterprise on the basis of particular risks and returns that are different from those of other segments. However as per IRDA requirements segment reporting as specified by AS 17 shall apply to all insurers irrespective of the requirements regarding listing and turnover mentioned therein.

2. Premium Recognition: Premium shall be recognized as income over the Risk Period or Contract Period-whichever is appropriate. Hence premium received in advance shall be treated separately in the financial statement. A Reserve for Unexpired Risk shall be created with that part of premium which is attributable to and to be carried forward to the succeeding accounting period and shall not be less than the following limits as specified by Sec. 64V(ii)(b) of the Insurance Act 1938:

- Fire & Misc. Business 50% of premium
- Marine Cargo Business 50% of premium
- Marine Hull Business 100% of premium

The reserves for Unexpired Risk are also known as Technical reserves. With the creation of Technical Reserve necessary adjustments are made so that premium income included in the Underwriting year’s results is the premium actually earned in that year. The adjustments comprise bringing forward an amount for unearned premium from the previous year (previous year’s Technical Reserves) and carrying forward an amount for unearned premium (current year’s Technical Reserve) into the following year.

3. Premium Deficiency: Premium Deficiency shall be recognized if the sum of claim costs, related expenses and maintenance cost exceeds the related reserves for the unexpired risks.

4. Acquisition Cost: Acquisition costs, if any, shall be expensed in the period in which they are incurred.

Acquisition costs are those costs that vary with and primarily related to the acquisition of new and renewal insurance business.

5. Claim Cost: Claim cost comprises the claims under policies and specific claim settlement costs. Claims under policies mean the claim made for losses incurred and those estimated under the policies following a loss occurred. Estimated liability of Outstanding claims which will result in future outgo shall be brought to account in respect of:

- Claims reported, but not paid on direct business.
- Claims reported, but not settled on inward Re-insurance business.
- Claims incurred, but not reported (IBNR)
- Claims incurred, but not enough reported (IBNER)

The change in estimated liability for outstanding claim at the beginning and at the end of the financial period shall be brought into account. The estimated liability for outstanding claims shall be provided net of salvage value if its realization is sufficiently certain.

Actuarial valuation of claim liability: Claims made in respect of contracts where the claim payment period exceeds four years shall be recognized on an actuarial basis subject to regulations that may be prescribed by the Authority

6. Procedure for Valuation of Investment: An insurer shall determine the values of investments in the following manner:

a) Real Estate / Investment Property: Investment Property shall be measured at historical costs less accumulated depreciation and impairment loss. If residual value becomes Zero, no revaluation is permissible. The insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred. An impairment loss shall be recognized as an expense in the Revenue/Profit & loss Account. Fair Value as at the balance sheet date and the basis of its determination shall be disclosed in the Financial Statement as additional information.

b) Debt Securities: Debt securities including Govt. securities and redeemable preference shares shall
he considered as ‘held to maturity security’ and shall be measured at historical cost.

c) Listed / Actively Traded Equity Securities:

i) Listed equity securities and derivative investments that are traded in the active market shall be valued at fair value as at Balance Sheet date.

ii) For the purpose of calculation of fair value, the lowest of the last quoted closing price of the stock exchange concerned shall be considered.

iii) Unrealized gains / losses arising out of changes in the fair value of listed equities and derivatives shall be taken to equity under the Account head ‘Fair Value Change Account’

iv) The profit or loss on sale of investment shall include accumulated changes in the fair value previously recognized in equity under the head ‘Fair Value Changes A/C’ in respect of particular security and being recognized to Profit & Loss Account on actual sale of the listed security.

v) Any balance or any part thereof shall not be available for distribution of dividends while the debit balance in the said account shall be deducted from the profits or free reserves before declaration of dividend.

7. Apportionment of Investment Income:

Investment income (net of expenses) is apportioned between Shareholders’ Fund and Policyholders fund in proportion to the Opening balance of these funds. Investment income belonging to policyholders is further apportioned to various depts. in proportion to respective Technical Reserves at the beginning of the year.

8. Loans: Loans shall be measured at historical cost subject to impairment provisions which will be provided for in consideration of the quality of loan assets on the basis of guidelines prescribed from time to time by the RBI.

9. Catastrophe Reserve: This reserve is to be created in accordance with the norms prescribed by the Authority. Investment of Funds out of Catastrophe Reserve shall be made in accordance with prescription of the Authority. Catastrophic Reserve means reserve which is meant for meeting losses arising from an entirely unexpected set of events and not for any specific known purpose. This reserve is in the nature of an amount set aside for the potential future liability against the insurance policies. Losses from storms, tornadoes, floods, earthquakes and volcanic eruptions are called catastrophic losses. Reserves against these types of losses are termed as Catastrophe Reserve. IRDA has not yet specified any norms and rules for Catastrophe Reserve though it has been specified in the format. However creation of catastrophe Reserve is very important in view of a study by the Munich Reinsurance Co. that natural catastrophes caused about $13 billion insured losses in 2002.


PART-III-CERTAIN INSTRUCTIONS FOR PREPARATION OF FINANCIAL STATEMENTS

1. The corresponding amounts for the preceding financial year to be shown in all financial statements.

2. Extent of risk retained and reinsured to be disclosed separately.

3. The expression “Reserve” shall not include any amount written off or retained by way of providing for depreciation, renewals or diminution in the value of assets.

4. The Expression Capital Reserve’ shall not include any amount regarded as free for distribution and ‘Revenue Reserve’ shall mean any reserve other than capital reserve

5. Any debit balance of Profit and Loss Account shall be shown as deduction from uncommitted reserves and the balance, if any, shall be shown separately.

PART -V-Preparation of Financial Statements

- Non-life insurer shall prepare Revenue Accounts (Policyholders Accounts), Profit and Loss Account (Shareholders Account) and the Balance Sheet in the Form B-RA, Form B- PL and form B-BS respectively.
Revenue Accounts shall be prepared separately for Fire, Marine and Misc Depts.


Separate Receipts and Payments Accounts shall be prepared in accordance with the Direct Method as prescribed in As-3 “Cash Flow Statement”

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**FORM B-RA**

Revenue Account for the Year Ended 31st March……..

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Schedule</th>
<th>Currn. Yr. (Rs.’000)</th>
<th>Prev. Yr. (Rs.’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Premium earned (Net)</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Profit/Loss on sale/ redemption of investments</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Others (to be specified)</td>
<td>3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Interest, Dividend &amp; Rent- Gross</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total (A)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Claims Incurred (Net)</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Commission</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Operating Expenses related to Insurance business</td>
<td>7</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total (B)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating profit/loss from Fire/Marine/Misc. Business</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business C=(A-B)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Appropriations**

- Transfer to Shareholders’ Account
- Transfer to Catastrophe Reserve
- Transfer to other Reserves (to be specified)

**Total (c)**

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Note to Form- B-RA

a) Premium income received from business concluded in and outside India shall be shown separately.

b) Reinsurance premium Income whether on business ceded or accepted are to be brought into account for gross (before deduction of commission) under the Reinsurance premium.

c) Claims incurred shall comprise claims paid, specific claim settlement costs wherever applicable and change in the outstanding provisions for claims at the year end.

d) Interest, dividends and rentals to be stated as gross and TDS amount to be included under ‘Advance Taxes Paid’

e) Income from rent shall not include any notional rent.
Profit and Loss Account for the year Ended 31st March

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Sched.</th>
<th>Curnt. Yr. (Rs. ‘000)</th>
<th>Prv. Yr. (Rs. ‘000)</th>
</tr>
</thead>
</table>

1. OPERATING PROFITS/LOSS
   a) Fire Insurance
   b) Marine Insurance
   c) Miscellaneous Insurance

2. INCOME FROM INVESTMENTS
   a) Interest, Dividends & Rents - Gross
   b) Profit on Sale of Investments

3. OTHER INCOME (To be specified)
   TOTAL (A)

4. PROVISIONS (Other than taxation)
   a) For diminution in value of investment
   b) For doubtful debts
   c) Others (to be specified)
   TOTAL (A) Profit Before Tax

Provisions for Taxation

APPROPRIATIONS
a) Interim Dividend Paid during the year
b) Proposed Final Dividend
c) Dividend distribution tax
d) Transfer to any Reserve or Other Account

Balance of profit / loss brought forward from last yr.
Balance carried forward to Balance Sheet

Note to B-PL
a) Items of expenses and income in excess of one per cent of total premium (less re-insurance) or Rs.5,00000 whichever is higher shall be shown separately.
b) Fees / expenses connected with claims shall be included in claims.
c) Foreign exchange gains / losses shall be shown under head ‘Others’
d) Interest, Dividends and rental receivable in connection with an investment shall be shown as gross amount, TDS being included under ‘Advance tax and tax deducted at source’
e) Income from rent shall include only realized rent not notional rent.

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Balance Sheet As At 31st March...

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Schedule</th>
<th>Curnt. Yr. (Rs. ‘000)</th>
<th>Prv. Yr. (Rs. ‘000)</th>
</tr>
</thead>
</table>

1. SOURCES OF FUNDS
   Shareholders Fund
   Reserves and Surplus
   Credit/Debit-Fair value Change A/c
   Sub-Total.
   Borrowings
   Policyholders Fund
   Credit/Debit-Fair value Change A/c
   Policy Liabilities
   Insurance Reserves
   Provisions for Linked Liabilities
   Sub-Total
   Funds for Future Appropriations
   TOTAL

2. APPLICATION OF FUNDS
   Investments
   Shareholders
   Policyholders
   Sub-Total (A)
   Assets Held to Cover Linked Liabilities
   Loans
   Fixed Assets
   Current Assets
   Cash and Bank Balances
   Advance and other Assets
   Sub-Total (A)
   Current Liabilities
   Provisions
   Sub-Total (B)
   Net Current Assets (C)=(A-B)
   Misc. Expenditure
   (To the extent not written off)
   Debit Balance in Profit & Loss Account
   (Shareholders’ Account)
   TOTAL

Contingent Liabilities:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Current Yr.</th>
<th>Prev. Yr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Partly Paid-up Investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Claims other than against policies not acknowledged as debts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Underwriting Commitments in respect of shares &amp; securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Guarantees given by or on behalf of the company</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Statutory demands / liabilities in dispute, not provided for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Reinsurance Obligations not provided for</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Others</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Cash Flow Statement (Example on Direct Method)
For the Period From 01-04… To 31.3….

<table>
<thead>
<tr>
<th>Balance at the beginning</th>
<th>Bank Account</th>
<th>Bank Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Balance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Cheque on Hand</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money in Transit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term FD</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Petty Cash</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imprests- Policy Stamps</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imprests- Postage Stamps</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imprests- Revenue Stamps</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Imprests- Agency Stamps</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Operating Activities**

### Inflow
- Premium Collections
- Advance Premium
- Cash Deposit
- Bank Guarantee
- Environment Fund
- Bhavishya Arogya
- Service Tax

### Transfer and Duplicate fees
- Coinsurance Premium
- Administrative Expenses
- Coinsurance Commission
- Recover of Expenses
- Claims and salvage
- Commission
- Brokerage
- Other Collections
- Other Items Including contra items
- Premium Accepted treaty
- Premium Accepted Facultative
- Claims Ceded Treaty
- Claims Ceded Facultative
- Commission Ceded Treaty
- Commission Ceded Facultative
- Service Charges Ceded Facultative
- Foreign Group
- Other Group

**A. Total Inflow**

### Outflow
- Premium Refunds
- Excess Refunds
- Cash Deposit Refund
- Environment Fund Refund
- Bhavishya Arogya Refund
- Service Tax Refund
- Bank Charges Others
- Refund Cheques
- Coinsurance Prem.
- Coinsurance Claims
- Administrative Exp.
- Coinsurance Comm.

### B. Total Outflow

1. **Net Funds Generated/Utilised From Operations (A-B)**

**Investing Activities**

### Inflows
- Sale of Assets
- Sale/Redemption of Investment
- Recovery of Loans Employees
- Recovery of Loans Others
- Investment Income Interest on FD
- Investment Income

### Outflows
- Others

**C. Total Inflow**

### D. Total Outflow

2. **Net Funds Generated/Utilised from Investing Activities (C-D)**

**Financing Activities**

### Inflows
- Others

### Outflows
- Others

3. **Net Funds Generated from Financing Activities**

### Balances at the End
- Bank Balance
- Cash and cheques on Hand
- Money in Transit
- Short term FD
- Petty Cash
- Imprests- Policy Stamps
- Imprests- Postage Stamps
- Imprests- Revenue Stamps
- Imprests- Agency Licence Stamps

Note: Above Cash flow Statement has been prepared on direct method as example. This formatted is not prescribed by IRDA while other financial statements have been formatted by IRDA.
SEGMENT REPORTING FOR THE FINANCIAL YEARS

Net Balances of all Revenue Items comprising Net Premium (after adjustment of Reserves for Un-expired Risks), Profit on realization of Investments, Interest, rent, Dividend, Incurred Claims, Commission, Operating Expenses Other Foreign Taxes, Revenue A/c results are to be segmented and apportioned in a columnar form among the following departments of insurance business as per IRDA regulations:


N.B. Above Segment Reporting is little bit different from general guidance of AS 17 as it is specified by IRDA, but the purpose and performance are same as intended in AS.

Part II- Disclosures forming part of Financial Statements

A. Disclosures by way of Notes to Balance Sheet:
1. Contingent Liabilities as stated earlier.
2. Ecumbrances to assets of the company in and outside India.
3. Commitments made and outstanding for loans, investments and fixed assets.
4. Claims less reinsurance paid to claimants in/outside India
5. Actuarial assumption of claim liabilities in the case of claim payment period exceeding 4 years.
7. Premium less reinsurance written from business in/outside India
9. Value of Contracts in relation to investments for
   a) Purchases where deliveries are pending.
   b) Sales where payments are pending.
10. Basis of allocation of operating expenses to various classes of business.
11. Historical cost of those investments valued on fair value basis.
12. Computation of Managerial Remuneration.
13. Basis of amortization of debt securities
14. a) Unrealized gains/losses arising out of changes in the fair value of listed equity and derivative instruments—taken into equity under the head “Fair Value Change Account”
   b) Credit Balance in “Fair Value Change Account”
15. Fair Value of Investment Property and the basis thereof.
16. Claim settled and remaining unpaid for more than 6 months on the Balance Sheet date.

B. Accounting Policies and Accounting Standard Followed:
1. All significant accounting policies in terms of the Accounting Standards issued by the ICAI and in terms of Accounting Principles stated in Part-I earlier- followed by the insurer shall be stated in the manner required by ASI issued by ICAI.
2. Any departure from accounting policies as stated above shall be disclosed with reasons.

C. The following information shall also be disclosed:
1. Segregation performing and non-performing investments for the purpose of income recognition as per direction, if any, issued by the Authority.
2. Investments, if made, in accordance with any statutory requirements should be disclosed separately together with its amount, nature, security and any special rights.
4. A summary of Financial Statements for last five years in the manner as may be prescribed by the Authority.
5. Accounting Ratios as may be prescribed by Authority.
6. Basis of allocation of Interest, Dividends and Rent between Revenue Accounts and Profit And Loss Account.

Note – 1. The schedules as specified by IRDA for respective financial statements could not be explained due to want of space, which may be explained afterwards if required.

References:
   i) The Gazette of India, Extraordinary, Part III- Section 4-Notification dt. 30.3.02.
   ii) The ICAI publication of Accounting Standards.