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3rd Edition

A COMPLETE GUIDE FOR ADVANCED AUDITING (CA FINAL)

Applicable for CA Final May, 2016 & November, 2016 Exams onwards

Short Notes for Quick Revision

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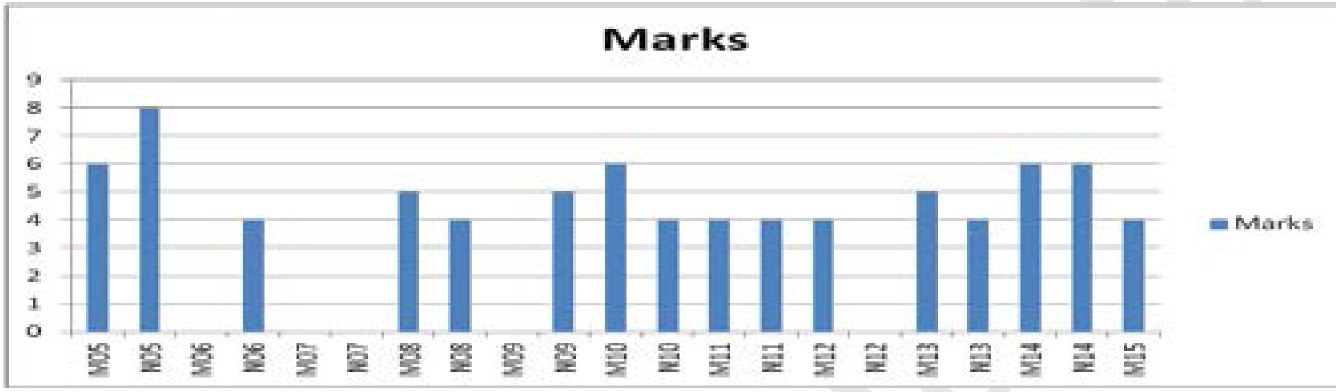
Advanced Auditing and Professional Ethics

CA Sumit Aggarwal

13 AUDIT OF GENERAL INSURANCE COMPANIES



1. Principal Enactments Governing Insurance Audit:

- The Insurance Act, 1938 (Including Insurance Rules, 1939)
- The Insurance Regulatory and Development Authority Act, 1999.
- The IRDA Act, 1999.
- The General Insurance Business (Nationalization) Act, 1972 (Including Rules framed thereunder)
- The Companies Act, 1956 (Now 2013)

2. Form and Content of Financial Statement:

- Balance Sheet,
- Profit & Loss account
- Receipt & Payments accounts
- Revenue account

3. Requirements of Schedule B to the IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002:

Part I: Accounting Principles for Preparation of Financial Statements:

- Applicability of Accounting Standards
- Premium
- Premium Deficiency
- Acquisition Costs
- Claims
- Recognition of Surplus arising in non-participating funds as profit/loss in the P&L A/c
- Loans
- Catastrophe Reserve

Part II: Disclosures forming part of Financial Statements

Part III: General Instructions for Preparation of Financial Statements.

Part IV: Contents of Management Report

Part V: Preparation of Financial Statements

For Detail along with format of the above, student may refer Chapter 5 of Volume I of the Paper 5 Advance Accounting, IPCC Study Material.

4. Applicability of Accounting Standards and CARO 2015: Every balance sheet, receipts and payments account [cash flow statement] and profit and loss account [shareholders' account] of the insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAI, to the extent applicable to the insurers carrying on general insurance business, except that:

- **AS 3:** cash flow statements - cash flow statement shall be prepared only under the direct method

- **AS 13:** Will apply where where GIC regulations silent.
- segment reporting shall apply to all insurers irrespective of the listing and turnover criteria.
- **AS 9:** revenue recognition- not applicable w.r.t. income of insurance business.
- **Applicability of CARO, 2015:** The provisions of CARO are not applicable to insurance companies.

5. Premium [M01 N02]: Premium is the consideration received by an insurer from the insured under an insurance contract, whereby the insurer agrees to undertake certain sum of risk on behalf of the insured. The premium collections are credited to a separate bank account and no withdrawals are normally permitted from that account for meeting the general expenditure. The premium receipt of insurance companies carrying on general insurance business normally arise out of 3 sources, viz.,

- premium received from direct business
- premium received from reinsurance business
- the share of co-insurance premium.

Premium received in advance, which represents premium income not relating to the current accounting period, shall be disclosed separately under the head 'Current Liabilities' in the financial statements. The objective of internal controls over premium is to ensure that:

- correct premium is calculated
- Premium collected before acceptance of any risk
- premium is accounted for in an appropriate manner and
- the premium is collected only in respect of such risks which are assumed by the company.

As per Insurance Act, no risk can be assumed by the insurer unless the premium is received or the same has been guaranteed by the insured or deposit of such amount, as may be prescribed, is tendered to the company.

5.1 Premium Deficiency: Premium deficiency shall be recognised if the sum of expected claim costs and other related expenses and maintenance costs exceeds related unearned premium.

5.2 Premium Revenue Recognition: Premium revenue recognition is based on the risk pattern to which the insurer is exposed. An insurer, based on past experience can reliably estimate the risk pattern for a particular type of insurance business. Most insurers recognize premium on the basis of the passage of time. This is generally appropriate where the risk is evenly spread over the policy period. Further in some cases, the risk pattern may not be evenly spread over the policy period because of the very nature of the risk covered, for example, infrastructure project involving varying degree of risk factors. In such cases, a deposit premium is paid at the beginning of the policy period and subsequently adjusted. The basis of premium recognition shall be adequately justified and preferably supported by external evidence such as an actuary or other technical expert's certification.

5.3 No Risk Assumption Without Premium: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India, if:

- *the premium payable is not received; or*
- *the premium payable is not guaranteed to be paid by such person in such manner and within such time, as may be prescribed; or*
- *the premium payable is not deposited in advance in in the prescribed manner.*

The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

5.4 Verification of Premium [N08 N10 N11 M14]: The auditor should apply the following procedures for verification of premium:

- before commencing verification of premium, auditor should look into and satisfy himself about the internal control and compliance in this area.
- ensure that premium income is recognized as per the guideline laid down by the IRDA.
- Ascertain, that no risk has been assumed until premium is received.
- ascertain that no risk has been assumed in respect of premium received in advance.
- ascertain that all the cover notes relating to the risks assumed have been serially numbered for each class of business.

- ensure that premium revenue is recognized based on the pattern of risk to which the insurer is exposed.
- ensure that the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' and has been disclosed separately.
- verify the collections lodged by agents after the balance sheet date to see whether any collection pertains to risk commencing for the year under audit.
- verify whether installments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income for the year under audit and premium falling due in subsequent period should be recognized as premium received in advance.
- examine the cut off procedures operated by the insurance company.
- where premium originally received has been refunded, and the auditor should verify whether the agency commission paid on such premium has been recovered.
- check that premium is originally recorded at gross amount, i.e. without providing for un-expired risk or re-insurances.
- verify whether service tax has been charged from the insured wherever applicable, and service tax so collected is disclosed under 'Current Liabilities' to the extent not deposited in Government's account.
- verify that in case of co-insurance business, the company's share of premium has been properly recorded in the books of accounts in case the risk has commenced.

5.5 **Outstanding Premium:** The auditor should apply the following audit procedures for verification of outstanding premium:

- verify whether balances in "outstanding premium accounts have been listed, analysed and reconciled for the purpose of audit
- check age-wise and sector-wise analysis of outstanding premium
- verify whether outstanding premium have since been collected.

Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

6. Commission:

The commission is the consideration payable for getting the insurance business. As per section 40 of Insurance Act, 1948, no commission can be paid to a person other than its agent. The objective of internal controls over commission is to ensure that commission is paid:

- in accordance with the rules and regulations of the company
- in accordance with the agreement with the agent
- paid to the agent who brought the business
- to ensure that the legal compliances have been complied with, for example, tax deduction at sources and provisions of the Insurance Act, 1938.

6.1 **Verification of Commission:** The auditor should apply the following procedures for verification of commission:

- vouch disbursement entries with commission bills and commission statements
- check whether the vouchers are authorised by the authorized person and TDS has been deducted properly as per Income Tax Act
- test check the calculation of commission amount
- scrutinize agents' ledger for any abnormal entries and examine accounts having debit balances, if any and obtain information for the same
- check whether the payment of commission for the period under audit has been properly accounted for
- verify that no commission is given to agents for business directly procured by it
- obtain management representation that all commission has been appropriately adjusted in the accounts.

7. **Operating Expenses Related to Insurance Business (Expenses of Management) [M99 N01]:** Management expenses, includes all charges whether direct or indirect, including commission payment of all kinds. But, it does not include HO expenses, expenses on shareholder and claim expenses. Following to be noted:

- All the administrative expenses in an insurance company are broadly classified under 13 heads as mentioned in Schedule 4 of Revenue Account.
- Any other expenses are required to be disclosed under the head 'Others'. 'Others' would include foreign exchange gains or losses as indicated in note 'B' of Schedule 4.
- Any major expenses (Rs. 5 lacs or in excess of 1% of net premium, whichever is higher) are required to be

shown separately.

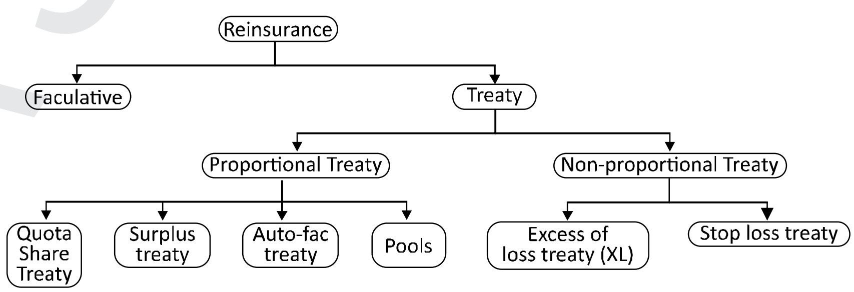
- expenses which do not have any direct relation to insurance business are to be shown separately in the Profit and Loss Account. For example: Expenses relating to investment department, brokerage, bank charges, transfer fees etc. These expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis.

8. **Reinsurance [N00 N03 N05 N09]:** Reinsurance is the arrangement whereby one insurer obtains insurance from another insurer on risks assumed by the former. The former is called the "ceding company", where latter is called the "reinsurer". Section 101 of the Insurance Act, 1938 provides that every insurer shall reinsure with Indian reinsurers such percentage of the sum assumed on each policy as may be specified by IRDA with previous approval of Central Government. The objective of internal controls over reinsurance transaction involves:
- determination of correct amounts for reinsurance ceded
- proper valuation of assets and liabilities arising out of reinsurance transactions
- adherence to legal provisions, regulations and reinsurance agreements.

8.1 **Verification of Reinsurance Inward:** The auditor should apply the following verification measures for reinsurance inward transactions:
- re-Insurance inward underwriting should be as per the norms and guidelines prescribed by the Insurance Act, 1938 and IRDA Regulations
- verify whether reinsurance inward transactions are as per the arrangements / agreements with reinsurer
- examine the accounting policy of the company with regard to reinsurance business received, premium received and payment of commission and claim costs
- in case of the foreign currency transaction, whether it is in accordance with the Accounting Standard (AS)-11, Accounting for Effects of Changes in Foreign Exchange Rates.
- examine whether the outstanding claim figures have been properly obtained well in time and sufficient provision has been made for all the outstanding claims
- check whether provision has also been made for claims incurred but not reported
- closing balances of the reinsurer's accounts should be reconciled and the confirmation of balances should be obtained from all the reinsurers

8.2 **Verification of Reinsurance Outward:** The following steps may be taken by the auditor in the verification of reinsurance outward:
- reinsurance outward underwriting should be as per the norms and guidelines prescribed by the Insurance Act, 1938 and IRDA Regulations
- ensure the appropriateness of accounting treatment of reinsurance business given for premium paid to reinsurer and payment of commission
- in case of the foreign currency transaction, whether it is in accordance with the Accounting Standard (AS)-11, Accounting for Effects of Changes in Foreign Exchange Rates
- verify whether reinsurance outward transactions are as per the arrangements/agreements with company.
- verify the confirmations received from reinsurers regarding claims for losses submitted to them
- verify any old outstanding claims paid or outstanding at the end of the year
- look into events after balance sheet date which might have significant impact on recovery of claims – paid or outstanding.
- check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

9. **Types of Reinsurance Contracts:**



(a) Facultative Reinsurance: Reinsurance whereby separate contracts are entered into for each particular risk. This is the oldest method of reinsurance. This type of reinsurance is used either when risks are not covered under treaties or the issuers does not want to cover the risk under the treaty, etc.

(b) Treaty Reinsurance: Under treaty reinsurance, a treaty agreement is entered into between the ceding company and the reinsurer(s) where reinsurances are within the limits of the treaty. These limits can be monetary, geographical, section of business, etc.

(c) Proportional Treaties: Such treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio. These treaties can be further classified into:

(d) Quota Share Treaty: Under this treaty, the ceding company agrees to cede a fix percentage of all policies issued by it under a defined scope of business covered by the agreement.

(e) Surplus Treaty: Under this treaty, the ceding company identifies excess liabilities under insurance policy issued by it and obtains reinsurance for such excess liabilities.

(f) Auto-fac Treaty: Under this treaty, a ceding company may reinsure up to a specified limit after cession of its surplus treaties.

(g) Pools: Under this category, more than one insurer may form a pool under an agreement whereby its members cede a pre-determined proportion of a particular category of business directly written by them into the pool. They also share the aggregate premiums and claims in the proportion and the share of premium ceded by each member.

(h) Non-Proportional Treaties: Such treaties are characterised by a sharing of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured. These treaties can be further classified into:

(i) Excess of Loss (XL) Treaties: in this treaty the reinsurer's liability arises only when a claim exceeds a predetermined figure relating to a specific branch of the ceding company's business or to its entire business.

(j) Stop Loss Treaties: It protects the ceding company from losing more than a specified amount for a given class of business.

10. **Claims [M04 M10]:** A demand for payment of policy benefit because of the occurrence of an insured event is known as 'claim'. The components of the cost of claims to an insurer comprise the claims under policies and claim settlement costs. The settlement cost of claims includes surveyor fee, legal expenses, etc. The liability for claims may arise on:

- direct business.
- inward reinsurance business.
- co-insurance business.

The liability also includes future payment in relation to:

- reported but unpaid claims.
- claims Incurred But Not Reported (IBNR) including inadequate reserve to settle the claims.

The accounting estimate shall also include claims cost adjusted for estimated salvage value if there is sufficient degree of certainty of its realisation. The objective of internal controls over claim is to ensure that:

- proper procedure is there for processing and payment of claims
- adequate procedure is there to identify and investigate suspicious claims
- reinsurance claims, if any, are duly lodged with the reinsurer
- monetary thresholds are established for review of claims paid by senior officer
- significant variance between expected and actual claims are identified and investigated.

10.1 **Verification of Claims Provisions [N14]:** The auditor should apply the following procedures for verification of claims:

- provision has been made for all unsettled claims as at the year end on the basis of claims lodged/ communicated by the insured against the company
- provision has been made for only such claims for which the company is legally liable
- events after the balance sheet date have been examined
- in determining the amount of provision, the 'average clause' has been applied in case of under-insurance

by parties

- in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability
- the claims are provided for net of estimated salvage, wherever applicable
- no contingent liability is carried in respect of any claim intimated in respect of policies issued.
- intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into
- in case of material differences in the liability estimated by the management and by the auditor, the same must be brought out in the auditor's report after obtaining further information or explanation from the management.

10.2 Verification of Claims Paid: The auditor should apply the following procedures for verification of claims paid:

- in case of co-insurance arrangements, claims paid have been booked only in respect of own share and the balance has been debited to other insurance companies
- in case of claims paid on the basis of advices from other insurance companies, (where the company is not the leader in co-insurance arrangements), whether share of premium was also received by the company
- claims which have been communicated after the year end for losses which occurred prior to the year end must be accounted for in the year of audit.
- that the claim payments have been duly sanctioned and acknowledged by the claimants
- that the amounts deposited with Court in matters under litigation/arbitration should not be classified as claims paid and treated as advance/deposit till final disposal of such claims. In such cases, full provision should be made for outstanding claims
- in case of final settlement of claims, an unqualified discharge letter is obtained from the insured not involving the company in any further liabilities in respect of the claim.

11. Investments [Sections 27B, 27C and 27D of the Insurance Act, 1938]:

- A General Insurance Company can only invest in approved securities. However, it can invest other than approved securities if the following conditions are satisfied:
  - ◊ such investments should not exceed 25% of the total investments
  - ◊ such investments are made with the consent of all the Directors.
- **An insurer should not invest in share or debenture of insurance or investment company in excess of least of the following:**
  - ◊ 10% of its own total assets
  - ◊ 2% of the subscribed share capital or debenture of the investee
- **An insurer should not invest in share or debenture of a company other than insurance or investment company in excess of least of the following:**
  - ◊ 10% of its own total assets
  - ◊ 10% of the subscribed share capital or debenture of the investee
- In case, the insurer has invested in partly paid up shares, the uncalled liability on the share is to be added to the amount invested for the purpose of computing percentages (%) referred above.
- Insurance Company cannot invest in the shares or debentures of a private company.
- Insurance Company cannot invest fund of the policy-holders outside India, however funds which do not belong to policy-holders can be invested outside India.
- The authority in exercise of its powers has issued detailed guidelines for investment by insurance companies. Every insurer carrying on the business of general insurance should invest and at all times keep invested its total Investment assets in the following manner:

No.	% of Total Investment Assets	Types Securities
1	>= 20%	Central Government Securities.
2	>= 30% (Including (1) above	Central & State Government Securities and other approved securities.

3	<= 70%	Approved Investment as specified in Section 27B and other investment as specified in section 27B(3) of the act and schedule II to the Regulations, subject to exposure norms as specified in Regulation 9.
4	<= 25%	Other investments as specified u/s 27B(3) of the act, subject to Exposure/ Prudential Norms as specified in Regulation 9
5		Housing and Loans to State Government for Housing and Fire Fighting Equipment, by way of Subscription or Purchase of:
5A	>= 5% (Total investment in housing (i.e.) investment in categories (1), (2), (3), and (4) above.	**A. Investment in Housing** a) Bonds/ Debentures issued by HUDCO, National Housing Bank b) Bonds/Debentures of Housing Finance Companies either duly accredited by National Housing Banks, for house building activities, or duly guaranteed by government or carrying current rating of not less than 'AA' by a credit rating agency registers under SEBI (Credit Rating Agencies) Regulations, 1999 C) Asset Backed Securities with the underlying Housing Loans, satisfying the norms specified in the Guidelines issued under these regulations from time to time.
5B	>= 10% (Total investment in infrastructure (i.e.) investment in categories (1), (2), (3), and (4) above.	**B. Investment in Infrastructure** Subscription or purchase of bonds/Debentures, Equity and Asset backed Securities with the underlying infrastructure assets would qualify for the purpose of this requirement.

- For Reinsurance Business, every re-insurer carrying on re-insurance business in India shall invest and at all times keep invested his investment assets in the same manner as above.
- On the basis of estimates made at the beginning of the year, the investments are made accordingly in each category. The estimates are reviewed and revised periodically if necessary.

12. Cash and Bank Balances: The auditor should apply the following audit procedures for verification of cash and bank balances:
- the auditor should physically verify cash balance at balance sheet date. If it is not possible to verify cash at balance sheet date, proper reconciliation should be drawn between verification date and balance sheet date.
- the cheque received but not deposited in bank should be shown as cheque in hand.
- perform test checking for bank transactions.
- obtain confirmation for year end bank balance.
- verify subsequent realization of all items appearing in bank reconciliation statement and amounts shown as being in transit.

13. Agents' Balance [N08 N10 N11 M14]: Agent's balance includes both the premium accepted and commission payable to them. The auditor should apply the following audit procedures for verification of agents' balance:
- Verify whether agent's balance have been listed, analysed and reconciled for the purpose of audit
- Verify whether there is any old outstanding debit or credit balance as at the year end which requires adjustment. A written explanation may be obtained from the management in this regard
- verify whether recovery of large outstanding in agent balance have been made in post audit period
- In case of doubtful debit balance, check whether provisions have been made or not
- Verify that agent's balance do not include employee's balances and balances of other insurance companies
- Verify that no credit of commission is given to agents for business directly procured by it
- Ensure that the relevant control account in the general ledger is reconciled with the subsidiary records
- Vouch adjustment or payments against old outstanding balance in agent's accounts.

14. Receipts and Payments Accounts [M05]: After the commencement of IRDA Act, 1999, every insurer, in respect of insurance business transacted by him and in respect of his share holders funds, should prepare a balance sheet, a profit and loss account, a separate account of receipts and payments and a revenue account in accordance with the regulations made by the IRDA, at the end of each financial year. Since receipts and payments account has been made a part of financial statements of an insurer, it is implied that the receipts and payment account is also required to be audited. The IRDA Regulations, 2002 require that the auditor of an insurance company should:

- Report whether the receipts and payments accounts of the insurer is in agreement with the books of accounts and returns
- Express an opinion as to whether the receipts and payments account has been prepared in accordance with the provisions of the relevant statutes
- Express an opinion as to whether the receipts and payments account give a true and fair view of the receipts and payments of the insurer for the relevant financial year/period under audit.

So it may be said that auditor is not only required to audit the receipts and payments accounts of the insurer but also express an opinion on the same.

15. Provision for Taxation: The auditor should apply the following audit procedures for verification of agents' balance:

- The auditor should check whether the provision for taxation has been made after taking into account the specific provisions applicable to general insurance companies.
- The auditor should, in addition to financial statements, examine other accounts furnished by the company to the C&AG.
- The auditor should assess the past trend regarding the approach of the Income Tax Department, the decision of the various appellate forums including the High Court and the Supreme Court vis-a-vis the computation made.
- Ensure that provisions of Chapter III of the Income Tax Act, 1961 have been complied with.
- Ensure that deductions under Chapter VI A of the Income Tax Act, 1961 have been properly taken into account
- Ensure that all TDS certificates have been kept and deduction on the same is claimed
- Examine the income of foreign branches and other income earned in foreign countries and the impact of the double taxation avoidance agreement, if any, entered into with those countries
- Ensure that the exemption provision relating to tax deducted at source from certain categories of income as exempted u/s 35A of the General Insurance (Business Nationalisation) Act, 1972 has been properly availed
- Examine sales tax implication on sale of salvage
- Examine the system of service tax collection and the payments to Statutory authorities and the internal system including the filing of returns
- Assess the applicability of the Wealth Tax Act, 1957 on the company.

16. Unexpired Risks Reserve [M08]: All policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks continue. Therefore, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end. According to the requirements of the Insurance Act, 1938, for the purpose of maintaining solvency margin, it is sufficient if the provision is made for unexpired risks:

- 50% for fire, marine cargo and miscellaneous business
- 100% for marine hull.

It may be noted that the insurance companies are governed by the provisions of Section 44 of the Income Tax Act, 1961. In this regard Income Tax Rules provides for creation of a reserve for unexpired risks. Deduction of these reserves is also allowed under the Income Tax Act under this Rule.

17. Co-insurance [N99 M00]: High business risks are shared between more than one insurer under co-insurance arrangements at agreed percentage. In case of co-insurance, the leading insurer receives the premium and issues a policy with the co-insurance clause & settles claims. The leading insurer provides statements of accounts to the co-insurers. The auditors should get information from the agreement arrived at the insurance council, where the insurance companies may chose to be the members.

17.1 Incoming Co-insurance: The auditor should apply the following audit procedures for verification of incoming Co-insurance:

- ensure that the premium account is credited on the basis of Statement of Accounts received from the leading insurer.
- if no Statement of Accounts is received then premium is accounted on the basis of advice received from leading insurer to ensure that premium in respect of risks assumed in any year is booked in the same year
- examine communication in the post-audit period and obtain written confirmation from management that all incoming advice has been accounted for the claim provisions and claims paid should also be verified with reference to advice received from the leading insurer.

17.2 Outgoing Co-insurance: The auditor should apply the following audit procedures for verification of outgoing Co-insurance:

- The auditor should scrutinize the transaction relating to outgoing business i.e. where the company is the leader.
- The auditor should verify the transactions with reference to the relevant risks assumed under policies and correspondingly for debits arising to the Co-insurer on account of their share of claims.

18. Catastrophe Reserve: Every General Insurance Company 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. Catastrophe reserve shall be created in accordance with norms, if any, prescribed by the Authority. Investment of funds out of catastrophe reserve shall be made in accordance with prescription of the Authority. The auditor should, depending upon the facts of the case, evaluate the adequacy of such a reserve.

19. Solvency Margin [Section 64VA of the Insurance Act, 1938] [N06 M12]:

- Every insurer is required to maintain an excess of the value of its assets over the amount of its liabilities at all times. The excess is known as 'Solvency Margin'.
- In the case of an insurer carrying on general insurance business, the solvency margin should be the highest of the following amounts:
  - ◊ 50/- Crore Rupees (100/- Crore rupees in case of a reinsurer)
  - ◊ a sum equivalent to 20% of net premium income
  - ◊ a sum equivalent to 30% of net incurred claims.
- Credit for re-insurance is allowed in computing Net Premium Income and Net incurred Claims.
- It may be noted that conditions regarding maintenance of the above mentioned solvency margin may be relaxed by the Authority in certain special circumstances:
  - ◊ if, at any time, an insurer does not maintain the required solvency margin, the insurer is required to submit a financial plan to the Authority indicating the plan of action to correct the deficiency in the solvency margin.
  - ◊ if an insurer fails to comply with the requirements of solvency margin, it shall deemed to be insolvent and may be wound up by the Court.

  Provided, in respect of any insurer, the Authority is satisfied that either by reason of unfavorable claim experience or because of sharp increase in the volume of the business, or for any other reason, compliance with provision of solvency margin would cause hardship to insurer, the Authority may direct for such period and subject to such conditions, such solvency margin not being less than lower of the amount mentioned above.

20. Trade Credit Insurance:

- "Trade credit insurance" means insurance of suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country (domestic risk) or situated in another country (export risk) against:
  - ◊ non-payment as a result of insolvency of the buyer.
  - ◊ non-payment after an agreed number of months after due date.
  - ◊ non-payment following an event outside the control of the buyer or the seller (political risk cover).
- Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage.
- **An insurer shall offer "trade credit insurance" product only if all requirements mentioned below are met:**
  - ◊ policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services.
  - ◊ policyholder is a supplier of goods or services in consideration for a fair market value.

◊ policyholder's trade receivable does not arise out of factoring or reverse factoring arrangement or any other similar arrangement.

◊ policyholder has a buyer or customer, who is liable to pay a trade receivable to the policy holder in return for the goods and services received by him from the policy holder, in accordance with a policy document filed with the insurer.

◊ policyholder undertakes to pay premium for the entire policy period.

◊ any other requirement that may be specified by the Authority from time to time.

- It may be noted, that this policy shall not be issued to banks/financiers/lenders or the beneficiary of such policy cannot be a banks/financiers/lenders. Further this policy shall also not applicable to any receivable arising from a financial or consultancy service.

21. Deposits [Sec. 7 of Insurance Act, 1938] [N13]:

- Every insurer shall, in respect of the insurance business carried on by him in India, deposit and keep deposited with the RBI in one of the offices in India a sum equivalent to 3% of total gross premium written in India in any FY.
- This deposit is to be kept for and on behalf of the GOI.
- The deposit can be made either by way of cash or investment in approved securities. If securities are deposited, their estimated market value on the date of deposit is to be seen. The amount of deposit required in the case of reinsurance business is rupees 20 crores.
- The amount of deposit required in case of marine insurance business is Rs. 1 lacs only.

22. Compliance with Corporate Governance Guidelines: [Circular No. IRDA/F&A/CIR/CG/081/05/2011, Dated 2-5-2011] : Attention is drawn to the Corporate Governance Guidelines issued by the Authority vide Circular no. IRDA /F&A/ CIR/025/2009-10, dated 05th August, 2009, and Circular No IRDA /F&I/CIR/ F&A/014/01/2010, dated 29th January, 2010. The following additional stipulations shall form part of the Guidelines:-

22.1 Annual Filing of Compliance status: W.e.f. F.Y. 2010-11, all insurers are required to file a Report on status of compliance with the CG Guidelines on an annual basis. This report shall be filed within 90 days from the end of the Financial year (i.e., before 30th June).

22.2 Filling up of the Vacancy to the Post of Independent Director on the Board: CG Guidelines also lays down the requirements regarding appointment of a minimum number of independent directors on the Board of Directors of an insurer. All insurers are required to ensure compliance with the stipulations regarding the minimum number of independent directors at all times. In case, the number of independent directors falls below the minimum requirement laid down, the vacancy shall be filled up within a maximum period of 180 days, under intimation to the Authority.

22.3 CG Guidelines provides for the formation of following three optional Committees:

- Remuneration Committee
- Nomination Committee
- Ethics Committee

It is further clarified that though the formation of such Committees is optional, once these committee are formed, the insurer is required to comply with the requirements on the "Role and Responsibilities" of such Committees as laid down in the said clause of the CG Guidelines.

No.	Question Bank	Exam	Marks	Refer Point/ Ans.
1	Enumerate the steps to be taken by an auditor for the verification of the premium income received by a general insurance company.	M01 PM	8	5
2	Describe the audit procedures to be followed for verification of premium by a Statutory Auditor of a General Insurance Company.	N02	8	5

3	Write short notes on "Management Expenses of Insurance Companies".	M99	4	7
4	In the context of audit of general insurance business, state the provisions regarding management expenses.	N01	8	
5	Enumerate the steps to be taken by an auditor for the verification of Re-insurance outward in case of a General Insurance Company.	N09 N03 PM	5, 8	8
6	What are the steps to be taken while auding re-insurance transactions in an insurance Company?	N00	8	
7	What are the steps to be taken by an auditor for the audit of re-insurance ceded?	N05 PM	8	
8	While auditing the claims paid in respect of a General Insurance Company, what aspects need to be looked into?	M10 PM	6	10
9	What are the specific areas to which you will give your attention while examining "Claim Paid" by a General Insurance Company.	M04 PM	8	10
10	ABC & Co., Chartered Accountants are the Auditors of Just Care General Insurance Company Limited. As on March 31, 2014 the Management made a provision for claims outstanding. Enumerate the steps to be taken by the Auditor while verifying the "Claims Provision".	N14 PM	6	10.1
11	State the procedure for verification of Agents' Balances in the course of audit of a General Insurance Company	N04 PM	4	13
12	Write short notes on "Verification of Outstanding premium and agents Balances".	N10	4	5.4 & 13
13	Write short notes on "Audit procedure in respect of "Outstanding premium and agents Balances" in Insurance company.	N11 PM	4	
14	As the auditor of an Insurance company state the audit procedures you would follow to verify outstanding premium and agents balances.	N08 PM	4	
15	M/s ABC & Co., a CA firm was appointed as the auditor of 'Always Safe General Insurance Ltd.' Advise them how they will verify outstanding premium and agent's balances.	M14	6	
16	In an audit of an Insurance Company, the Receipts and Payments accounts is also subjected to audit. Comment on this statement in brief.	M05 PM	6	14
17	RQ Insurance Ltd, has made a provision of 25% on unexpired risks reserve in its books. Comment.	M08 PM	5	16
18	Write short notes on "Co-insurance".	N99	4	17
19	Write short notes on "Incoming and outgoing Co-insurance".	M00 PM	4	
20	Write short notes on "Solvency margin in case of an insurer carrying on general insurance business".	N06 PM	4	19
21	Write short notes on "Solvency Margin".	M12	4	
22	ABC Limited, an Indian insurance company carrying on general insurance business, is facing liquidity problems and, therefore, it has decided to maintain deposits u/s 7 of the Insurance Act, 1938 at one percent of total gross premium written in India. The company thinks that it is sufficient, as the company has a Paid-up Capital of Rs. 150 Crores. As an Auditor of ABC Limited what would be your suggestion to the company for compliance of Insurance Act and rules and regulations made there under?	N13 PM	4	21

23	As at 31st March 2013 while auditing Safe Insurance Ltd you observed that a policy has been issued on 25th March 2013 for fire risk favouring one of the leading corporate houses in the country without the actual receipt of premium and it was reflected as premium receivable. The company maintained that it is a usual practice in respect of big customers and the money was collected on 5th April, 2013. You further noticed that there was a fire accident in the premises of the insured on 31st March 2013 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond.	M13 PM	4	Ans-1
24	State the disclosure requirements in respect of contingent liabilities in the notes to the Balance Sheet of a General Insurance Company.	M11 PM	4	Ans-2

Answer

Ans -1:

No Risk Assumption without Premium: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India, if

- the premium payable is not received; or
- the premium payable is not guaranteed to be paid by such person in such manner and within such time, as may be prescribed; or
- the premium payable is not deposited in advance in in the prescribed manner.

The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co-insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

Ans- 2:

The following shall be disclosed by way of notes to balance sheet of a GIC in respect of contingent liabilities:

- Partly paid up investments.
- Underwriting Commitments outstanding.
- Statutory demands/Liabilities in dispute, not provided for.
- Claims, other than those under policies, not acknowledged as debts.
- Guarantees given by or on behalf of the Company.
- Reinsurance obligations to the extent not provided for in the accounts.

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