

Audit of General Insurance Companies

THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (PREPARATION OF FINANCIAL STATEMENTS AND AUDITOR'S REPORT OF INSURANCE COMPANIES) REGULATIONS, 2002

As per these regulations an Insurance Company has to prepare following statements/Accounts in prescribed format:

Statement/Account	Life Insurance Companies	General Insurance Companies
Revenue Account	Form A-RA	Form B-RA
Profit & Loss Account	Form A-PL	Form B-PL
Balance Sheet	Form A-BA	Form B-BS

Form and Contents of Financial Statements -

The Regulations contain **three schedules**.

‘**Schedule A**’ is applicable to companies carrying on life insurance business.

‘**Schedule B**’ of the Regulations lays down the accounting principles, disclosures forming part of financial statements, general instructions for preparation of financial statements, the contents of the management report and the formats in which the financial statements of an insurer carrying on general insurance business should be drawn up. Schedule B is in **five parts**, covering various aspects related to the preparation of financial statements, which form the main basis for preparation of financial statements of general insurance companies.

‘**Schedule C**’ to the Regulations lays down the matters to be dealt with by the auditor's report of an insurance company. Schedule C is applicable to insurers carrying on general insurance business as well as life insurance business.

Schedule B FORM B-RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

REVENUE ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 20__.

	Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
1.	Premiums earned (Net)	1		
2.	Profit/ Loss on sale/redemption of Investments			
3.	Others (to be specified)			
4.	Interest, Dividend & Rent – Gross			
	TOTAL (A)			
1.	Claims Incurred (Net)	2		
2.	Commission	3		
3.	Operating Expenses related to Insurance Business	4		
	TOTAL (B)			
	Operating Profit/(Loss) from Fire/Marine/Miscellaneous Business C= (A - B)			
	APPROPRIATIONS			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserve			
	Transfer to Other Reserves (to be specified)			
	TOTAL (C)			

FORM B-PL

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 20__.

	Particulars	Schedule	Current Year	Previous Year
			(Rs.'000)	(Rs.'000)
1.	OPERATING PROFIT/(LOSS)			
	(a) Fire Insurance			
	(b) Marine Insurance			
	(c) Miscellaneous Insurance			
2.	INCOME FROM INVESTMENTS			
	(a) Interest, Dividend & Rent – Gross			
	(b) Profit on sale of investments			
	Less: Loss on sale of investments			
3.	OTHER INCOME (To be specified)			
	TOTAL (A)			
4.	PROVISIONS (Other than taxation)			
	(a) For diminution in the value of investments			
	(b) For doubtful debts			
	(c) Others (to be specified)			
5.	OTHER EXPENSES			
	(a) Expenses other than those related to Insurance Business			
	(b) Bad debts written off			
	(c) Others (To be specified)			
	TOTAL (B)			
	Profit Before Tax			
	Provision for Taxation			
	APPROPRIATIONS			
	(a) Interim dividends paid during the year			
	(b) Proposed final dividend			
	(c) Dividend distribution tax			
	(d) Transfer to any Reserves or Other Accounts (to be specified)			
	Balance of profit/ loss brought forward from last year			
	Balance carried forward to Balance Sheet			

Notes: to Form B-RA and B- PL

- Premium income received from business concluded in and outside India shall be separately disclosed.
- Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e. before deducting commissions) under the head reinsurance premiums.
- Claims incurred shall comprise claims paid, specific claims settlement costs wherever applicable and change in the outstanding provision for claims at the year-end..
- Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.5,00,000 whichever is higher, shall be shown as a separate line item.
- Fees and expenses connected with claims shall be included in claims.
- Under the sub-head "Others" shall be included items like foreign exchange gains or losses and other items.
- Interest, dividends and rentals receivable in connection with an investment should be stated as gross amount, the amount of income tax deducted at source being included under 'advance taxes paid and taxes deducted at source'..
- Income from rent shall include only the realised rent. It shall not include any notional rent.

FORM B-BS

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

BALANCE SHEET AS AT 31ST MARCH, 20__.

		Schedule	Current Year	Previous Year
			(Rs.'000)	(Rs.'000)
	SOURCES OF FUNDS			
	SHARE CAPITAL	5		
	RESERVES AND SURPLUS	6		
	FAIR VALUE CHANGE ACCOUNT			
	BORROWINGS	7		
	TOTAL			
	APPLICATION OF FUNDS			
	INVESTMENTS	8		
	LOANS	9		
	FIXED ASSETS	10		
	CURRENT ASSETS			
	Cash and Bank Balances	11		
	Advances and Other Assets	12		
	Sub-Total (A)			
	CURRENT LIABILITIES	13		
	PROVISIONS	14		
	Sub-Total (B)			
	NET CURRENT ASSETS (C) = (A - B)			
	MISCELLANEOUS EXPENDITURE (to the extent not written off or adjusted)	15		
	DEBIT BALANCE IN PROFIT AND LOSS ACCOUNT			
	TOTAL			

CONTINGENT LIABILITIES

	Particulars	Current Year	Previous Year
		(Rs.'000).	(Rs.'000).
1.	Partly paid-up investments		
2.	Claims, other than against policies, not acknowledged as debts by the company		
3.	Underwriting commitments outstanding (in respect of shares and securities)		
4.	Guarantees given by or on behalf of the Company		
5.	Statutory demands/ liabilities in dispute, not provided for		
6.	Reinsurance obligations to the extent not provided for in accounts		
7.	Others (to be specified)		
	TOTAL		

SCHEDULE C

AUDITOR'S REPORT

The report of the auditors on the financial statements of every insurer shall deal with the matters specified herein:

1. The auditor shall comment on:
 - a. That they have obtained all the information and explanations which, to the best of their knowledge and belief were necessary for the purposes of their audit and whether they have found them satisfactory;
 - b. Whether proper books of account have been maintained by the insurer so far as appears from an examination of those books;
 - c. Whether proper returns, audited or unaudited, from branches and other offices have been received and whether they were adequate for the purpose of audit;
 - d. Whether the Balance sheet, Revenue account , Profit and Loss account and the Receipts and Payments Account dealt with by the report are in agreement with the books of account and returns;
 - e. Whether the actuarial valuation of liabilities is duly certified by the appointed actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the Authority, and/or the Actuarial Society of India in concurrence with the Authority.
2. The auditors shall express their opinion on:
 - (a) Whether the following gives true and fair view:
 - (i) Whether the balance sheet gives a true and fair view of the insurer's affairs as at the end of the financial year/period;
 - (ii) Whether the revenue account gives a true and fair view of the surplus or the deficit for the financial year/period;
 - (iii) Whether the profit and loss account gives a true and fair view of the profit or loss for the financial year/period;
 - (iv) Whether the receipts and payments account gives a true and fair view of the receipts and payments for the financial year/period;
 - (b) The financial statements stated at (a) above are prepared in accordance with the requirements of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999) and the Companies Act, 1956 (1 of 1956), to the extent applicable and in the manner so required.
 - (c) Investments have been valued in accordance with the provisions of the Act and these Regulations.
 - (d) The accounting policies selected by the insurer are appropriate and are in compliance with the applicable accounting standards and with the accounting principles, as prescribed in these Regulations or any order or direction issued by the Authority in this behalf.
3. The auditors shall further certify that:
 - a) they have reviewed the management report and there is no apparent mistake or material inconsistencies with the financial statements;
 - b) the insurer has complied with the terms and conditions of the registration stipulated by the Authority.
4. A certificate signed by the auditors [which shall be in addition to any other certificate or report which is required by law to be given with respect to the balance sheet] certifying that:–
 - (a) they have verified the cash balances and the securities relating to the insurer's loans, reversions and life interests (in the case of life insurers) and investments;
 - (b) to what extent, if any, they have verified the investments and transactions relating to any trusts undertaken by the insurer as trustee; and
 - (c) no part of the assets of the policyholders' funds has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investments of the policyholders' funds.

Note: CARO is Not Applicable to Insurance Companies

REVISED GUIDELINES FOR APPOINTMENT OF STATUTORY AUDITORS OF INSURANCE COMPANIES

- 1) Each insurance company will have two auditors on a joint audit.
- 2) One of the Joint Auditor may have a term of 5 years and the other 4 years in the first instance. Thereafter, the maximum duration for which the auditor could be retained would be for a period of 5 years.
- 3) There will be a cooling period of two years. An audit firm which completes a tenure of five/four years as the case may be, at the first instance, in respect of an insurance company should not accept statutory audit assignment of that Insurance company in the next two years. However, audit firm may accept statutory audit of any other insurance company subject to the compliance of maximum two statutory audits.
- 4) It is clarified that cooling period is applicable in respect of audit firms that completes a term of five/four years as the case may be as on 31st March 2006.

Appointment of auditors –

The appointment of statutory auditors is made by the C&AG in GIC.

The appointment of auditors of the agencies abroad is made by the BOD of each company.

Solvency Margin (Applicable to insurance company carrying on General insurance business)

Insurer maintains excess of assets over amount of its liabilities at all times, higher of following:

- 50 crores (100 Cr. For reinsurer)
- 20% of net premium income.
- 30% of net incurred claims.

If non-maintenance of S.M., insurer to submit a financial plan to authority indicating plan of action, else it shall deemed to be insolvent and wound up by court.

Audit Procedures Relating To P&L Items:

Both premiums and claims have a significant impact on the insurance companies' revenues.

i) Verification of Premium:

a	The premium collections should be credited to separate Bank account.
b	No Risk shall be assumed by the insurer without receipt of premium.
c	The premium normally arises out of three sources – • for direct business, • for reinsurance business and • Share of co insurance premium.
d	Some portion of premium is allocable to succeeding period, thus called unearned premium. Check Reserve for unexpired risk
e	Cover notes should be serially numbered
f	Internal controls and procedures w.r.t. premium should be operating effectively.
g	Company should not assume any risk for uncollected premium, short premium, not collected in time, etc.
h	Verify the collection after B/S date, whether it pertains to risks commencing for the yearend audit
i	Check whether premium register has been kept chronologically i.e. in order of time of premium received, and Service Tax has been charged on a day to day basis.
j	Due date and date of collection of installments should be reconciled.
k	Refund of premium (whether made in genuine cases only).

ii) Verification of Claims

a	Check whether provision has been made for all unsettled claims.
b	Provision has been made only for those for which company is legally liable.
c	Provision made should not exceed insured amount.
d	In determining the amount of provision, Event after B/S date should be considered
e	In case of co-insurance, provision only for its share of anticipated liability
f	Reasons for long delays after claim lodged to be ascertained.
g	Check whether claims are provided for net of salvage value.
h	Intimation of loss should be received within reasonable time.

i	Claim paid duly sanctioned by the authority concerned.
j	Claim paid, discharge note from claimant

iii) Commission

a	Commission should be paid only to authorized agents
b	Examine internal controls over payment of commission.
c	Examine whether it has been paid as per appropriate rate.
d	Obtain confirmation from the agents.
e	Obtain management representation that all commission has been appropriately adjusted in the accounts.
f	Correlate with this year's business

iv) Operating Expenses Related to Insurance Business - All administrative expenses relating to insurance business should be mentioned in schedule 4 to the financial statement. The **Insurance Act** requires that

- Expenses in excess of Rs. **5 Lacs or 1% of net premium**, whichever is **higher**, should be shown separately; and
- Expenses not directly relating to insurance business should be shown separately for example, expenses relating to investment department, bank charges etc.

Audit Procedures Relating To Balance Sheet Items:

i) Investments - The auditor should keep in mind the **following provisions** of the Insurance Act, 1938 while examining the investments-of an insurance company.

Provisions related to Investments

a	An insurance company can only invest in approved securities. However, it can invest otherwise than in approved securities if the following conditions are satisfied. • Such investments should not exceed 25% of the total investments; and • Such investments are made with the consent of board of directors.
b	An insurer should not invest in shares or debentures of insurance or investment company in excess of least of the following: • 10% of its own total assets; • 2% of the investee's subscribed share capital or debentures.
c	An insurer company should not invest in shares or debentures of a company other than insurance or investment company in excess of least of the following • 10% of its own total assets; • 10% of investee's subscribed share capital or debentures.
d	An insurance company cannot invest in shares and debentures of a private company.
e	The insurance companies cannot invest the funds of its policy holders outside India.

Valuation of Investments - AS 13, "Accounting for Investments", do not apply to insurance companies. The salient features of **valuation guidelines** laid down for insurance companies are discussed as follows:

a. Real Estate Investment Property - Such investments should be **valued at historical cost** less accumulated depreciation and impairment loss. The residual value of investment property is considered as **zero** no revaluation of the property is permitted.

b. Debt Securities - Debt securities including Government Securities and Redeemable Preference Shares are required to be considered as '**held till maturity**' securities and shall be measured at **historical cost**. If historical cost is more than the face value, the premium should be amortized over the period remaining to maturity.

c. Equity securities and derivate instruments traded in active markets - The equity securities and derivative instruments that are listed are required to be measured at the **fair value** at the balance sheet date. "**Fair value**" has been defined as the **last quoted closing price** at the stock exchange where the security is listed. Any impairment loss should be charged to profit and loss account. Unrealized gains or loss should be taken to equity under the head '**fair value change account**'. The profit on sale of such securities is determined after taking into account the amounts pertaining to the security sold already credited or debited to equity under the head "fair value change account". This profit or loss is transferred to Profit and Loss Account. Any credit balance in Fair Value Change Account will not be available for distribution as

dividends. Also any debit balance in such an account shall be reduced from profits / free reserves while declaring dividends.

d. Unlisted and other actively traded securities - Unlisted and other actively traded securities and derivative instruments should be **valued at historical cost**. Provision for diminution in value should be made. If estimates based on external evidence show an increase in value of investments over its carrying amount such provision should be reversed.

ii) Outstanding Premium & Agents' Balance - The audit procedures, which may be followed with regard to agent's balance, are as follows:

a	Verify whether agent's balances and outstanding balances in outstanding premium account have been listed, analysed and reconciled for the purposes of audit.
b	Verify whether recoveries of large outstanding have been made in post audit period.
c	Verify whether there is any old outstanding debit or credit balances as at the yearend which require adjustment. A written explanation may be obtained from the management is to their nature.
d	Verify that agent's balances do not include employees' balances and balances of other insurance companies.
e	Verify that no credit of commission is given to agents for businesses directly procured by it.
f	Vouch adjustments / payments against old outstanding balances in agents account.
g	Ensure that the relevant control account in the General Ledger is reconciled with the subsidiary records.

iii) Unexpired Risk Reserve - Not all risk expires as on B/S date. Risk will be there in succeeding year w.r.t. premium received in this year; thus provide for —

- a. **50%** of all other types and
- b. **100%** for marine Hull.

% is to be taken of net premium income i.e. premium received, net of reinsurance premium paid. Further, the provisions of section 44 of the Income Tax Act, 1961, govern Insurance companies. In this regard, the IT Rules provide for creation of a reserve for unexpired risks. Thus deduction of these reserves is also allowed under the Income Tax Act.

iv) Catastrophe Reserve - Every insurance company carrying on general insurance business is required to create a 'Catastrophe Reserve' to meet future potential liabilities against insurance policies in force. Catastrophe Reserve cannot be created for a specific purpose. The auditor should, depending upon the facts of the case evaluate the adequacy of such a reserve.

Reinsurance –

The arrangement whereby one insurer obtains insurance from another insurer on risks assumed by the former is called reinsurance. The former is called the ceding company which the latter is called the reinsurer.

i) Types of Reinsurance Contracts

- a. **Facultative Reinsurance:** Reinsurance whereby **separate contracts** are entered into for **each particular risk**. This type of reinsurance is used either when risks are not covered under treaties or the issuer does not want to cover the risk under the treaty etc. It is used mainly when:-
 - i. The risk is not covered by the Treaty.
 - ii. The Insurer doesn't want his re-insurance treaties overburdened with particularly heavy and abnormal risks.
 - iii. The nature of the business is such that technical guidance or consultation with re-insurer is needed at every stage of acceptance of the risk as in case of atomic energy installations, oils and rigs for drilling, etc.
- b. **Treaty Reinsurance:** Where a treaty has been entered into between the ceding company and the reinsurer for reinsurance of particular risks covered under the treaty, it is called as treaty reinsurance. Under this contract it is obligatory for the re-insurer to accept all risks within the scope of the treaty and it is obligatory for the ceding company to ceded risks in accordance with the terms of the treaty. In case of treaty re-insurance contracts, the insurer generally prepares a statement of treaty reinsurance accounts

on quarterly basis and sends it to the re-insurer for reconciliation of claims lodged, claims outstanding, claims paid, etc.

ii) Verification of Reinsurance Inwards / Reinsurance accepted–

a	Obtain evidences as to effectiveness of system of control over reinsurance inwards
b	The agreement should be as per guidelines prescribed in the Insurance Act & IRDA.
c	The auditor should examine the arrangements with principal insurer.
d	The auditor should ensure the appropriateness of accounting treatment of reinsurance business received, premium received and payment of commission
e	He should examine whether intimation of loss has been received well in time.
f	It is also be verified that claim as been paid as per the terms and conditions.
g	Check whether provision has been made for all claims payable to principal insurer.
h	He should carefully examine any old outstanding.
i	Balance confirmation should also be obtained from principal insurer .

iii) Verification of Reinsurance Outward / Reinsurance ceded–

a	Obtain evidences as to effectiveness of system of control over reinsurance outwards.
b	The agreement should be as per guidelines prescribed in Insurance Act and IRDA.
c	The auditor should examine the arrangements with re-insurers.
d	The auditor should ensure the appropriateness of accounting treatment of reinsurance business given, premium paid to reinsurer and receipt of commission.
e	He should examine whether intimation of loss has been given to them well in time.
f	It is also be verified that claim has been received as per terms and conditions.
g	He should carefully examine any old outstanding.
h	Balance confirmation should also be obtained from reinsurer .

Co-Insurance

1. In case of high business risks, the risks are shared among more than one insurance co.
2. In case of coinsurance, the leading insurer issues the documents, collects premiums and settles claims.
3. The leader renders statements of Accountants to the co-insurers.
4. The auditor should check whether the premium account is credited on the basis of statements revived from the leading insurer.
5. Auditor should obtain a **written confirmation** from management that all premium received from leader has been accounted for.
6. The **claims provisions** and claims **paid** should also be verified.
7. It should be ensured that claim is paid only for its share in coinsurance.
8. For leader, the auditor should examine the relevant documents.

Directions under Section 619 (3)(a) of the Companies Act, 1956 in respect of System of Accounts:

i) Examine the following systems and give your views as regards their deficiencies along with suggestions for remedial measures:-

- a. Recording of receipts and expenditure.
- b. Drawing periodical trial balance.
- c. Compilation of accounts.
- d. Reconciliation of inter-office accounts.
- e. Reconciliation of registers/records relating to property, assets. Investments, premiums, claims, loans, etc., with financial books.
- f. Maintenance of up-to-date records in respect of assets, which are pledged, encumbered or blocked in any way.

ii) Are the bank accounts of the company reconciled with the bank statements regularly? If not, describe the failures.

iii) Are control accounts and subsidiary accounts up-to-date and reconciled regularly? If not, describe the failures.

iv) Examine the accounting policies of the company. Are these in conformity with the AS. Give particulars of material departures from these standards, if any, along with their effect on FS; quantify the impact wherever possible.