FINANCIAL STATEMENTS OF INSURANCE COMPANY

B.COM CC408 SEMESTER 4
CORPORATE ACCOUNTING

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Learning Objectives:

After studying this unit, you will be able to:

- ♦ Understand the basic concepts of Insurance.
- ♦ Learn the meaning of some important terms used in insurance business, namely premium, considerations for annuities granted, claims, surrender value, bonus, paid-up policy, re-insurance and agents' balances.
- ♦ Learn two main types of insurance business i.e. life insurance and general insurance and will be able to distinguish between them.
- ♦ Understand the meaning and various types of fire, marine and miscellaneous policies.
- ♦ Provisions of the Insurance Act requiring preparation of financial statements for the insurance business and maintenance of register or record of policies.

Summary Notes and Questions for the Practice

BASIC CONCEPTS	
Claims	it refers to the amount payable by insurer to the insured when policy becomes due or the event denoting the risk covered under the policy of insurance occurs. Claim = Claim intimated + Survey fees + Medical expenses – Claims received on insurance.
Premium	it refers to the consideration received by the insurance company to undertake the risk of the loss. It is always net of premium paid on reinsurance.
Annuity (LIC)	it is fixed annual payment received regularly till insured lives. This is in consideration of lump-sum money paid by him in the beginning of the policy.
Bonus	the profit of LIC is distributed among the shareholders and policy holders. The policy holders get 95% of the profit of LIC by way of bonus. The bonus may be of following types: • *Cash Bonus:* paid on declaration of bonus in cash. • *Revisionary Bonus:* it is paid with the policy value at the time of maturity instead of cash at the time of declaration. This bonus is added in the amount of claims. • *Bonus in reduction of Premium:* Bonus is not paid in cash but adjusted against the future premiums. • *Interim Bonus:* it refers to bonus paid on the maturity of policy in the year for which the profit has not yet been determined. Such a bonus is included in claims.
Reinsurance	if an insurer is not willing to bear the entire risk under insurance cover, it gets itself reinsured with another insurer for a part of the risk thereby reducing his risk itself. Some risk retains with some other insurer.

Commission on Reinsurance Accepted	the reinsurer generally allows commission to the reinsured (the insurance company which is seeking to get a risk reinsured) on part of business ceded. This is treated as an expense of the insurance company which is providing the reinsurance cover i.e. the reinsurer.
Commission on Reinsurance ceded	The insurer who is getting reinsurance (reinsured) generally gets commission for giving the business under reinsurance contract to the reinsurer. It appears as an income in revenue account of the reinsured company.
Coinsurance	when a large risk is offered to an insurance company, then that insurance company retains certain percentage of sum insured and contracts other insurance company to underwriter the balance risk. In this way, all the companies jointly bear the risk. One is called as the leader who issues the policy and acts on behalf of others.
Reserve for unexpired Risk:	For Marine Business = 100% of net premium income For others = 40% of net premium income *(Income tax authorities allow even a provision of 50% of net premium income from other sources)*
Financial Statements	***Life Insurance Business*** The insurance company carrying life insurance business is required to prepare Balance sheet form A – BS Revenue account [Policy holders' account] Form A- RA Profit and loss account form A-PL. These forms have been given in the IRDA Regulations, 2002. No form has been specified for cash flow statement.
	General Insurance Business The insurance company carrying on general insurance business is required to prepare Balance sheet form B – BS Revenue account [Policy holders' account] Form B- RA Profit and loss account form B-PL. These forms have been given in the IRDA Regulations, 2002. No form has been specified for cash flow statement.

Question 1

Explain in short, the following principles and term of insurance business:

(i) Principle of Indemnity;

(ii) Insurable interest;

(iii) Principle of "UBERRIMAE FIDEI".

(iv) Catastrophic Loss

Answer

(i) Principle of indemnity: Insurance is a contract of indemnity. The insurer is called indemnifier and the insured is the indemnified. In a contract of indemnity, only those who suffer loss are compensated to the extent of actual loss suffered by them. One cannot make profit by insuring his risks.

(ii) Insurable interest: All and sundry cannot enter into contracts of insurance. For example, A cannot insure the life of B who is a total stranger. But if B. happens to be his wife or his debtor or business manager, A has insurable interest i.e. vested interest and therefore he can insure the life of B. For every type of policy insurable interest is insisted upon. In the absence of such interest the contract will amount to a wagering contract.

(iii) Principle of UBERRIMAE FIDEI: Under ordinary law of contract there is no positive duty to tell the whole truth in relation to the subject-matter of the contract. There is only the negative obligation to tell nothing but the truth. In a contract of insurance, however there is an implied condition that each party must disclose every material fact known to him. All contracts of insurance are contracts of uberrima fidei, i.e., contracts of utmost good faith. This is because the assessment of the risk and the determination of the premium by the insurer depend on the full and frank disclosure of all material facts in the proposal form.

(iv) Catastrophic Loss: A loss (or related losses) which is unbearable i.e. it causes severe consequences such as bankruptcy to a family, organization, or insurer.

Question 2

(i) Write short note on Unexpired Risks Reserve

(ii) Write short note on Re-insurance.

Answer

(i) In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all policies expire on that date. Many policies extend into the following year based on the date on which they were taken and as such the risk continues beyond the date of closing of books fo the insurer. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the financial year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is calculated on the net premium income earned by the insurance company during the year.

(ii) If an insurer does not wish to undertake the whole risk under a policy written by him, he may reinsure a part of the risk with some other insurer. In such a case the insurer is said to have ceded a part of his business to other insurer. The reinsurance transaction may thus be defined as an agreement between a 'ceding insurance company' and another insurance company called the 'reinsurer' whereby the former agrees to 'cede' and the latter agrees to accept a certain specified share of risk or liability under a insurance policy upon terms as set out in the agreement.

A 'ceding company' is the original insurance company which has accepted the risk and has agreed to 'cede' or pass on that risk to another insurance company or a reinsurance company. It may however be emphasised that the agreement of reinsurance is purely an arrangement between two insurance companies and the original insured does not acquire any right under a reinsurance contract against the reinsurer. In the event of loss, therefore, the insured's claim for full amount is against the original insurer. The original insurer has to claim the proportionate amount from the reinsurer.

There are two types of reinsurance contracts, namely, facultative reinsurance and treaty reinsurance. Under facultative reinsurance each transaction has to be negotiated individually and each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. Under treaty reinsurance a treaty agreement is entered into between ceding company and the reinsurer whereby the volume of the reinsurance transactions remain within the limits of the treaty.

Question 3

From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2013:

	Direct Business	Re-Insurance
	₹	₹
Claim paid during the year	46,70,000	7,00,000
Claim Payable — 1st April, 2012	7,63,000	87,000
31st March, 2013	8,12,000	53,000
Claims received	–	2,30,000
Claims Receivable — 1st April, 2012	–	65,000
31st March, 2013	–	1,13,000
Expenses of Management (includes ₹ 35,000 Surveyor's fee and ₹ 45,000 Legal expenses for settlement of claims)	2,30,000	–

Answer

General Insurance Company (Abstract showing the amount of claims)

Net Claims incurred

		₹
Claims paid on direct business (46,70,000 + 35,000 + 45,000)		47,50,000
Add: Re-insurance	7,00,000	
Add: Outstanding as on 31.3. 2013	53,000	
Less: Outstanding as on 1.4. 2012	(87,000)	6,66,000
		54,16,000
Less : Claims received from re-insurance	2,30,000	
Add: Outstanding as on 31.3. 2013	1,13,000	
Less: Outstanding as on 1.4. 2012	(65,000)	(2,78,000)
		51,38,000
Add : Outstanding direct claims at the end of the year		8,12,000
		59,50,000
Less : Outstanding direct claims at the beginning of the year		(7,63,000)
Net claims incurred		51,87,000

Note : The expenses incurred on settlement of claims such as surveyor's fee, legal expenses etc should be shown under "claims incurred during the year"

Question 4

From the following balances extracted from the books of Perfect General Insurance Company Limited as on 31.3.2013 you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2013 to and a Profit and Loss Account for the same period:

	₹		₹
Directors' Fees	80,000	Interest received	19,000
Dividend received	1,00,000	Fixed Assets (1.4.2012)	90,000
Provision for Taxation (as on 1.4. 2012)	85,000	Income-tax paid during the year	60,000

	Fire	Marine
	₹	₹
Outstanding Claims on 1.4. 2012	28,000	7,000
Claims paid	1,00,000	80,000
Reserve for Unexpired Risk on 1.4.2012	2,00,000	1,40,000
Premiums Received	4,50,000	3,30,000
Agent's Commission	40,000	20,000
Expenses of Management	60,000	45,000
Re-insurance Premium (Dr.)	25,000	15,000

The following additional points are also to be taken into account :

(a) *Depreciation on Fixed Assets to be provided at 10% p.a.*

(b) *Interest accrued on investments ₹ 10,000.*

(c) *Closing provision for taxation on 31.3. 2013 to be maintained at ₹ 1,24,138*

(d) *Claims outstanding on 31.3. 2013 were Fire Insurance ₹ 10,000; Marine Insurance ₹ 15,000.*

(e) *Premium outstanding on 31.3.2013 were Fire Insurance ₹ 30,000; Marine Insurance ₹ 20,000.*

(f) *Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.*

(g) *Expenses of management due on 31.3.2013 were ₹ 10,000 for Fire Insurance and ₹ 5,000 in respect of marine Insurance*

Answer

Form B – RA (Prescribed by IRDA)
Perfect General Insurance Co. Ltd

Revenue Account for the year ended 31st March, 2013 Fire and Marine Insurance Businesses

	Schedule	Fire Current Year	Marine Current Year
		₹	₹
Premiums earned (net)	1	4,27,500	1,40,000
Profit / (Loss) on sale / redemption of investments		—	—
Others (to be specified)			
Interest, Dividends and Rent – Gross		—	—
Total (A)		4,27,500	1,40,000
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Premium Deficiency			
Total (B)		1,92,000	1,58,000
Profit from Fire / Marine Insurance business (A-B)		2,35,500	(18,000)

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)		*Fire Current Year*	*Marine Current Year*
		₹	₹
Premiums from direct business written		4,80,000	3,50,000
Less: Premium on reinsurance ceded		(25,000)	(15,000)
Total Premium earned		4,55,000	3,35,000
Less: Change in provision for unexpired risk		(27,500)	(1,95,000)
		4,27,500	1,40,000
Schedule – 2			
Claims incurred (net)		82,000	88,000
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management		70,000	50,000

Form B-PL

Perfect General Insurance Co. Ltd.

Profit and Loss Account for the year ended 31st March, 2013

Particulars	*Schedule*	*Current Year*	*Previous Year*

		₹	₹
Operating Profit/(Loss)			
(a) Fire Insurance		2,35,500	
(b) Marine Insurance		(18,000)	
(c) Miscellaneous Insurance		—	
Income From Investments			
Interest, Dividend & Rent–Gross		1,29,000*	
Other Income (To be specified)			
Total (A)		3,46,500	
Provisions (Other than taxation)		—	
Depreciation		9,000	
Other Expenses –Director's Fee		80,000	
Total (B)		89,000	
Profit Before Tax		2,57,500	
Provision for Taxation		99,138	
Profit After Tax		1,58,362	

Working Notes:

		Fire	Marine
		₹	₹
1.	Claims under policies less reinsurance		
	Claims paid during the year	1,00,000	80,000
	Add: Outstanding on 31st March, 2013	10,000	15,000
		1,10,000	95,000
	Less : Outstanding on 1st April, 2012	(28,000)	(7,000)
		82,000	88,000
2.	Expenses of management		
	Expenses paid during the year	60,000	45,000
	Add: Outstanding on 31st March, 2013	10,000	5,000
		70,000	50,000
3.	Premiums less reinsurance		
	Premiums received during the year	4,50,000	3,30,000
	Add: Outstanding on 31st March, 2013	30,000	20,000
		4,80,000	3,50,000
	Less : Reinsurance premiums	(25,000)	(15,000)
		4,55,000	3,35,000

* Interest and dividend in case can't be bifurcated between fire and marine thus taken to profit and loss account.

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance. Reserve for unexpired risks for fire insurance = ₹ 4,55,000 X 50% = ₹ 2,27,500. Opening Balance in reserves for unexpired risk for fire insurance was ₹ 2,00,000. Hence, additional transfer to reserve for fire insurance in the year will be ₹ 27,500. On similar basis of calculation, the additional transfer to reserve for marine insurance will be ₹ 1,95,000

5. Provision for taxation account

	₹		₹
31.3.2013 To Bank A/c (taxes paid)	60,000	1.4.2012 By Balance b/d	85,000
31.3.2013 To Balance c/d	1,24,138	31.3.2013 By P & L A/c (Bal Fig)	99,138
	1,84,138		1,84,138

Question 5

X Fire Insurance Co. Ltd. commenced its business on 1.4.2012. It submits you the following information for the year ended 31.3.2013:

	₹
Premiums received	*15,00,000*
Re-insurance premiums paid	*1,00,000*
Claims paid	*7,00,000*
Expenses of Management	*3,00,000*
Commission paid	*50,000*
Claims outstanding on 31.3.2013	*1,00,000*
Create reserve for unexpired risk @40%	

Prepare Revenue account for the year ended 31.3.2013

Answer

Form B – RA (Prescribed by IRDA)

Name of the Insurer: X Fire Insurance Co. Ltd.

Registration No. and Date of registration with the IRDA: ……………………

Revenue Account for the year ended 31st March, 2013

	Particulars	*Schedule*	*Current year ended on 31st March, 2013*
			₹
1.	Premiums earned (Net)	1	8,40,000
	Total (A)		8,40,000
1.	Claims incurred (Net)	2	8,00,000
2.	Commission	3	50,000
3.	Operating Expenses	4	3,00,000
	Total (B)		11,50,000
	Operating Profit/(Loss) from Fire Insurance Business [C =(A – B)]		(3,10,000)

Schedule 1

Premiums earned (Net)

	₹
Premium received	15,00,000
Less: Premium on re-insurance paid	(1,00,000)
	14,00,000
Less: Reserve required for unexpired risk @ 40% of Net Premium	5,60,000
Net Premium Earned	8,40,000

Schedule

2 Claims

	₹
Claims paid	7,00,000
Add: Claims outstanding on 31.3.2013	1,00,000
	8,00,000

Schedule 3

Commission

Commission paid during the year	50,000
Total in the Year	50,000

Schedule 4

Operating

expenses

	₹
Expenses of Management	3,00,000

Question 6

Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2013 from the following details:

	₹
Claims paid	*4,90,000*
Legal expenses regarding claims	*10,000*
Premiums received	*13,00,000*
Re-insurance premium paid	*1,00,000*
Commission	*3,00,000*
Expenses of management	*2,00,000*
Provision against unexpired risk on 1st April, 2012	*5,50,000*
Claims unpaid on 1st April, 2012	*50,000*
Claims unpaid on 31st March, 2013	*80,000*

Answer **Form B Revenue Account**

Name of the Insurer :

Registration No. and Date of Registration with the IRDA:

Fire Insurance Revenue Account for the year ended 31st March, 2013

	Particulars	*Schedule*	*Amount (₹)*
(1)	Premium earned	1	11,50,000
(2)	Other income		-
(3)	Interest, dividend and rent		-
	Total (A)		11,50,000
(4)	Claims incurred	2	5,30,000
(5)	Commission	3	3,00,000
(6)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,30,000
	Operating Profit (A)- (B)		1,20,000

Schedule 1 : Premium earned (net)	₹
Premium received	13,00,000
Less: Re-insurance premium	(1,00,000)
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	(50,000)
	11,50,000

Schedule 2 : Claims Incurred	₹
Claims paid including legal expenses (4,90,000 + 10,000)	5,00,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,30,000

Schedule 3 : Commission	₹
Commission paid	3,00,000
	3,00,000

Schedule 4: Operating expenses	₹
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31st March, 2013 = 50% of net premium	
i.e. 50% of ₹ 12,00,000 (See Schedule 1)	6,00,000
Less : Unexpired risk reserve as on 1st April, 2012	(5,50,000)
Change in the provision for unexpired risk	50,000

Question 7

Prepare the Fire Insurance Revenue A/c of Jasmine Fire Insurance Co. Ltd. as per IRDA regulations for the year ended 31st March, 2013 from the following details:

Particulars	*Amount (₹)*
Claims Paid	*5,00,000*
Legal Expenses regarding claims	*10,000*
Premiums received	*12,50,000*
Re-insurance premium paid	*50,000*
Commission	*3,00,000*
Expenses of Management	*2,00,000*
Provision against unexpired risk as on 1st April, 2012	*5,75,000*
Claims unpaid on 1st April, 2012	*50,000*
Claims unpaid on 31st March, 2013	*80,000*

Provide for unexpired risk @ 50% less reinsurance.

Answer

FORM B - RA

Name of the Insurer: Jasmine Fire Insurance Co. Ltd.

Registration No. and Date of Registration with the IRDA:

Revenue Account for the year ended 31st March, 2013

	Particulars	Schedule	Amount (₹)
(1)	Premium earned	1	11,75,000
(2)	Profit / Loss on sale / redemption of investments		-
(3)	Other income		-
(4)	Interest, dividend and rent		-
	Total (A)		11,75,000
(5)	Claims incurred	2	5,40,000
(6)	Commission	3	3,00,000
(7)	Operating expenses related to Insurance business	4	2,00,000
	Total (B)		10,40,000
	Operating Profit (A)- (B)		1,35,000

Schedule 1 : Premium earned (net)	**₹**
Premium received	12,50,000
Less: Re-insurance premium	(50,000)
Net premium	12,00,000
Adjustment for change in reserve for unexpired risks (Refer W.N.)	(25,000)
	11,75,000

Schedule 2 : Claims Incurred	**₹**

Claims paid including legal expenses (5,00,000 + 10,000)	5,10,000
Add : Claims outstanding at the end of the year	80,000
Less : Claims outstanding at the beginning of the year	(50,000)
Total claims incurred	5,40,000
Schedule 3 : Commission	₹
Commission paid	3,00,000
	3,00,000
Schedule 4: Operating expenses	₹
Expenses of management	2,00,000
	2,00,000

Working Note:

Change in the provision for unexpired risk	₹
Unexpired risk reserve on 31st March, 2013 =50% of net premium (i.e. 50% of ₹ 12,00,000)	6,00,000
Less : Unexpired risk reserve as on 1st April 2012	(5,75,000)
Change in the provision for unexpired risk	25,000