AUDIT OF INSURANCE COMPANIES

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Know the applicable legal framework for Insurance Company including the required minimum paid-up capital, registration requirements etc.
- Recognise the reporting requirements in case of Insurance Companies i.e. contents of auditors' report.
- Understand various types of Life Insurance and General Insurance Business.
- Know the meaning of some important terms used in the Life insurance and General Insurance business.
- Gain the knowledge of the Audit Procedures of the Life Insurance business and General Insurance business.
- Acquire the knowledge of Form and Contents of Financial Statements.
CHAPTER OVERVIEW

AUDIT OF INSURANCE COMPANIES

1. INTRODUCTION

Insurance is a contract between two parties whereby one party agrees to undertake the risk of another in exchange for consideration known as premium and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period (in case of life insurance) or to indemnify the other party on happening of an uncertain event (in case of general insurance). The party bearing the risk is known as the ‘insurer’ or ‘assurer’ and the party whose risk is covered is known as the ‘insured’ or ‘assured’.

The insurance industry occupies a very important place among financial services all over the world. Today insurance affects people from all walks of life. Individuals as well as business firms turn to insurance for managing various risks. Everyday new coverage is added to the existing policy. The expanding scope of insurance highlights the growing importance of insurance to individuals and organizations alike. A proper appreciation of what insurance is and what it can do to help an individual or an organization is therefore necessary.
Life Insurance industry is one of the flourishing industries in today’s globalised world. Next to banking, the life insurance industry is growing both in terms of economic impact as well as the one who generates employment opportunities in today’s emerging markets such as India. Life insurance deals with the insurance of individuals, groups, and pension plans. Since 1st September, 1956, transacting life insurance business in India was the exclusive privilege of the nationalised insurance company viz., LIC. However, with the passing of the IRDA Act, 1999, the life insurance sector has been thrown open to private players.

As defined under the Insurance Act, 1938, ‘general insurance business’ means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.

**Important points of distinction between Life Insurance and General Insurance**

<table>
<thead>
<tr>
<th>Life Insurance</th>
<th>General Insurance</th>
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<tbody>
<tr>
<td>Term may be fixed or variable.</td>
<td>Term is fixed (usually 1 year).</td>
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<tr>
<td>Pay-outs are certain either as claims or maturity benefits.</td>
<td>Pay-outs are uncertain as claims may or may not arise.</td>
</tr>
<tr>
<td>Multi-purpose (e.g. investment, tax benefits, insurance).</td>
<td>solely for the purpose of insurance.</td>
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### 2. LEGAL FRAMEWORK

It is important for the auditor to familiarize himself with various statutes governing the insurance industry. The auditor, while familiarizing himself with various rules, regulations, relevant notifications should also look into the important aspects arising out of those which might have an effect on determination of nature, timing and extent of audit procedures, while performing his role as an auditor.

The primary legislations which deal with the insurance business in India are the Insurance Act, 1938 and the IRDA Act, 1999. Various aspects relating to audit are dealt with around the framework of the following statutes and rules made thereunder:

- (a) The Insurance Act, 1938 as amended by the Insurance Laws (Amendment) Act, 2015 (including Insurance Rules, 1939);
- (b) The Insurance Regulatory and Development Authority Act, 1999 as amended by the Insurance Laws (Amendment) Act, 2015;
Various regulations/guidelines/notifications issued by IRDAI from time to time. As of today there are 530 directions from IRDAI in the form of circulars, Regulations, Guidelines, Notifications, & Orders.

Some relevant statutory provisions are discussed below:

**Insurer** - Section 2(9) of the Insurance Act, 1938 defines the term ‘Insurer’ as:

(a) an Indian Insurance Company, or  
(b) a statutory body established by an Act of Parliament to carry on insurance business, or  
(c) an insurance co-operative society, or  
(d) a foreign company engaged in re-insurance business through a branch established in India.

It may be noted that a "foreign company" shall mean a company or body established or incorporated under a law of any country outside India and includes Lloyd's established under the Lloyd's Act, 1871 (United Kingdom) or any of its Members.

**Policy Holder** - Section 2(2) of the Insurance Act, 1938 defines the term policy holder as a person to whom the whole of the interest of the policy holder in the policy is assigned once and for all, but does not include an assignee thereof whose interest in the policy is defensible or is for the time being subject to any condition.

**Prohibition of Insurance Business by Certain Persons** - Third proviso to section 2C(1) of the Insurance Act, 1938 (inserted by the IRDA Act, 1999) prohibits persons other than an Indian insurance company to begin to transact the insurance business after the commencement of the IRDA Act, 1999.

### 2.1 Registration of Indian Insurance Companies:

Section 3 of the Insurance Act, 1938 requires every insurer to obtain a certificate of registration before commencement of insurance business in India. The section empowers the Authority to make regulations for registration of insurers. It may be noted here that no insurer other than an Indian insurance company can commence the insurance business after the enactment of the IRDA Act, 1999. The registration of Indian insurance companies is done in accordance with the IRDA (Registration of Indian Insurance Companies) Regulations, 2000.

### 2.2 Requirements as to the Minimum Paid-up Capital:

The minimum paid-up equity share capital of an Indian insurance company carrying on insurance business should be Rs.100 crores excluding preliminary expenses incurred in the formation and registration of company. The insurer may enhance the same in accordance with the provisions of
the Companies Act, 2013, SEBI Act, 1992 and the rules, regulations or directions issued thereunder or any other law for the time being in force.

2.3 Insurance Regulatory and Development Authority (IRDA) Act, 1999 and Regulations framed thereunder

As mentioned earlier, the IRDA Act, 1999 has established the Insurance Regulatory and Development Authority (the Authority) and has also provided for establishment of the Insurance Advisory Committee to advise the Authority on various matters. The IRDA Act, 1999 has also made amendments to the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalisation) Act, 1972 by insertion of the First, Second and Third Schedules to the IRDA Act, 1999. These Schedules contain amendments to rationalise the provisions of the Insurance Act, 1938 and other statutes with the IRDA Act, 1999 and the Regulations.

3. FORM AND CONTENTS OF FINANCIAL STATEMENTS

Every insurer, in respect of insurance business transacted and in respect of shareholder’s funds, is required to prepare a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments, a Revenue Account for each year in accordance with the Regulations as may be specified. Every insurer should keep separate accounts relating to funds of shareholders and policyholders.

Section 11 of the Insurance Act, 1938 provides that every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015, in respect of insurance business transacted by him and in respect of his shareholders’ funds, shall, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.

The Authority, in pursuance of the powers conferred to it by the provisions of section 114 A of the Insurance Act, 1938, has issued regulations for the preparation of the financial statements and auditor’s report of companies carrying on insurance business. The Regulations contain three schedules.

| Schedule A is applicable to companies carrying on Life Insurance business. |
| Schedule B is applicable to Companies carrying on General Insurance business. |
| 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. |
4. AUDIT OF ACCOUNTS

Under section 12 of the Insurance Act, 1938, the financial statements of every insurer are required to be audited annually by an auditor. Section 2(4) of the Insurance Act, 1938 defines the term ‘auditor’ as a person qualified under the Chartered Accountants Act, 1949 to act as an auditor of a company. The auditor, for audit of financial statements, has the powers to exercise the rights vested in, and discharge the duties and be subject to the liabilities and penalties imposed on auditors of companies under the Companies Act, 2013. (there is also a requirement by IRDAI that half year accounts ended September 2016 need to be reviewed by the statutory auditor)

The provisions of section 12 of the Insurance Act, 1938 apply only in a case where the financial statements of the insurer are not subject to audit under the Companies Act, 2013. A company carrying on general insurance business is subject to audit requirements laid down under the Companies Act, 2013.

The financial statements under section 12 include Balance Sheet, Profit and Loss Account, Revenue Account. Section 12 of the Insurance Act, 1938 does not cover the requirement for audit of the Receipts and Payments Account of an insurer. However, sub-section (1) of section 11 of the Insurance Act, 1938 requires that every insurer, in respect of insurance business transacted by him and in respect of his shareholders’ funds, should prepare, at the end of each financial year, a Balance Sheet, a Profit and Loss Account, a separate Account of Receipts and Payments and a Revenue Account in accordance with the regulations as may be specified. 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 Authority, in exercise of the powers conferred by the Insurance Act, 1938, issued the IRDA (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2002. These Regulations require the auditor of an insurance company to report whether the Receipts and Payments Account of the insurer is in agreement with the books of account and returns. The auditor is also required to express an opinion as to whether the Receipts and Payments Account has been prepared in accordance with the provisions of the relevant statutes and whether the Receipts and Payments Account gives a true and fair view of the receipts and payments of the insurer for the period under audit. This also implies that the auditor is required to audit the Receipts and Payments Account of the insurer.

4.1 Appointment of Auditors

The appointment of statutory auditors in the General Insurance Corporation of India, and its subsidiaries and the divisions is made by the Comptroller and Auditor General of India, as in the case of other public sector undertakings (For example, in the case of New India Assurance Company Ltd., United India Insurance Company Ltd.). However, in the case of others, auditor is appointed at the AGM after ensuring that the auditor satisfies the compliance requirements with the relevant sections of the IRDAI Guidelines on
Corporate Governance. These guidelines pose certain restrictions on the number of insurance companies a statutory auditor can audit. Currently, an auditor can conduct audit only for three insurance companies and not more than 2 life or 2 general. The Guidelines also mandate a mandatory joint audit for all insurance companies.

4.2 Remuneration of Auditors

The remuneration of auditor of an insurance company is to be fixed in accordance with the provisions of section 142 of the Companies Act, 2013 in the general meeting or in such a manner as the company in general meeting may determine.

4.3 Rights and duties of Branch Auditors

It is a practice in certain public sector insurance companies that the divisional offices prepares atrial balance in a manner that it provides information required to be included in the various formats of financial statements prescribed in the Insurance Act. Each trial balance, in which are incorporated the figures relating to the branches of the divisions, is required to be audited and the report thereon is furnished to the statutory auditors. The divisions of the companies carrying on general insurance business are treated for the purposes of the Companies Act, 2013 as their branches. It follows that the branch auditors appointed to conduct the audit of the divisions have the same rights and obligations under the statute as those of the, statutory auditors to whom they are expected to submit their report.

However, in case of private companies, the accounting and operational systems of the company are centralized and hence, the principle of divisional offices preparing accounts and they being consolidated is not applicable to such companies. The accounts of all the divisions, trial balances and their balance sheets are prepared at the Head office only.

4.4 Investment Risk Management Systems and Process Audit

The IRDA vide Circular No. INV/CIR/008/2008-09 Dt. 22nd Aug, 2008 advised that the Chartered Accountants firm, which is not the Statutory or Internal or Concurrent Auditor of the concerned Insurer shall certify that the Investment Risk Management Systems and Processes are in place. For this purpose, the ICAI has also issued “Technical Guide on Review and Certification of Investment Risk Management Systems and Processes of Insurance Companies” in consultation with the IRDA.

4.5 Direction of C&AG

The Comptroller and Auditor General of India has the power to direct the manner in which the accounts shall be audited and give such instructions in regard to any matter relating to performance of functions by the auditor and to conduct the supplementary or test audit of the accounts of such companies by such person or persons as may be authorised in this behalf. For the purposes of such audit, the C&AG may require information or additional information on such matters and in such form as may be directed by him in terms of Section 143(5) and 143(6) of the Companies Act, 2013. The statutory auditors are required to submit a copy of their report to the C&AG who has the right to comment upon or supplement the audit report.
4.6 Applicability of CARO, 2016

The additional reporting requirement under Companies (Auditor’s Report) Order, 2016 is exempted for an insurance company as defined under the Insurance Act, 1938.

5. REQUIREMENTS OF THE INSURANCE ACT, 1938 VIS A VIS THE COMPANIES ACT, 2013

Disclosures under the Companies Act, 2013 relating to the Balance Sheet and Profit and Loss Account of the company also apply to an insurance company.

Proviso to sub-section (1) of section 129 of the Companies Act, 2013 provides that the financial statements of a company shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose, in the case of an insurance company, any matters which are not required to be disclosed under the Insurance Act, 1938, or the IRDA Act, 1999. However, if an insurance company so desires, it may disclose additional information that is not specifically required to be disclosed under the Insurance Act, 1938.

According to section 1 of the Companies Act, 2013, the provisions of the Companies Act, 2013 shall apply to insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999. Section 117 of Insurance Act, 1938, provides that nothing in the Insurance Act, 1938 shall affect the liability of an insurer, being a company, to comply with the provisions of the Companies Act, 2013 in matters not otherwise specifically provided for by Insurance Act, 1938. Therefore, the provisions of the Companies Act, 2013 would be applicable wherever the Insurance Act, 1938 does not cover the relevant aspects and the insurer is a company within the meaning of the Companies Act, 2013. The provisions of the Companies Act, 2013 should be applied in a harmonised manner with the provisions of the Insurance Act, 1938, and the rules and regulations framed thereunder.

Note: Students may refer Chapter 5 on the Company Audit for the requirements given under the Companies Act, 2013.

6. AUDITING IN AN INFORMATION TECHNOLOGY ENVIRONMENT

The Information Technology environment does not materially affect the scope and objectives of an audit. However, in view of the computerisation in general and the insurance industry in particular, the auditor has to familiarise himself with the IT environment in insurance companies. He should gain an understanding to the workflow of various important transactions.

The auditor may select a few transactions of each type and trace them through the system, i.e., identify the audit trail. This would help him in not only understanding flow of transactions and manner
of processing but it will also provide him evidence as to whether the results of processing are correct. Where the auditor is satisfied about the design and operation of the IT system, he may limit the extent of his checking of transactions in so far as those aspects are concerned, where the IT system has in-built control.

The auditor should seek a written representation from the management about any changes in the IT systems that have taken place during the year. Where different systems have been in operation during the year, the auditor should separately examine the efficacy of each such system. The auditor should also obtain a written representation from the management that there have been no changes in the system during the year other than those specified.

7. TAX AUDIT

It is necessary for general insurance companies to get their accounts audited under Section 44 AB of the said Act. For this purpose, the tax auditor(s) may be appointed by the company itself by means of a resolution of the Board of Directors or by the Chairman/ Managing Directors if so authorised in this behalf. The company is expected to fix separate remuneration for the auditor(s) appointed for this purpose.

The Form of tax audit report applicable would be Form 3CB and the prescribed particulars would have to be given in Form 3CD, in accordance with Rule 6G of the Income Tax Rules, 1962, pursuant to Section 44AB of the Income Tax Act, 1961.

8. SPECIFIC CONTROL PROCEDURES RELATED TO AUDIT OF LIFE INSURANCE COMPANIES

Life Insurance Industry in India has witnessed varied product designs during last 5 decades. Based on the peculiarities involved, Life Insurance Products can broadly be categorised as follows:

<table>
<thead>
<tr>
<th>Types of Life Insurance Products</th>
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<tbody>
<tr>
<td>i. <strong>Term / Protection:</strong> Term life Insurance is traditional form of Life Insurance Product. Term insurance generally takes care of pure income replacement needs rather than Capital appreciation requirements. Term Insurance covers the policy holder for specific period and pays the death benefits only if the policy holder dies during the policy period.</td>
</tr>
<tr>
<td>ii. <strong>Endowment/ Pure Endowment:</strong> Endowment policies cover the risk for a specified period and at the end of the policy the sum assured is paid back to the policyholder along with all bonus accumulated during the policy term.</td>
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<tr>
<td>iii. <strong>Money Back Plan:</strong> Money Back policies are type of Endowment policies which provides periodic payments of partial benefits during the term of policy so long as the policy holder is alive. Peculiar nature of these policies is that, in event of death at any time during policy...</td>
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</table>
term, the death claim would comprise of full sum assured without deduction of any survival benefit amounts. Also, bonus is calculated on sum assured.

| iv. | **Whole Life Insurance Product**: It provides cover throughout the life time of the person. Unlike Endowment plans they do not carry any maturity value and sum assured is paid to the family in case of unfortunate death of the policyholder. |
| v. | **Unit Linked Insurance Plan (ULIP)**: Unit Linked Insurance Plans are such Insurance plans where the value of the policy changes as per the underlying Investment Assets. It allows protection and flexibility in Investment. The Premium paid is used for the purchase of units in Investment assets. |
| vi. | **Pension or Retirement Plans**: A pension plan is retirement solution where policyholder decides the age retirement age and agrees to pay premium till the time of the retirement and thereafter he has option to commute a part of his fund value and take an annuity for the balance. Pension plan provides Income protection as well as the Life Cover. |
| vii. | **Annuities**: Annuity is a contract where Insurer in return for the payment at regular intervals till fixed date make series of agreed payments at regular intervals from fixed date. |
| viii. | **Group Insurance**: Group Insurance is an insurance that covers a group of people, who are the members of the societies, employees of an organisation or professionals in common group. |
| ix. | **Others** |

### 8.1 Requirements of Schedule A to the IRDA (Preparation of Financial Statements and Auditors’ Report of Insurance Companies) Regulations, 2002

#### Part I: Accounting Principles for Preparation of Financial Statements

1. **Applicability of Accounting Standards**: Every balance sheet, Revenue Account (Policy holders account), Receipts and Payments account (Cash flow statement) and Profit and Loss account (Shareholder’s account) of an insurer shall be in conformity with the Accounting standards (AS) issued by the ICAI, to the extent insurers carrying on life insurance business, except that:
   - Accounting standard 3 (AS 3) – Cash flow statements – Cash flow statement shall be prepared only under the direct method.
   - Accounting standard 17 (AS 17) – Segment Reporting – shall apply to all insurers irrespective of the requirements regarding the listing and turnover mentioned therein.
2. **Premium**: Premium shall be recognized as income when due. For linked business the due date for payment may be taken as the date when the associated units are created.
3. **Acquisition Costs**: Acquisition costs if any shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with and are primarily related to the acquisition of new and renewal insurance contracts. The most essential test is the obligatory
relationship between costs and the execution of insurance contracts (i.e. commencement of risks)

4. **Claims:** The ultimate cost of claims shall comprise the policy benefit amount and specific claims settlement costs, wherever applicable.

5. **Actuarial valuation- Liability for Life Policies:** The estimation of liability against life policies shall be determined by the appointed actuary of the insurer pursuant to his annual investigation of the life insurance business. Actuarial assumptions are to be disclosed by way of notes to the account.

The liability shall be so calculated that together with future premium payments and investment income, the insurer can meet all future claims (Including bonus entitlements to policyholders) and expenses.

6. **Procedure to determine ‘Value of Investments’:** An insurer shall determine value of investments in the following manner:

<table>
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<tr>
<th>(a) <strong>Real estate investment property</strong> – The value of investment property shall be determined at historical cost, subject to revaluation at least once in every three years. The change in the carrying cost of the investment property shall be taken to revaluation reserve.</th>
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<tr>
<td>- The insurer shall assess at each balance sheet date whether any impairment of the property has occurred.</td>
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<tr>
<td>- Gains/losses arising due to changes in the carrying amount of real estate shall be taken to equity under ‘Revaluation Reserve’. The Profit on sale of investments or loss on sale of investments, as the case may be, include any accumulated changes in the carrying amount previously recognized in equity under the heading revaluation reserve in respect of particular property and being recycled to the relevant revenue account or profit and loss account on sale of that property.</td>
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<tr>
<td>- The bases for revaluation shall be disclosed in the notes to accounts. The authority may issue directions specifying the amount to be released from the revaluation reserve for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the authority’s direction, no other amount shall be distributed to shareholders out of revaluation reserve account.</td>
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<tr>
<td>- An impairment loss of shall be recognized as an expense in the revenue/ Profit and loss account immediately, unless the asset is carried at revalued amount. Any impairment loss of a revalued asset shall be treated as a revaluation decrease of that asset and if the impairment loss exceeds the corresponding revaluation reserve, such excess shall be recognized as expense in the Revenue/Profit and loss account.</td>
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</table>
(b) **Debt Securities** – Debt securities, including government securities and redeemable preference shares, shall be considered as ‘held to maturity’ securities and shall be measured at historical cost subject to amortization.

(c) **Equity Securities and Derivative Instruments that are traded in markets** - Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value on the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price at the stock exchanges where the securities are listed shall be taken.

- The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.
- An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal and the prices are publicly available.
- Unrealised gains/losses arising due to changes in the fair value of the listed equity shares and the derivative instruments shall be taken to equity under the head ‘Fair value change account’. The profit on sale of investments or loss on sale of investment as the case maybe shall include accumulated changes in the fair value previously recognized under equity under the heading ‘Fair value changes account’ in respect of a particular security and being recycled to the relevant Revenue account or Profit and loss account on actual sale of that security.

- The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the Authority’s prescription, no other amount shall be distributed to shareholders out of Fair Value Change Account. Also, any debit balance in Fair Value Change Account shall be reduced from profit/free reserves while declaring dividends.
- The insurer shall assess, on each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognized as an expense in Revenue/Profit and Loss Account to the extent of the difference between the re-measured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognized as expense in Revenue/ Profit and Loss Account. Any reversal of impairment loss earlier recognized in Revenue/Profit and Loss Account shall be recognized in Revenue/Profit and Loss Account.

(d) **Unlisted and other than actively traded Equity Securities and Derivative Instruments** – Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active markets.
shall be measured at historical cost. Provision shall be made for diminution value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

For the purposes of this regulation, a security shall be considered as being not actively traded, if as per guidelines governing mutual funds laid down from time to time by SEBI, such a security is classified as "thinline traded".

7. **Loans:** Insurance companies not only cater valuable death cover under policy but also extend helping hand by way of granting loan under policies during life time of policyholder when he is in need of funds. As per the privileges and conditions given on the policy documents, insurer grants loan on the security of policy document to the person who is entitled for the same.

Loans shall be measured at historical cost subject to impairment provisions. The impairment provisions shall not be lower than the amounts derived on the basis of guidelines prescribed from time to time by the Reserve Bank of India, that apply to Companies and Financial institutions.

8. **Linked (ULIP) Business:** The accounting principles used for valuation of Investments are to be consistent with principles as enumerated above. A separate set of financial statements, for each segregated fund of the linked business should be annexed.

Segregated funds represents funds maintained in accounts to meet specific investment objectives of policy holders who bear the Investment risk. Investment income/ gains and losses generally directly accrue to the policy holders.

9. **Funds for Future Appropriation:** The funds for future appropriation represent all funds, the allocation of which, either to policyholders or to the shareholders, has not been determined by the end of the financial year.

### Part II: Disclosures forming part of Financial Statements

<table>
<thead>
<tr>
<th>A. The following shall be disclosed by way of notes to the Balance Sheet:</th>
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<tbody>
<tr>
<td>1. <strong>Contingent Liabilities:</strong></td>
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<tr>
<td>(a) Partly-paid up investments</td>
</tr>
<tr>
<td>(b) Underwriting commitments outstanding</td>
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<td>(c) Claims, other than those under policies, not acknowledged as debts</td>
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<tr>
<td>(d) Guarantees given by or on behalf of the company</td>
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<tr>
<td>(e) Statutory demands/liabilities in dispute, not providedfor</td>
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<td>10.</td>
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B. The following accounting policies shall form an integral part of the financial statements:

All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies, followed by the insurer, shall be stated in the manner required under Accounting Standard AS 1 issued by the ICAI.

Any departure from the accounting policies shall be separately disclosed with reasons for such departure.

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C. The following information shall also be disclosed:

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<tr>
<td>1.</td>
<td>Investments made in accordance with any statutory requirement should be disclosed separately. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account, Profit and Loss Account and Receipts and Payments Account shall be given.</td>
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<tr>
<td>2.</td>
<td>Segregation into performing/non-performing investments for purpose of Income recognition as per the directions, if any, issued by the Authority;</td>
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<td>3.</td>
<td>Assets to the extent required to be deposited under local laws or otherwise encumbered;</td>
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<tr>
<td>4.</td>
<td>Percentage of business sector-wise;</td>
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<td>5.</td>
<td>A summary of financial statements for the last five years, in the manner as may be prescribed by the Authority;</td>
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<tr>
<td>6.</td>
<td>Bases of allocation of investments and income thereon between Policy-holders' Account and Shareholders' Account;</td>
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<tr>
<td>7.</td>
<td>Accounting Ratios as may be prescribed by the Authority.</td>
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</table>

**Part III: General Instructions for Preparation of Financial Statements:**

1. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account, Profit and Loss Account and Receipts and Payments Account shall be given.

2. The figures in the financial statements may be rounded off to the nearest thousands.

3. Interest, dividends and rentals receivable in connection with an investment should be stated at gross amount, the amount of income-tax deducted at source should be included under 'advance taxes paid and taxes deducted at source.'

4. (I) For the purposes of financial statements, unless the context otherwise requires—

   (a) the expression 'provision' shall, subject to (II) below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy;

   (b) the expression 'reserve' shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability or loss;
(c) the expression 'capital reserve' shall not include any amount regarded as free for
distribution through the profit and loss account; and the expression 'revenue reserve'
shall mean any reserve other than a capital reserve;

(d) the expression liability shall include all liabilities in respect of expenditure contracted
for and all disputed or contingent liabilities.

(II) Where:

(a) any amount written. off or retained by way of providing for depreciation, renewals or
diminution in value of assets, or

(b) any amount retained by way of providing for any known liability or loss, is in excess
of the amount which in the opinion of the directors is reasonably necessary for the
purpose, the excess shall be treated as a reserve and not provision.

5. The company shall make provisions for damages under lawsuits where the management is of
the opinion that the award may go against the insurer.

6. Extent of risk retained and re-insured shall be separately disclosed.

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

**Part IV: Contents of Management Report**

There shall be attached to the financial statements, a management report containing, inter alia, the
following duly authenticated by the management:

1. Confirmation regarding the continued validity of the registration granted by the Authority;

2. Certification that all the dues payable to the statutory authorities have been duly paid;

3. Confirmation to the effect that the shareholding pattern and any transfer of shares during the
year are in accordance with the statutory or regulatory requirements;

4. Declaration that the management has not directly or indirectly invested outside in India the
funds of the holders of policies issued in India.

5. Confirmation that the required solvency margins have been maintained.

6. Certification to the effect that the values of all the assets have been reviewed on the date of
the Balance Sheet and that in his (Insurer) belief the assets set forth in the Balance Sheets are
shown in the aggregate at amounts not exceeding their realisable or market value under
respective headings of the Assets.

7. Certification to the effect that no part of the life insurance fund has been directly or indirectly
applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the
application and investment of the Life Insurance funds.
8. Disclosure with regards to the overall risk exposure and strategy adopted to mitigate the same.

9. Operations in other countries, if any, with a separate statement giving the Management’s estimate of country risk and exposure risk and the hedging strategy adopted.

10. Ageing of claims indicating the trends in average claim settlement time during the preceding five years;

11. Certification to the effect as to how valuation of Investments has been carried out.

12. Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.

13. A responsibility statement indicating therein that:
   (a) in the preparation of financial statements, the applicable accounting standards, principles and policies have been followed along with proper explanations relating to material departures, if any;
   (b) the management has adopted accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the Company at the end of the financial year and of the Operating profit or loss of the Company for the year.
   (c) the management has taken proper and sufficient care for the maintenance of adequate accounting records with the applicable provisions of the Insurance Act, 1938 (4 of 1938)/Companies Act, 2013, for safeguarding the assets of the Company and for preventing and detecting fraud and other irregularities;
   (d) the management has prepared the financial statements on a going concern basis.;
   (e) the management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively;

14. A schedule of payments, which have been made to individuals, firms, companies and organisations in which Directors of the Insurer are interested.

8.2 Audit of Accounts of Life Insurance Companies

The internal control functions have been categorized below under main operational cycles considering the peculiar nature of life insurance business. Areas where the internal controls are similar to the ones adopted by other companies such as for cash and bank, receipts and payments and fixed assets, have to be dealt with as per the publications on the Internal Control Questionnaire, published by the Institute of Chartered Accountants of India. Since various operational cycles are inter-linked, the internal controls operating within the systems of such cycles should be reviewed simultaneously.
Areas which are peculiar to Life Insurance business are enumerated below:

1. **Actuarial Process:** Actuaries in Life Insurance business have gained tremendous importance. The role of Actuary in life insurance has shifted from supervising compliance to certify whether products and financial reports are in accordance with the general regulatory guidelines.

   The job of actuary or actuarial department in any Life Insurance Company involves, detailed analysis of data to quantify risk. The actuarial department is calculating and modelling hub of the Company. Within the department fundamentals of Insurance business is determined from pricing to policy valuations techniques.

   **Role of Auditor:** Auditors in the Audit report are required to certify, 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 IRDA.

   Hence, Auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, Auditor may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.

   Actuarial department broadly concentrates following key areas of Insurance business:
   - Product Development/ Pricing and Experience analysis.
   - Model Development.
   - Statutory Valuations and reserving.
   - Business Planning.
   - Solvency management.
   - Management reporting on various business valuations and profitability models of the Life Insurance business.

2. **Underwriting:** A proposal is an application for an insurance cover. The process of verifying the level of risk in each new entrant is called ‘selection’ or ‘underwriting’.

   The underwriter assesses the risk and determines the premium to be charged. The function of the underwriter is to acquire-or to “write”-business that will bring money to the insurance company, and to protect the company’s business from risks that they feel will make a loss. The underwriters may either decline the risk or may provide a quotation in which the premiums have been loaded or in which various exclusions have been stipulated, which restrict the circumstances under which a claim would be accepted and paid.

   **Role of Auditor:** While verifying the process of underwriting, the objective of the Audit should be to review the process of acceptance of risk through the underwriting process, and evaluate and test the effectiveness of internal controls in place to ensure timely and accurate Insurance policy, adherence to the IRDA Act and Rules and regulations made thereunder.
3. **Reinsurance**: Reinsurance is a risk mitigating tool adopted by Insurer whereby the risk underwritten by one Insurer is transferred partially to another Insurer. In other words, Reinsurance means one insurer purchasing coverage from a second insurance company for a risk that the first insurer is insuring.

**Role of Auditor**: The primary objective of the audit should be to check and confirm that reinsurance premium calculation and payment is in accordance with the agreement with the reinsurer. Necessary provision has been made for outstanding reinsurance premium and is properly accounted for in books of accounts under respective heads.

The audit in this regard would normally cover the followings areas of the reinsurance:

i. Verification of agreements entered with the reinsurer.

ii. Updating/renewals of agreements, and verifying whether Insurer has adhered to the terms and conditions of the agreement.

iii. Verification of payments made to the reinsurer and verifying whether adequate provisions are carried out in books.

4. **Free Look Cancellation (FLC)**: As per clause 6(2) of IRDA (Protection of Policyholders Interest) Regulations, 2002, “the insurer shall inform by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms and conditions of the policy and where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, when he shall be entitled to a refund of the premium paid, subject only to a deduction of a proportionate risk premium for the period on cover and the expenses incurred by the insurer on medical examination of the proposer and stamp duty charges”.

Accordingly, FLC is an option provided to the policyholder wherein he has a period of 15 days from the date of receipt of the policy document to review the Terms & Conditions of the policy and in case of disagreement to any of the terms & conditions, he/she has the option to return the policy stating the reason for policy’s cancellation. FLC requests can be received through any mode—e-mail, fax and letters depending on insurer’s policy. In case of written letters the signature of the policy holder should be matched with the original proposal form. FLC request is processed only when the policy holder is not satisfied with the terms and conditions of the policy document and not for any other reasons. FLC refund is paid either by cheque or in case the policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank account details is submitted.

| FLC refund is calculated as follows: | 
|------------------------------------|---|
| FLC premium paid | XXX |
| (Less) - proportionate risk premium | XXX |
| (Less) - medical charges. If any, by the insurer. | XXX |
Role of Auditor: The primary objective of the audit is to check and confirm that FLC requests are received within 15 days from receipt of policy document by the policy holder, verification of signatures of the policy holder and processing of FLC request within TAT defined by the insurer. Also checking of appropriate accounting entries are recorded for refund.

5. Policy Lapse and Revival: “Lapse” is the discontinuance of the policy owing to non-payment of premium dues. The term “lapse” is not defined in the insurance legislation, except stating that “a policy which has acquired a surrender value shall be kept alive to the extent of the paid up sum assured” - vide section 113(2) of the Insurance Act, 1938.

In order to keep a life insurance policy “in force” the policy holder is required to pay premiums when due (either monthly/quarterly/annual/bi-annual). If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as “grace period”. If the policy holder does not make the payment within the grace period, the policy gets “lapsed”. Thus, a payment within the grace period is deemed to be a payment on the due date.

Lapsation affects all the stakeholders – the policy holder, agents and the insurer. A lapsed policy ceases to provide insurance protection to the insured. It forfeits the benefits under the policy and cost of new policy is higher. Agents do not get renewal premium commission if the policy is lapsed.

The terms and conditions of the policy stipulate, that where the premium is not paid within the grace period, the policy lapses but may be revived during the life time of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy and that it would be better to take out a fresh policy.

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS, wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor: The primary objective of the audit is to check and confirm that due dates are recorded and monitored properly and polices are marked as “lapsed” on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.

6. Policy Surrender: Surrender of an insurance policy refers to the voluntary termination of the insurance contract before the expiry of the term of the contract. The process of surrender is initiated by the policy holder. A policy becomes eligible for surrender on completion of 3 years from the commencement of the policy provided that 3 years premium have been paid within the due dates. The policy holder has to submit surrender request form duly signed off by him at branch/processing centre along with the original policy document and the discharge voucher. Eligibility for surrender is mentioned in the policy document. The policy can be surrendered only when the insured person is alive.
Role of Auditor: The primary objective of the audit is to check and confirm that surrender requests are received from the policy holder only, and that adequate controls are in place to ensure proper verification process for checking of request, whether premiums are paid on regular basis. Check whether surrender amount is paid only to the policy holder and is paid only as per terms and conditions mentioned in the policy document and appropriate accounting entries are passed.

7. Premium Collection, Accounting and reconciliation:

Premium accounting refers to recognizing the premium earned by the insurer as income in the accounting system.

Income is recognized as:

1. New business premium – premium received for the first policy year and
2. Renewal premium – premium received for subsequent policy years.

Premium received but not identifiable against any policy would be treated as ‘unallocated premium’/ ‘suspense amount’.

Further following points should be noted while recognizing the premium:

1. When the new policy is issued by the Insurer, new business premium is recognised on the realisation of premium. Generally, Policy is underwritten only after the receipt of the first premium. However, in certain cases, policies are issued awaiting realisation of premiums, for eg policies are issued subject to realisation of cheques issued by the Insured. Auditors are required to check these cases and ensure proper accounting of the same.

2. Renewal income is recognized (1) on realization of the premium amount or (2) when premium is due but not received up to the end of grace period.

3. Auditors should also evaluate various sub-processes, employed by the Insurance Companies in accounting of premiums like collection of premium from the policy holders, booking of premium, banking, accounting and reconciliation of the same.

Following are the certain illustrative points, Auditors are required to follow during the Audit of Accounting of Premiums:

1. Collection of Premium:
   - Check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.
   - Check that there is appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis.

2. Calculation of Premium:
   - Check that Accounting system, employed by the Company, calculates premium amounts and its respective due dates correctly.
Check that system employed as such is equipped to calculate all types of premium modes correctly.

3. Recognition of Income:
   - Check that premium is recognised only on the basis of ‘Issued Policies’ and not on underwriting dates.
   - Check that there is inbuilt mechanism the system all the premium collected are correctly allocated all various components of the Policies.
   - Check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified/ followed up.

4. Accounting of ‘Advance Premium’:
   - Check, whether system has capability to identify regular and advance premium.
   - Check whether there is a process of applying advance premium to a contract when premium is due.

5. Reporting of Premium figures to IRDA/ Management:
   - Check the methodology for generation of MIS from the system and there is no manual intervention.
   - Check the procedure for Maker/ Checker before finalising the MIS.
   - Check whether there is a reconciliation process between premium Income as per financials and as reported.

6. Other Areas:
   - Check whether there are appropriate SOPs developed by the Companies and are strictly followed by all the departments/ branches of the Company.
   - Ensure duly approved Delegation of Authority parameters matrix already in place for authorisation limits.
   - Premium recognition and refund of premium are independent processes with adequate segregation of duties amongst the personnel.
   - Check that the Company conducts premium reconciliation on daily basis.
   - Check the robustness of interface between administration and accounting system.


8. Claims: Checking of accuracy of processing and accounting of claims lodged with the Insurer, is the primary objective of Audit of Life Insurance Companies.
Claims review primarily ensure focus on the following areas:

- Claims lodgement and processing
- Authority matrix for approval of claims
- Review of payouts and disbursements
- Review of Reinsurance recovery process
- Review of reporting of claims (life & health) and benefits paid.

Following are the certain illustrative points, Auditors are required to follow during the Audit of Claims:

1. Auditor should review the standard policy document template to ensure that the policy document prescribes the minimum documentary evidence needed to support a claim.
2. Ensure that the Insurer maintains a register or record of claims, in which every claims are entered along with the date of the claim and date on which the claim was discharged.
3. In case the claims are rejected, the reasons for the rejections should be closely reviewed.
4. Check whether all claims received are registered and enter into the system.
5. It should be ensured that there is a system of collecting appropriate KYC documents, as required, and discrepancies, if any, are intimated to the policyholders within 15 days of intimation.
6. It should be ensured that all the processed claims are accounted into the system properly.
7. It should be ensured that appropriate provisioning has been carried out, in the cases of all the claims intimated but not paid.
8. It should be ensured that Claims cost includes the Claims settlement Cost.
9. In case of living/survival/maturity/annuity benefits it should be ensured that liability is automatically triggered.

Claims payouts would include a wide variety of customer benefits including:
- Death Claims
- Maturity Claims
- Annuities
- Health Claims
- Rider Claims
- Policy surrenders
- Other Survival benefits.
10. It should be ensured that there is system of regular reconciliation is carried out between claims management system and General ledger.

11. Liability of claims should be booked net of reinsurance.

9. Investments: The Investment portfolio of Life Insurance companies comprise of Shareholders’ funds and Policyholders’ funds. Policyholders’ funds can further be segregated as linked and non-linked. Investment regulations are however prescribed separately for the following investment categories:

- i. Linked Funds
- ii. Pension and Annuity Funds
- iii. Controlled Funds

As Insurers essentially manage the funds for policyholders it becomes imperative for the insurer to have adequate systems and processes that should not only ensure robust internal controls, financial transparency and equity but also bring effective governance so as to serve the interests of the management, stakeholders, consumers and the society, at large.

IRDA (Investment) regulations, 2000 gives details of the pattern in which Funds of the Life Insurance business, should be kept invested at any given point of time.

The overall functioning of the Investment function should include the following independent functions:
- Investments front office / dealing desk
- Investments mid office – Compliance, Risk Management, Reporting, Reconciliations
- Treasury – Cash Management, Deal settlement, Broker empanelment, Custody
- Investment accounting – Fund accounting, NAV computation and declaration.

Role of Auditor: The Auditor during his review of Investment Department should mainly consider the following:

- Review the Investment management structure to ensure adequate segregation of duties between Investment Front office, Mid Office and Back office
- Review of insurer’s Standard Operating Procedures which are prescribed by the IRDA Regulations and are required to cover the entire gamut of investment related processes and policies
- Review of insurer’s Investment policy
- Review of functioning and scope and minutes of Investment Committee
- Compliance of all Investment regulations, various other circulars specified by IRDA and other
regulations specified in the Insurance Act, 1938

Review of insurer’s Disaster Recovery, Backup and Contingency Plan

Review of access Controls, authorization process for Orders and Deal execution, etc

Review of insurer’s Cash Management System to track funds available for Investment considering the settlement obligations and subscription and redemption of units, etc. The system should be validated not to accept any commitment beyond availability of funds and restrict Short Sales at the time of placing the order. Further insurer’s system should be able to determine the amount of Investible surplus

Ensure that the system is be able to automatically monitor various Regulatory limits on Exposure and Rating of debt instruments

Review of fund wise reconciliation with Investment Accounts, Bank, and Custodian records

Ensure that there is split between Shareholders’ and Policyholders’ funds, and earmarking of securities between various funds namely Life (Participating & Non-Participating), Pension & Group (Participating & Non-Participating) and Unit Linked Fund

Review the arrangements and reconciliations of holdings with the insurer’s custodian

Review and check insurer’s Investment Accounting and valuation policy and the controls around this process

insurer’s risk management policies and processes to manage investment risk such as Market risk, Liquidity risk, Settlement risks, etc

Determine the extent of activities outsourced and the controls over such activities

Controls over NAV computation and declaration

Controls over various system interfaces such as Seamless integration of data, between front office and back office, in the Investments accounting system

Flow of data from PMS to the Investment Accounting system

Controls around personal dealings, insider trading and front running.

10. Operating Expenses related to Insurance Business (Expenses of Management): All the administrative expenses in an insurance company are broadly classified under 14 heads as mentioned in Schedule 3 forming part of Financial Statements given under Schedule A to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2002. In so far as financial statements are concerned, this Schedule is part of the Revenue Account to be prepared for insurance business. Any other expenses are required to be disclosed under the head ‘Others’. Any major expenses (₹5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.

Role of Auditor: The auditor should ensure that these expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. The accounting policy should clearly indicate the basis of apportionment of these expenses to the
respective Revenue Accounts (i.e., Participating and Non-participating policies and in between Linked and Non-Linked business) along with the certificate that all expenses of management, wherever incurred, directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses.

11. Legal and Professional Charges: As far as legal and professional charges are concerned, attention is drawn to the head ‘Claims Incurred’ under Schedule 2 where it is clearly stated that fees, legal and other expenses should form part of claim cost, and therefore, are not to be included under the head Legal and Professional Charges.

Role of Auditor: The auditor should ensure that all other expenses which are not covered under the claims cost are required to be included under this head.

12. Employees’ Remuneration and Welfare Benefits: The employees’ remuneration includes all kinds of payments made to employees in consideration of their services. The reimbursement of medical expenses or premium in respect of employees’ health cover is covered under the employees’ remuneration and welfare. Any medical fees incurred towards maintenance of health care policies (which are not for employees) are required to be debited to the claims cost under the health care and not to be included under this head. Any expenses towards medical treatment of employees incurred by the company should also be included under this head. Non-training expenses have to be shown separately.

Role of Auditor: The auditor is required to ensure the compliance of above.

13. Interest and Bank Charges: All expenses incurred towards maintenance of Bank Account, interest and other charges levied by bankers to the normal course of business other than bank expenses relating to investments (interest, bank charges, custodial charges, etc.) are shown under the head, “Interest and Bank Charges”. Any other interest charged on the borrowings which could not form part of the Revenue Account not to be included under this head.

14. Depreciation: Charging of depreciation is governed by Schedule II to the Companies Act, 2013. In addition, compliance of relevant Accounting Standard is also to be taken care.

15. Interest, Dividend and Rent: An insurance enterprise, like any other, earns interest dividend and rent through its assets. The interest, dividend and rent earned are to be apportioned between Revenue Account and Profit and Loss Account.

The Regulations require that basis of allocation of interest, dividend and rent between the Revenue Account and Profit and Loss Account should be clearly indicated in the company’s accounting policy.

The interest or dividend earned as against the policyholders’ funds is required to be apportioned to the Revenue Account. The interest earned on, say, grant of vehicle loans, housing loans, deposits with banks of the shareholders, funds, rent received on let out properties owned by the company, by way of investments shareholders, funds, etc. are required to be shown under the profit and Loss Account.
9. SPECIFIC CONTROL PROCEDURES RELATED TO AUDIT OF GENERAL INSURANCE COMPANY

The system of recording, classifying and summarising the transactions in insurance companies, is, in substance, no different from other entities. However, in case of insurance companies, the ledger accounts specially those of premiums, claims, commissions, etc. need to be given greater attention. The functions of accounting system in general insurance business under IT environment may be based on:

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Every insurer, in respect of insurance business transacted and in respect of shareholder’s funds, is required to prepare a Balance Sheet, a Profit and Loss Account (in respect of transactions of the shareholders, in their capacity as shareholders), a separate Account of Receipts and Payments, a Revenue Account (in respect of transactions with policy holders on account of insurance) for each year in accordance with the Regulations as may be specified. Every insurer should keep separate accounts relating to funds of shareholders and policyholders.

9.1 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

1. Applicability of Accounting Standards - 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:

<table>
<thead>
<tr>
<th>Accounting Standard 3 (AS 3) – Cash Flow Statements – Cash Flow Statement shall be prepared only under the Direct Method.</th>
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<tbody>
<tr>
<td>Accounting Standard 13 (AS 13) – Accounting for Investments, shall not be applicable.</td>
</tr>
<tr>
<td>Accounting Standard 17 (AS 17) - Segment Reporting – shall apply irrespective of whether the securities of the insurer are traded publicly or not.</td>
</tr>
</tbody>
</table>

2. Premium – Premium shall be recognised as income over the contract period or the period of risk, whichever is appropriate. Unearned premium as well as premium received in advance, both of which represent premium income not relating to the current accounting period, shall be disclosed separately in the financial statements.

A reserve for Unearned Premium, may be created as the amount representing that part of the premium written which is attributable and to be allocated to the succeeding accounting periods.

Premium Received in Advance, which represents premium received prior to the commencement of the risk, shall be shown separately under the head ‘Current Liabilities’ in the financial statements.

Unearned premium shall be shown separately under the head ‘Current Liabilities’ and appropriate disclosures regarding management’s basis of assessment shall be made in the financial statements.
Premium received in advance shall not be included in the unearned premium and shall be shown separately.

Premium revenue recognition is based on the pattern of risk to which the insurer is exposed. An insurer, based on past experience can reliably estimate the pattern of risk for a particular type of insurance business. Most insurers bring premium revenue to account on the basis of the passage of time. This is generally appropriate where the risk of events occurring that give rise to claims is more or less uniform throughout the policy period subject to any regulatory prescription in this regard.

For some classes of insurance, it is usual for the premium to be adjusted as a result of events and information that becomes known during or after the policy period, e.g. marine cargo. Further, in some cases, risk pattern may not be evenly spread over the period of insurance because of the very nature of the risk covered e.g. some infrastructure projects involving varying degrees of risk factors. A deposit premium is paid in such cases at the beginning of the policy period and subsequently adjusted. The basis of determination of premium earned shall be adequately justified, preferably supported by external evidence such as by certification from an actuary and/or other technical experts. Adequate disclosure of such basis shall be made.

3. **Premium Deficiency**—Premium deficiency shall be recognised if the sum of expected claim costs, related expenses and maintenance costs exceeds related unearned premiums.

For contracts exceeding four years, once a premium deficiency has occurred, future changes to the liability shall be based on actuarial/technical evaluation.

4. **Acquisition Costs**—Acquisition costs, if any, shall be expensed in the period in which they are incurred. Acquisition costs are those costs that vary with, and are primarily related to, the acquisition of new and renewal insurance contracts. The most essential test is the obligatory relationship between costs and the execution of insurance contracts (i.e. commencement of risk).

5. **Claims**—The components of the ultimate cost of claims to an insurer comprise the claims under policies and claims settlement costs. Claims under policies comprise the claims made for losses incurred, and those estimated or anticipated under the policies.

A liability for outstanding claims shall be brought to account in respect of both direct business and inward reinsurance business. The liability shall include:

(a) Future payments in relation to unpaid reported claims;

(b) Claims Incurred But Not Reported (IBNR) including inadequate reserves (sometimes referred to as Claims Incurred But Not Enough Reported (IBNER)).

which will result in future cash/asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liability for outstanding claims in respect of claims under policies whether due or intimated at the beginning and at the end of the financial period. The accounting estimate shall also include claims cost adjusted for estimated salvage value if there is sufficient degree of certainty of its realisation.
**Actuarial Valuation of claim liability - in some cases:** Estimate of claims made in respect of contracts exceeding four years shall be recognised on an actuarial basis, subject to regulations that may be prescribed by the Authority. In such cases, certificate from a recognised actuary as to the fairness of liability assessment must be obtained. Actuarial assumptions shall be suitably disclosed by way of notes to the account.

Necessary provision for unexpired risk shall be made subject to any minimum, statutorily required.

6. **Procedure to determine the value of investments** - An insurer shall determine the values of investments in the following manner:-

| a) | **Real Estate – Investment Property**- Investment Property shall be measured at historical cost less accumulated depreciation and impairment loss, residual value being considered zero and no revaluation being permissible.  
|    | The Insurer shall assess at each balance sheet date whether any impairment of the investment property has occurred.  
|    | An impairment loss shall be recognised as an expense in the Revenue/Profit and Loss Account immediately.  
|    | Fair value as at the balance sheet date and the basis of its determination shall be disclosed in the financial statements as additional information. |
| b) | **Debt Securities**-Debt securities including government securities and redeemable preference shares shall be considered as “held to maturity” securities and shall be measured at historical cost subject to amortisation. |
| c) | **Equity Securities and Derivative Instruments that are traded in active markets**-Listed equity securities and derivative instruments that are traded in active markets shall be measured at fair value as at the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price of the stock exchanges where the securities are listed shall be taken.  
|    | The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.  
|    | An active market shall mean a market, where the securities traded are homogenous, availability of willing buyers and willing sellers is normal and the prices are publicly available.  
|    | Unrealised gains/losses arising due to changes in the fair value of listed equity shares and derivative instruments shall be taken to equity under the head ‘Fair Value Change Account’ and on realisation reported in Profit and Loss Account. The ‘Profit on sale of investments’ or ‘Loss on sale of investments’, as the case may be, shall include accumulated changes in the fair value previously recognised in equity under the heading Fair Value Change Account in respect of a particular security and being recycled to Profit and Loss Account on actual sale of that listed security.  
|    | For the removal of doubt, it is clarified that balance or any part thereof shall not be available |
for distribution as dividends. Also, any debit balance in the said Fair Value Change Account shall be reduced from the profits/free reserves while declaring dividends.

The insurer shall assess, at each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognised as an expense in Revenue/Profit and Loss Account to the extent of the difference between the remeasured fair value of the security/investment and its acquisition cost as reduced by any previous impairment loss recognised as expense in Revenue/Profit and Loss Account. Any reversal of impairment loss, earlier recognised in Revenue/Profit and Loss Account shall be recognised in Revenue/Profit and Loss Account.

d) **Unlisted and other than actively traded Equity Securities and Derivative Instruments** -

Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active market will be measured at historical costs. Provision shall be made for diminution in value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

For the purposes of this regulation, a security shall be considered as being not actively traded, if its trading volume does not exceed ten thousand units in any trading session during the last twelve months.

7. **Loans** -- Loans shall be measured at historical cost subject to impairment provisions.

The insurer shall assess the quality of its loan assets and shall provide for impairment. The impairment provision shall not be less than the aggregate amount of loans which are subject to defaults of the nature mentioned below:

- (i) interest remaining unpaid for over a period of six months; and
- (ii) instalment(s) of loan falling due and remaining unpaid during the last six months.

8. **Catastrophe Reserve** - 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.

It is clarified that this reserve is towards meeting losses which might arise due to 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 in force.

### PART II: Disclosures forming part of Financial Statements

A. The following shall be disclosed by way of notes to the Balance Sheet:

1. Contingent Liabilities:
2. Encumbrances to assets of the company in and outside India.
4. Claims, less reinsurance, paid to claimants in/ outside India.
5. Actuarial assumptions for claim liabilities in the case of policies exceeding four years.
6. Ageing of claims – distinguishing between claims outstanding for more than six months and other claims.
7. Premiums, less reinsurance, written from business in/ outside India.
8. Extent of premium income recognised, based on varying risk pattern, category wise, with basis and justification therefor, including whether reliance has been placed on external evidence.
9. Value of contracts in relation to investments, for:

10. Operating expenses relating to insurance business: basis of allocation of expenditure to various classes of business.
11. Historical costs of those investments valued on fair value basis.
14. (a) Unrealised gain/losses arising due to changes in the fair value of listed equity shares and derivative instruments are to be taken to equity under the head ‘Fair Value Change Account’ and on realisation reported in profit and loss Account.
   (b) Pending realisation, the credit balance in the ‘Fair Value Change Account’ is not available for distribution.
15. Fair value of investment property and the basis therefor.
16. Claims settled and remaining outstanding for a period of more than six months on the balance sheet date.

**B. The following accounting policies shall form an integral part of the financial statements:**

All significant accounting policies in terms of the accounting standards issued by the ICAI, and significant principles and policies given in Part I of Accounting Principles. Any other accounting policies followed by the insurer shall be stated in the manner required under Accounting Standard AS 1 issued by ICAI.

Any departure from the accounting policies as aforesaid shall be separately disclosed with reasons for such departure.

**C. The following information shall also be disclosed:**

1. Investments made in accordance with any statutory requirement should be disclosed separately together with its amount, nature, security and any special rights in and outside India.

2. Segregation into performing/ non performing investments for purpose of income recognition as per the directions, if any, issued by the Authority.


4. A summary of financial statements for the last five years, in the manner as may be prescribed by the Authority.

5. Accounting Ratios as may be prescribed by the Authority.


**PART III: General Instructions for Preparation of Financial Statements**

1. The corresponding amounts for the immediately preceding financial year for all items shown in the Balance Sheet, Revenue Account and Profit and Loss Account should be given.

2. The figures in the financial statements may be rounded off to the nearest thousands.

3. Interest, dividends and rentals receivable in connection with an investment should be stated as gross value, the amount of income tax deducted at source being included under 'advance taxes paid'.

4. Income from rent shall not include any notional rent.

5. (I) For the purposes of financial statements, unless the context otherwise requires -
(a) the expression ‘provision’ shall, subject to note II below mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability or loss of which the amount cannot be determined with substantial accuracy;

(b) the expression "reserve" shall not, subject to as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;

(c) the expression capital reserve shall not include any amount regarded as free for distribution through the profit and loss account; and the expression "revenue reserve" shall mean any reserve other than a capital reserve;

(d) The expression "liability" shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

(II) Where:

(a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or

(b) any amount retained by way of providing for any known liability is in excess of the amount which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated for the purposes of these accounts as a reserve and not as a provision.

6. The company should make provisions for damages under lawsuits where the management is of the opinion that the award may go against the insurer.

7. Risks assumed in excess of the statutory provisions, if any, shall be separately disclosed indicating the amount of premiums involved and the amount of risks covered. The auditor shall, however, make an appropriate qualification in this regard in his report.

8. 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 IV: CONTENTS OF MANAGEMENT REPORT**

There shall be attached to the financial statements, a management report containing, *inter alia*, the following duly authenticated by the management:

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<td>1.</td>
<td>Confirmation regarding the continued validity of the registration granted by the Authority;</td>
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<td>2.</td>
<td>Certification that all the dues payable to the statutory authorities have been duly paid;</td>
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<td>3.</td>
<td>Confirmation to the effect that the shareholding pattern and any transfer of shares during the year are in accordance with the statutory or regulatory requirements;</td>
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<td>4.</td>
<td>Declaration that the management has not directly or indirectly invested outside India the</td>
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funds of the holders of policies issued in India;

5. Confirmation that the required solvency margins have been maintained;

6. Certification to the effect that the values of all the assets have been reviewed on the date of the Balance Sheet and that in his (insurer’s) belief the assets set forth in the Balance-sheets are shown in the aggregate at amounts not exceeding their realisable or market value under the several headings – “Loans”, “Investments”, “Agents balances”, “Outstanding Premiums”, “Interest, Dividends and Rents outstanding”, “Interest, Dividends and Rents accruing but not due”, “Amounts due from other persons or Bodies carrying on insurance business”, “Sundry Debtors”, “Bills Receivable”, “Cash” and the several items specified under “Other Accounts”;

7. Certification to the effect that no part of the life insurance fund has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investment of the life insurance funds;

8. Disclosure with regard to the overall risk exposure and strategy adopted to mitigate the same;

9. Operations in other countries, if any, with a separate statement giving the management’s estimate of country risk and exposure risk and the hedging strategy adopted;

10. Ageing of claims indicating the trends in average claim settlement time during the preceding five years;

11. Certification to the effect as to how the values, as shown in the balance sheet, of the investments and stocks and shares have been arrived at, and how the market value thereof has been ascertained for the purpose of comparison with the values so shown;

12. Review of asset quality and performance of investment in terms of portfolios, i.e., separately in terms of real estate, loans, investments, etc.

13. A responsibility statement indicating therein that:
   (i) in the preparation of financial statements, the applicable accounting standards, principles and policies have been followed along with proper explanations relating to material departures, if any;
   (ii) the management has adopted accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the operating profit or loss and of the profit or loss of the company for the year;
   (iii) the management has taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the applicable provisions of the Insurance Act 1938 (4 of 1938) / Companies Act, 1956 (1 of 1956), for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
   (iv) the management has prepared the financial statements on a going concern basis;
(v) the management has ensured that an internal audit system commensurate with the size and nature of the business exists and is operating effectively.

PART V: Preparation of Financial Statements

(1) An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit. It may be noted that an insurer shall prepare Revenue Account separately for fire, marine, and miscellaneous insurance business.

(2) An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 – “Cash Flow Statement” issued by the ICAI.

9.2 Audit of Accounts of General Insurance Business

The internal control functions have been categorised below under main operational cycles considering the nature of general insurance business. Areas where the internal controls are similar to the ones adopted by other companies such as for cash and bank receipts and payments and fixed assets, have been dealt in the Internal Control Questionnaire, published by the Institute of Chartered Accountants of India. Since various operational cycles are inter-linked, the internal controls operating within the systems of such cycles should be reviewed simultaneously.

Audit Procedures: The important part of the business operations of general insurance companies comprises the issuance of policies for risks assumed and to indemnify the insured for losses to the extent covered by such policies. In financial terms, these operations get translated into the receipt and recording of premiums and the recording and settlement of claims. Both premiums and claims have a significant impact on the insurance companies’ revenues, it would be an important part of the duty of the auditor to satisfy himself that the financial transactions involving both these operations have been fairly and properly recorded in the relevant books of account. The auditor should also ensure that the legal requirements as to the disclosure of these items are complied with in the financial statements.

1. Premium: 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 objectives of internal controls over premium is to ensure that correct premium is calculated and collected before acceptance of any risk, that premium is accounted for in an appropriate manner and that the premium is collected only in respect of such risks which are assumed by the company.

No Risk Assumption without Premium – 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 unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and
until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner.

**Premium Revenue Recognition:**

According to the IRDA (Preparations & Presentations of the Financial Statements & Auditor's Report), Regulations 2000, Premium Revenue Recognition is based on the pattern of Risk to which the insurer is exposed. These Regulations envisage that an Insurer based on the past experience, can reliably estimate the pattern of Risk for a particular type of business.

**Verification of Premiums** – Verification of premium is of utmost importance to an auditor. The auditor should apply, inter alia, the following procedures for verification of premium –

Insurance premium is collected upon issuing policies. It is the consideration for bearing the risk by the insurance company. The assumption of the risk starts on the issue of a policy document or any equivalent document that evidences risk has been accepted by the company on the acceptance of proposal form or cover note by the respective underwriting department. This receipt is recorded as the premium income in the books of the insurance company only when the risk is accepted by the company. Money received against which the company has not issued a policy document, cover note or any other document that evidences acceptance of risk is recorded as a liability. It is recorded as premium income only after the company has accepted risk. Premium may be accepted either in cash/cheque/Demand Draft/pay order, bank guarantee, cash deposit, etc. The premium collections are credited to a separate bank account. As per the policy of the insurance company, the collections are transferred to the Regional Office or Head Office. As soon as the insurance policy is issued, an entry is made in the Register of Policies showing all the relevant details.

**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 unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance 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.

**Verification of Premiums** - Verification of premium is of utmost importance to an auditor. The auditor should apply, inter alia, the following procedures for verification of premium –

| (i) | Before commencing verification of premium income, the auditor should look into the internal controls and compliance thereof as laid down for collection and recording of the premiums. |
| (ii) | The auditor should broadly review the systems used by the company to collect money, underwrite and issue the policy. |
| (iii) | The auditor should ascertain that all the cover notes relating to the risks assumed have been serially numbered for each class of business. The auditor should also verify that there is an |
adequate internal check on the issue of stationery comprising of cover notes, policy documents, stamps, etc. The auditor may apply sampling techniques for verification of larger volume of transactions.

(iv) The auditor should ensure that premium in respect of risks incepting during the relevant accounting year has been accounted as premium income of that year on the basis of premium revenue recognition. The auditor, as part of his audit procedures, should make an assessment of the reasonability of the risk pattern established by the management. The auditor should also see whether 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. Normally, such instances relate to the issue of cover notes and certificates at the end of the accounting year relating to risks commencing in the next accounting period. Generally, there is a column in the Premium Register called “Commencement of Risk”, indicating the date and time from which the risk under the policy issued has commenced. The auditor should verify that policy documents have not been issued, in case:

(a) premium had not been collected at all;
(b) premium had been collected but the relevant cheques have been dishonoured; (refer Cheque Dishonoured Book);
(c) premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);
(d) premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); and
(e) instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 per cent of the total premium payable by instalments).

(v) The auditor should examine whether the reinsurance company is not under a risk in respect of amount lying at credit and outstanding as at the year-end in the following accounts:
(vi) The auditor should 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. The auditor should also check that the premium has been recorded originally at the gross figure, i.e., without providing for unexpired risks and reinsurances.

(vii) In case of co-insurance business, where the company is not the leader, because of the non-availability of the relevant information in many cases the premium is not booked even though the risk has commenced during the relevant accounting year. The auditor should see that the company’s share of the premium has been accounted for on the basis of the available information on nature of risk and the provisional premium charged by the leading insurer. The auditor should examine the communications issued to the company by the leading insurers advising them of the company’s share of premium income. Such communications should be seen even in respect of the post-audit period. Where the company is the leader, the auditor should obtain a reasonable assurance that only the company’s own share of premium has been shown as income and accounts of the other companies have been credited with their share of the premium collected.

(viii) The auditor should check whether Premium Registers have been maintained chronologically, for each underwriting department, giving full particulars including service tax charged as per acceptance advice on a day-to-day basis. The auditor should verify whether the figures of premium mentioned in the register tally with those in General Ledger.

(xi) Where policies have been issued with a provision to collect premium periodically (i.e., under instalment clause, special declaration policy or periodical declaration under open policies in marine insurance), the auditor should check whether premium are collected as and when they become due.

(x) The auditor should verify whether instalments falling due on or before the balance sheet date, whether received or not, have been accounted for as premium income as for the year under audit. Also examine whether instalments of premium falling due in the subsequent year have not been recognised in the accounts as outstanding premium.

(xi) The auditor should verify the year end transactions to check that amounts received during the year in respect of risks commencing/ instalments falling due on or after the first day of next financial year are not credited to premium account but credited to Premium Received in Advance Account.

(xii) The auditor should verify the collections remitted by agents immediately after the cut-off date to verify the risk assumed during the year under audit on those collections.

(xiii) The auditor should also check that in case of cancellation of policies/cover notes issued, no risk has been assumed between the date of issue and subsequent cancellation thereof.

(xiv) Where premium originally received has been refunded, the auditor should verify whether the agency commission paid on such premium has been recovered.
The auditor should verify whether GST has been charged from the insured, at the rates in force, on the total premium for all classes of business other than those exempted under service tax laws. Check whether GST so collected is disclosed under ‘Current Liabilities’ to the extent not deposited in Government’s Account.

In the case of co-insurance business, the auditor should verify whether GST at the rates in force, based on the place of business and place of delivery on the whole premium has been charged or collected from the insured by the company in case it is the leader. Check that GST/service tax so collected on premium charged from the insured by the company have been regularly deposited in the Government’s Account.

The auditor should also check that money collected by the agents from the policyholders have been received by the company as quickly as possible.

2. Claims: A demand for payment of policy benefit because of the occurrence of an insured event is known as ‘claim’. Claims in general insurance business are primarily in the nature of indemnity i.e re-imbursing the loss incurred to the policy holder. Cost of claims to the company includes all the expenses incurred in settlement of claims. Internal controls are established over claims to ensure that only bonafide claims are paid and that claims paid do not exceed the value of loss incurred and/or do not exceed the sum insured. Cost of claims are properly recorded and disclosed in the financial statements.

The components of the cost of claims to an insurer comprise the claims under policies and claim settlement costs. Claims under policies comprise the claims paid for losses incurred, and those estimated or anticipated claims pending settlements under the policies. Settlement cost of claims includes surveyor fee, legal expenses, etc. A liability for outstanding claims should be brought to account on the following:

(i) Direct Business; (ii) Inward Reinsurance Business; and (iii) Co-Insurance business

The liability includes future payments in relation to unpaid reported claims and claims incurred but not reported including inadequate reserves which would result in future cash or asset outgo for settling liabilities against those claims. Change in estimated liability represents the difference between the estimated liabilities for outstanding claims in respect of claims under policies, whether due or intimated at the beginning and at the end of the financial period. The accounting estimate also includes claims cost adjusted for salvage value if there is sufficient degree of certainty of its realisation.
Registers and Records - The following register and records are generally prepared in respect of claims:

(i) Claims Intimation Register;
(ii) Claims Paid Register;
(iii) Claims Disbursement Bank Book;
(iv) Claims Dockets, normally containing the following records:
    Claim intimation, claim form, particulars of policy, survey report, Photograph showing
damage, repairer’s bills, letter of subrogation, police report, fire service report, claim
settlement note, claim satisfaction note, salvage report, salvage disposal note, claims
discharge voucher, etc.;
(v) Report of quality assurance team; and
(vi) Salvage register.

The Claim Account is debited with all the payments including repair charges, fire fighting expenses,
police report fees, survey fees, amount decreed by the Courts, travel expenses, photograph charges,
etc. The provision for claims incurred but not reported is not made at Branch/Divisional Office level
but at the Head Office level.

Verification of Claims

Claims Provisions - The auditor should obtain from the divisions/branches, the information for each
class of business, categorizing the claims value-wise before commencing verification of the claims
provisions, so that appropriate statistical sampling techniques may be applied, to ensure that
representative volume of claims is verified for each class of business. The auditor should determine
the total number of documents to be checked giving due importance to claim provisions of higher
value.

The outstanding liability at the year-end is determined at the divisions/branches where the liability
originates for outstanding claims. Thereafter, based on the total consolidated figure for all the
divisions/branches, the Head Office considers a further provision in respect of outstanding claims.
The auditor should satisfy himself that the estimated liability provided for by the management is
adequate with reference to the relevant claim files/dockets, keeping in view the following:

(i) that provision has been made for all unsettled claims as at the year-end on the basis of
claims lodged/communicated by the parties against the company. The date of loss (and not
the date of communication thereof) is important for recording/recognizing the claim as
attributable to a particular year.

(ii) Insurance companies normally have an ‘initial provision’ or ‘default provision’ based on a
pre-determined formula or on a primary assessment of the damage by a surveyor. The
auditor would need to review the pre-determined formula to ensure that initial reserving
made is adequate.
In certain circumstances, the claims are incurred by the insurance company but are not reported at the balance sheet date by the insured. Such claims are known as claims incurred but not reported (IBNR). The auditor should check the records for subsequent periods to ascertain that adequate provision has been created for such claims also.

(iii) that provision has been made for only such claims for which the company is legally liable, considering particularly, (a) that the risk was covered by the policy, if in force, and the claims arose during the currency of the policy; and (b) that claim did not arise during the period the company was not supposed to cover the risk, e.g., where the premium was not paid or where cheques covering premium have been dishonoured (refer section 64VB of the Insurance Act, 1938) or where a total loss under a policy has already been met/settled.

(iv) that the provision made is normally not in excess of the amount insured except in some categories of claims where matters may be sub-judice in legal proceedings which will determine the quantum of claim, the amount of provision should also include survey fee and other direct expenses.

(v) that in determining the amount of provision, events after the balance sheet date have been considered, e.g., (a) claims settled for a materially higher/lower amount in the post-audit period; (b) claims paid by other insurance companies during the year under audit and communicated to company after the balance sheet date where other companies are the leaders in co-insurance arrangements; and (c) further reports by surveyors or assessors & (d), re-insurance cover available is considered.

(vi) that the claims status reports recommended to be prepared by the Divisional Manager on large claims outstanding at the year-end have been reviewed with the contents of relevant files or dockets for determining excess/short provisions. The said report should be complete as to material facts to enable the auditor to take a fair view of the provision made.

(vii) that in determining the amount of provision, the ‘average clause’ has been applied in case of under-insurance by parties.

(viii) that the provision made is net of payments made ‘on account’ to the parties wherever such payments have been booked to claims.

(ix) that in case of co-insurance arrangements, the company has made provisions only in respect of its own share of anticipated liability.

(x) that wherever an unduly long time has elapsed after the filing of the claim and there has been no further communication and no litigation or arbitration dispute is involved, the reasons for carrying the provision have been ascertained.

(xi) that wherever legal advice has been sought or the claim is under litigation, the provision is made according to the legal advisor’s view and differences, if any, are explained.

(xii) that in the case of amounts purely in the nature of deposits with courts or other authorities, adequate provision is made and deposits are stated separately as assets and provisions are
not made net of such deposits.

(xiii) that no contingent liability is carried in respect of any claim intimated in respect of policies issued.

(xiv) that the claims are provided for net of estimated salvage, wherever applicable.

(xv) that intimation of loss is received within a reasonable time and reasons for undue delay in intimation are looked into.

(xvi) that provisions have been retained as at the yearend in respect of guarantees given by company to various Courts for claims under litigation.

(xvii) that due provision has been made in respect of claims lodged at any office of the company other than the one from where the policy was taken, e.g., a vehicle insured at Mumbai having met with an accident at Chennai necessitating claim intimation at one of the offices of the company at Chennai.

In cases of material differences in the liability estimated by the management and that which ought to be provided in the opinion of the auditor, the same must be brought out in the auditor’s report after obtaining further information or explanation from the management. For determining the adequacy of the provisions in respect of any category of business, the auditor may resort to the method of testing the actual payments, wherever made, with the provisions made earlier for that category of business. Whether such liability has been estimated in the past on a fair and realistic basis can, thus, be examined by looking into current year’s payments against provisions of the earlier year.

Claims Paid - The auditor may determine the extent of checking of claims paid on the same line as suggested for outstanding claims. Other aspects in respect of claims paid to be examined by the auditors are as follows:

(i) that in case of co-insurance arrangements, claims paid have been booked only in respect of company’s share and the balance has been debited to other insurance companies;

(ii) that 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. Such 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;

(iii) that the claims payments have been duly sanctioned by the authority concerned and the payments of the amounts are duly acknowledged by the claimants;

(iv) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure;

(v) that the amounts of the nature of pure advances/deposits with Courts, etc., in matters under litigation/arbitration have not been treated as claims paid but are held as assets till final disposal.
of such claims. In such cases, full provision should be made for outstanding claims;

(vi) that payment made against claims partially settled have been duly vouched. In such cases, the sanctioning authority should be the same as the one which has powers in respect of the total claimed amount;

(vii) that in case of final settlement of claims, the claimant has given an unqualified discharge note, not involving the company in any further liability in respect of the claim; and

(viii) that the figures of claims, wherever communicated for the year by the Division to the Head Office for purposes of reinsurance claims, have been reconciled with the trial balance-figure.

(ix) that payments have been made within 30 days of the receipt of the last document received. In case, there are delays, interest on such delays have to be paid as per IRDAI regulations.

(x) that the salvage recovered has been duly accounted for in accordance with the procedure applicable to the company and a letter of subrogation has been obtained in accordance with the laid down procedure.

3. Commission/Brokerage

The commission is the consideration payable for getting the insurance business. The term ‘commission’ is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed ‘Commission on reinsurance accepted’ and is reduced from the amount of commission expenditure. The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules and regulations of the company and in accordance with the agreement with the agent, commission is paid to the agent who brought the business and the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism and provisions of the Insurance Act, 1938 have been complied with.

It is a well-known fact that insurance business is solicited by insurance agents. The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured through them and is debited to Commission on Direct Business Account. There is a separate head for commission on reinsurance accepted which usually arise in case of Head Office. It may be noted that under section 40 of Insurance Act, 1938, no commission can be paid to a person who is not an agent of the insurance company. Commission cannot be paid in excess of the maximum rates of commission as framed by IRDAI. The rates of commission/brokerage are agreed and documented with the agent and filed with IRDAI

Role of Auditor: The auditor should, inter alia, do the following for verification of commission:

| Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI |
| Ensure that commission/brokerage is paid as per rates with the agent and rates filed with IRDAI |
| Ensure that commission/brokerage is paid to the agent/broker who has solicited the business |
Ensure that the agent/broker is not blacklisted by IRDAI and is not terminated for fraud etc.

Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills and commission statements.

Check whether the vouchers are authorised by the officers-in-charge as per rules in force and income tax is deducted at source, as applicable.

Test check correctness of amounts of commission allowed.

Scrutinise agents' ledger and the balances, examine accounts having debit balances, if any, and obtain information on the same. Necessary rectification of accounts and other remedial actions have to be considered.

Check whether commission outgo for the period under audit been duly accounted.

4. Operating Expenses related to Insurance Business (Expenses of Management)

All the administrative expenses in an insurance company are broadly classified under 13 heads as mentioned in Schedule 4 forming part of Financial Statements given under Schedule B to the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002. In so far as financial statements are concerned, this Schedule is part of the Revenue Account to be prepared for insurance business. Any other expenses are required to be disclosed under the head ‘Others’. Any major expenses (₹5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately. Careful reading of the words ‘expenses related to insurance business’ clearly indicate any expenses which do not have any direct relation to insurance business are to be shown separately in the Profit and Loss Account. Expenses relating to investment department, brokerage, bank charges, transfer fees, etc. do not have a direct relationship to the day-to-day working of the insurance business and as such would not be included in the revenue account.

These expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. The accounting policy should clearly indicate the basis of apportionment of these expenses to the respective Revenue Accounts (i.e., fire, marine and miscellaneous) along with the certificate that all expenses of management, wherever incurred, directly or indirectly, read with the accounting policy, have been fully debited to the respective Revenue Account as expenses. Refer to Schedule 4 on Operating Expenses for specific items.

5. Legal and Professional Charges: As far as legal and professional charges are concerned, attention is drawn to the head ‘Claims Incurred’ under Schedule 2 where it is clearly stated that survey fees, legal and other expenses should form part of claim cost, and therefore, are not to be included under the head Legal and Professional Charges. Hence, the auditor should ensure that all other expenses which are not covered under the claims cost are required to be included under this head.
6. Employees’ Remuneration and Welfare Benefits: The employees’ remuneration includes all kinds of payments made to employees in consideration of their services. The reimbursement of medical expenses or premium in respect of employees’ health cover is covered under the employees’ remuneration and welfare. Any medical fees incurred towards maintenance of health care policies (which are not for employees) are required to be debited to the claims cost under the health care and not to be included under this head. Any expenses towards medical treatment of employees incurred by the company should also be included under this head. Non training expenses have to be shown separately. Incentives paid to employees of the company who have solicited insurance policies is also debited in this account and not to the commission account.

7. Interest and Bank charges: All expenses incurred towards maintenance of Bank Account, interest and other charges levied by bankers to the normal course of business other than bank expenses relating to investments (interest, bank charges, custodial charges, etc.) are shown under the head, “Interest and Bank Charges”. Any other interest charged on the borrowings which could not form part of the Revenue Account not to be included under this head.

8. Depreciation: Charging of depreciation is governed by Schedule II to the Companies Act, 2013. In addition, compliance of relevant Accounting Standard is also to be taken care.

9. Interest, Dividend and Rent: Funds received from the policy holders are invested in securities as per the investment pattern specified by IRDAI. Interest income from such investments forms a major part of the income of a general insurance company.

An insurance enterprise, like any other, earns interest dividend and rent through its assets. The interest, dividend and rent earned are to be apportioned between Revenue Account and Profit and Loss Account, based on the nature of investments i.e Policyholders or shareholders. The Regulations require that basis of allocation of interest, dividend and rent between the Revenue Account and Profit and Loss Account should be clearly indicated in the company’s accounting policy. The interest or dividend earned as against the policyholders’ funds is required to be apportioned to the Revenue Account. The interest earned on, say, deposits with banks of the shareholders, funds, rent received on let out properties owned by the company, by way of investments shareholders, funds, etc. are required to be shown under the profit and Loss Account.

10. Underwriting: The underwriting function, which comprises of examination and evaluation of applications for insurance, the rating of risks and the establishment of premiums, is fundamental to the operations of a general insurance company. The prime objectives of an internal control system for underwriting is adherence to guidelines for acceptances of insurance, proper recording of insurance risk and its evaluation.

11. Investments: Insurance Companies make investments apart from earning income, to comply with the relevant statutory requirements and also for meeting any unforeseen contingencies and claims. The regulations issued by the authority from time to time affect the quantum of investments, the nature of assets in which investments are to be made.

Investments by general insurance companies are governed by the provisions of section 27, 27A, 27B, 27C, 27D and 27E of the Insurance Act, 1938 as well as by the guidelines issued from time to
time by the Ministry of Finance through General Insurance Corporation of India.

**Audit Procedures** - The auditor’s primary objective in audit of investments is to satisfy himself as to their existence and valuation. Examination of compliance with statutory and regulatory requirements is also an important objective in audit of investments insofar as non-compliance may have a direct and material effect on the financial statements.

The auditor should verify the investment scrips from the custodian statement, demat account or other equivalent electronic accounts where the balance of securities lie, at the close of business on the date the balance sheet. In exceptional cases where physical verification of investment scrips on the balance sheet date is not possible, the auditor should carry out the verification on a date as near to the balance sheet date as possible. In such a case, he should take into consideration any adjustments for subsequent transactions of purchase, sale, etc.

He should take particular care to see that only genuine investments are produced before him, and that securities held by the insurance company on behalf of others (e.g., those held as security against loans) are not shown to him as the insurance company’s own investments. To ensure this, the auditor should – require that all investment scrips held in the name of the of the insurance company – whether belonging to it or to borrowers should be produced before him simultaneously. Normally, the investments of an insurance company are held by the insurance company itself or a depository (in the case of dematerialised securities other than government securities).

Investments are normally dealt with at the Head Office and not at the branches. However, sometimes, for realisation of interest, etc. and other similar purposes, investments of an insurance company may be held at Branch Offices also. In such cases, the auditor should examine the record maintained at the Head Office to record details of investments held at other locations and request the respective branch auditors to physically verify such investments as a part of their audit. The auditor should obtain a written confirmation to this effect from the branch auditors. In case the verification has been done on a date other than the balance sheet date, a statement showing the reconciliation of the investments held at the time of physical verification with the investments held as on the balance sheet date should also be obtained from the branch auditors. The branch auditors should report whether adequate records are maintained by the branch for the securities held by it on behalf of the Head Office.

Investments should not normally be held by any other person (as laid down in the City Equitable Fire Insurance Co. case). If any investments are so held, proper enquiry should be made to ensure that there is some justification for it, e.g., shares may be held by brokers for the purpose of transfer or splitting-up, etc. Shares may also be lodged with the companies concerned for transfer etc. When investments are held by any other person on behalf of the insurance company, the auditor should obtain a certificate from him. The certificate should state the reason for holding the investment (e.g., in safe custody or as security).

In respect of scripless dealings in investments through the OTC Exchange of India, the auditor should verify the interim and other acknowledgements issued by dealers as well as the year-end confirmation certificates of the depository organisation.
The auditor should also examine whether securities lodged for transfer are received back within a reasonable period. Similarly, he should examine whether share certificates, etc. are received within a reasonable period, of the lodging of the allotment advice. In case there is an unusual delay in registration of transfers, etc., the auditor should see that adequate follow-up action has been taken. He may, in appropriate cases, also enquire from the issuers, or their registrars, about the delays. In cases where the issuer/registrar has refused to register the transfer of securities in the name of the insurance company, the auditor should verify the validity of the title of the insurance company over such securities.

The auditor should examine whether the portfolio of the insurance company consists of any securities whose maturity dates have already expired. It is possible that income on such investments may also not have been received. In case the amount of such investments or the income accrued thereon is material, the auditor should seek an explanation from the management on this aspect. He should also consider whether any provision for loss on this account is required. Similarly, where income on any security is long overdue, the auditor should consider whether provision is required in respect of such income accrued earlier.

Investments in securities now-a-days constitute a substantial part of total assets of many insurance companies. Method of valuation of investments followed by an insurance company may, therefore, have a significant effect on its Balance Sheet and Profit and Loss Account. The auditor should examine whether the method of accounting followed by the insurance company in respect of investments, including their year-end valuation, is appropriate.

The auditor should examine the manner of accounting for investments in the context of the guidelines of the Insurance Regulatory and Development Authority and the accounting policy followed by the insurance company in respect of investments. The auditor should examine the appropriateness of accounting policies followed by the insurance company. In case any of the accounting policies is not appropriate, the auditor should consider the effect of adoption of such policy on the financial statements and, consequently, on his audit report.

A change in the method of valuation of investments constitutes a change in accounting policy and adequate disclosure regarding the fact of the change along with its financial effect should be made in the balance sheet.

The auditor should examine whether income from investments is properly accounted for. This aspect assumes special importance in cases where the insurance company has opted for receipt of income through the Electronic Clearing Service.

There may be cases where the certificates of tax deduction at source (TDS) received along with the interest on investments are found missing. This increases the incidence of tax on the insurance company. The auditor should see that there is a proper system for recording and maintenance of TDS certificates received by the insurance company.

12. **Cash and Bank Balances:** Cash and Bank balances at Branch Office/Divisional Office level also constitute significant items related to balance sheet. The auditor should apply the following audit procedures for verification of claims.
(i) The auditor should physically verify cash balance cheques in hand collected from the policy holders, impress for meeting day to day expenditures, postage stamps balance, revenue, policy, licence fees, franking machine balance. The auditor should also obtain a certificate from the management for the above mentioned balances as at the balance sheet date.

If for some reason, the physical verification of the above on the balance sheet date is not possible then the same can be done at a subsequent date and by way of backward calculations, cash in hand at the balance sheet date can be verified.

(ii) The auditor should also check whether late collections of cash and cheques on the last working day of the financial year, which could not be deposited into bank account on the same day, have been identified and booked as Cash in Hand and Cheques in Hand Account, respectively.

(iii) The auditor should also check the dates of the cheques in hand to ensure that they belong to the correct accounting period.

(iv) The auditor may apply test check on the bank transactions.

(v) The auditor should also check Bank Reconciliation statement and long outstanding entries therein.

(vi) The auditor should obtain confirmation of Bank Balances for all operative and inoperative accounts.

(vii) The auditor should physically verify Term Deposit Receipts issued by bankers.

(viii) The auditor should verify the deposits and withdrawals transactions at random and check whether the Account is operated by authorised persons only.

(ix) The auditor should verify the subsequent realisations for all items appearing in the reconciliation.

(x) In case of funds, in-transit, he should verify that the same are properly reflected as part of bank balance.

13. **Outstanding Premium and Agents’ Balances**: The following are the audit procedures to be followed for verification of outstanding premium and agents’ balances:

(i) Scrutinise and review control account debit balances and their nature should be enquired into.

(ii) Examine inoperative balances and treatment given for old balances with reference to company rules.

(iii) Enquire into the reasons for retaining the old balances.

(iv) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.

(v) Check age-wise, sector-wise analysis of outstanding premium.

(vi) Verify whether outstanding premiums have since been collected.

(vii) Check the availability of adequate bank guarantee or premium deposit for outstanding premium.
14. **Provision for Taxation:** The steps to be conducted by the auditor for audit and verification are given below:

(i) The auditor should check whether the provision for taxation has been made after taking into account the specific provisions applicable to insurance companies carrying on general insurance business.

(ii) It should be seen by auditor whether for the purpose of computation not only the profit, as disclosed by the annual accounts, copies of which are required under the Insurance Act, 1938 to be furnished to IRDAI, is taken.

(iii) 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.

(iv) The compliance with the provisions of Chapter III of the Income Tax Act, 1961 which provides for income which do not form part of total income is also to be seen.

(v) The auditor should see whether deductions under Chapter VIA of the Income Tax Act, 1961 which provides for deduction have been made in computing total income is properly taken into account.

(vi) The auditor should examine whether income computation relating to foreign branches and other income earned outside India is dealt with properly as per the double taxation avoidance agreement, if any, entered into with those countries.

(vii) Also, the auditor should check whether the grossing up of TDS relating to the income has been properly done for the purpose of computation of taxable income.

(viii) The auditor should ensure that the provisions of the Income Tax Act, 1961 regarding the tax to be deducted at source have been properly complied with, relating to the payments / credits for which the TDS provisions of the Income Tax Act are applicable and the amount so deducted are remitted within the stipulated time. Also check TDS implication on the interest paid/payable and included on claim settlement / outstanding claims.

(ix) The auditor should see the system of service tax collection and the payment to the statutory authorities and the internal system including the filing of statutory returns.

(x) The examination of sales tax implication on the sale of salvage should also be seen as it is applicable to the respective states and the past trend in this regard.

(x) The auditor should check the liability under the VAT and whether provision for adequate amount has been made in the books or not.

(xii) The auditor should verify that adequate provision has been made for additional liability relating to earlier years for which demands have been received in the current year and where the company has gone into appeal, the fact that no provision has been made and that an appeal has been preferred has to be disclosed in the notes to accounts.

15. **Unexpired Risks Reserve (URR):** The need for Unexpired Risks Reserve arises from the fact that 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. In other words, 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. There are two methods of creating this reserve. One is based on the proportionate number of days of risk remaining to risk expired, which is called 1/365 method. The other method is by taking a URR directly on 50% of the premium amount. As per section 64V of the Insurance Act, 1938, for the purpose of compliance with the provisions of maintaining control level of solvency margin, a proper value of every item of liability of the insurer shall be placed in the manner as may be specified by the regulations made in this behalf.

It may be mentioned that the profit and gain of insurance companies are governed by the provisions of section 44 of the Income Tax Act, 1961. In this regard, Rule 5 of the First Schedule to the Income Tax Act-Computation of Profit & Loss of General Insurance Business provides for creation of a reserve for unexpired risks as prescribed under Rule 6E of the Income Tax Rules, 1962. According to this Rule, the insurance companies are allowed a deduction of 50 per cent of net premium income in respect of Fire and Miscellaneous Business and 100 per cent of the net premium income relating to Marine Insurance business.

16. **Reinsurance:** A reinsurance transaction may be defined as an agreement between a ‘ceding company’ and a ‘reinsurer’ whereby the former agrees to ‘cede’ and the latter agrees to accept a certain specified share of risk or liability 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 the reinsurance company. It may, however, be emphasised that the insured does not acquire any right under a reinsurance contract. In the event of loss, the insured’s claim for full amount is against the original insurer only. The original insurer in turn, lodges a claim with the reinsurer.

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*Marine Source: Humpunjabi.com

*Fire Source: SpiderKerala.net*
Type of Reinsurance Contracts

There are broadly two types of reinsurance contracts, viz., facultative reinsurance and treaty reinsurance. A diagrammatic presentation is as below:

**Facultative Reinsurance** - It is that type of reinsurance whereby the contract relates to one particular risk and is expressed in the reinsurance policy. This is the oldest method of reinsurance and it necessitates consideration of each risk separately. Each transaction under facultative reinsurance has to be negotiated individually. Each party to the transaction has a free choice, i.e., for the ceding company to offer and the reinsurer to accept. The main drawbacks of this type of insurance are the volume of work involved and time taken to cover the risk. It is, however, still used even today, mainly when:

(i) automatic covers have already been exhausted.
(ii) the risk is excluded from the Treaties.
(iii) the insurer does not want his reinsurance treaties overburdened with particularly heavy and abnormal risks.
(iv) the insurer has no automatic cover at his disposal in a particular branch, where he issues policies rarely.
(v) the nature of business is such that technical guidance or consultation with the reinsurer is required at every stage of acceptance of the risk itself or for a type of business where the number of risks is very small, for example, in atomic energy installations, oils rigs, etc.

**Treaty Reinsurance** - Under this type of 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. Under this contract, it is obligatory for the reinsurer to accept all risks within the scope this treaty and it is obligatory for the ceding company to cede risks in accordance with the terms of the treaty. In the case of treaty reinsurance...
contracts, the insurer generally prepares a statement of treaty reinsurance accounts, either on quarterly basis or on half-yearly basis. These statements are sent to the re-insurer for the purpose of reconciliation of claims lodged under the reinsurance contracts, outstanding claims, claims paid and claims paid in advance. It may be noted here that the treaty reinsurance contracts generally provide that in the event of any large claim being lodged with the insurer, the re-insurer shall make the payment even before the claim is finally settled or the statement of treaty reinsurance is received by the reinsurer. The reinsurer, in such cases, treats the amount paid to the insurer as ‘advance against claim’. The Advance against Claim Account is squared up as and when the claim is settled and the information of this settlement is sent to the reinsurer through statement of treaty reinsurances. Such payments by the reinsurer are called Cash Loss Payments. Treaties can also be divided into two categories, viz., proportional treaties and non-proportional treaties.

**Proportional Treaties** - Such treaties are based on pro-rata apportionment of the sum insured, premium and losses, according to a pre-determined percentage/ratio.

**Non-Proportional Treaties** - Such treaties are characterised by a distribution of liability between the ceding company and the reinsurer on the basis of losses rather than the sum insured, as is the case in proportional reinsurance. The following are the other characteristics of non-proportional treaties:

(i) Premium is not calculated on each cession, but on the whole portfolio of the ceding company.

(ii) The premium rate is predetermined.

(iii) Cost of reinsurance can vary substantially each year, depending on the premium income, loss ratio and reinsurance marked situations.

(iv) Normally no commission is paid.

### A. Verification of Re-insurance Inward

Under regulation 4 of the IRDA (General Insurance Re-insurance) Regulations, 2013, every insurer desirous of writing inward re-insurance business should have a well defined underwriting policy. The decisions on acceptance of re-insurance should be taken by persons with good knowledge and experience. The insurer is required to file with the Authority, its underwriting policy and any changes therein from time to time. The auditor should apply the following verifications measures for re-insurance inward transactions:

(i) Re-insurance Inward underwriting should be as per the norms and guidelines prescribed by the Insurance Act, 1938 and IRDA Regulations. It is necessary to ensure that the inward reinsurance arrangements and acceptances, both Indian and foreign are done as per the prescribed parameters applicable for the particular year.

(ii) The auditor should check that domestic inward acceptances are in accordance with the approved programme.

(iii) The auditor should verify whether re-insurance inward acceptance, both Indian and foreign, are
as per arrangements / agreements entered into with Indian and foreign insurance companies.

(iv) The auditor should also verify whether the policy adopted for booking the accounts is on “receipt” basis or “due” basis with the appropriate basis of estimation towards accounts not received and that the basis of estimation is fair and consistently applied and properly disclosed.

(v) The auditor should examine whether proper system exists to have control over the quantum of agreements existing at any point of time and also that periodical accounting statements received in connection with the agreements.

(vi) The auditor should verify whether proper closing returns have been received for premiums and claims for facultative acceptances.

(vii) The auditor should check the accounts for closure of any underwriting year, with portfolio withdrawals as per the terms and conditions agreed.

(viii) The auditor should evaluate the system and practice adopted in recognising the foreign currency transaction and also whether it is in accordance with the Accounting Standard -11 “The Effects of Changes in Foreign Exchange Rates”.

(ix) The auditor should verify whether profit commission has been calculated as per the agreement and terms and conditions and all the statements rendered are properly taken into account.

(x) The auditor should check whether there is any run off claim / large claim of long chain in nature which requires any provisioning.

(xi) The auditor should also verify whether the Foreign Inward acceptance components, consisting of premium, commission, brokerage and other expenses, claims consisting of paid claims opening and closing outstanding claims etc., have been recorded and accounted as per the accounts rendered by the companies. It is essential that the statement should be rendered in the currency in which it was agreed to be transacted and the conversion of foreign currency balances from the accounts submitted have been done at the appropriate conversion rates as per Accounting Standard -11.

(xii) The auditor should examine whether the outstanding claim figures have been properly obtained well in time, under proper systematic arrangements and sufficient provisioning has been made for all the outstanding claims. The auditor should see that regarding foreign inward, appropriate provisioning is done after adopting prescribed conversion rate to the Indian rupee. The auditor should ensure that confirmation regarding the outstanding claims have been received in respect of all inward arrangements.

(xiii) As per IRDA (General Insurance Re-insurance) Regulations, 2013, every re-insurer is required to make provision for outstanding claims for every reinsurance arrangement accepted on the basis of loss information advices received from brokers /cedants and where such advices have not been received, on an actuarial estimation basis. In addition, every re-insurer has to make an appropriate provision for ‘Incurred but Not Reported (IBNR)’ claims on its reinsurance accepted portfolio on actuarial estimation basis. This aspect has to be looked into as this may
result in a lot of difference in the financial results of the company.

(xiv) Closing balances of the re-insurer’s accounts should be reconciled and the confirmation of balances should be obtained from all the companies.

(xv) The auditor must ensure that foreign inward accounts balances have been re-stated at the prevailing value at the year end and that difference arising out of re-statement has been taken to Profit and Loss Account.

(xvi) The auditor should verify the requirement of provision / writing off of reinsurance inward balances based on the doubtful nature of recovery, if any.

(xvii) The auditor should check whether Indian inward balances including with the GIC have reconciled and identical balances arrived at and affect, if any, due to co-insurance transactions should also be looked into.

B. Verification of Re-insurance Outward

The following steps may be taken by the auditor in the verification of re-insurance outward:

(i) The auditor should verify that re-insurance underwriting returns received from the operating units regarding premium, claims paid, outstanding claims tally with the audited figures of premium, claims paid and outstanding claims.

(ii) The auditor should check whether the pattern of re-insurance underwriting for outward cessions fits within the parameters and guidelines applicable to the relevant year.

(iii) The auditor should also check whether the cessions have been made as per the stipulation applicable to various categories of risk.

(iv) The auditor should verify whether the cessions have been made as per the agreements entered into with various companies.

(v) It should also be seen whether the outward remittances to foreign re-insurers have been done as per the foreign exchange regulations.

(vi) It should also be seen whether the commission on cession has been calculated as per the terms of the agreement with the re-insurers.

(vii) The auditor should verify the computation of profit commission for various automatic treaty arrangements in the light of the periodical accounts rendered and in relation to outstanding loss pertaining to the treaty.

(viii) The auditor should examine whether the cash loss recoveries have been claimed and accounted on a regular basis.

(ix) The auditor should also verify whether the Claims Paid item appears in Outstanding Claims list by error. This can be verified at least in respect of major claims.

(x) He should see whether provisioning for outstanding losses recoverable on cessions have been
confirmed by the re-insurers and in the case of major claims, documentary support should be insisted and verified.

(xi) Accounting aspects of the re-insurance cession premium, commission receivable, paid claims recovered, and outstanding losses recoverable on cessions have to be checked.

(xii) The auditor should check percentage pattern of gross to net premium, claims paid and outstanding claims to ensure comparative justification.

(xiii) The auditor should also check that the re-insurers balance on cessions and whether the sub ledger balances tallies with the general ledger balances.

(xiv) The auditor should review the individual accounts to find out whether any balance requires provisioning / write off or write back.

(xv) He should verify whether the balances with re-insurers are supported by necessary confirmation obtained from them.

(xvi) He should verify whether opening outstanding claims not paid during the year find place in the closing outstanding claims vis-a-vis the reinsurance inwards outstanding losses recoverable on cessions appears in both opening and closing list. If not, the reason for the same should be analysed.

(xvii) Any major event after the Balance Sheet date which might have wider impact with reference to subsequent changes regarding the claim recovery both paid and outstanding and also re-insurance balances will need to be brought out suitably.

17. Co-Insurance: Where the insured chooses to have more than one insurer for the same transaction of risk, it would amount to coinsurance. The concept of co-insurance emerges, when there is a predetermined set of understandings, leader of the business receives the premium and issues policy with a co-insurance clause in the policy and the referred leader also settle the claims to the insured in case of the occurrence of claims. Balances pertaining to other companies relating to premiums and claims are accounted under co-insurance as “Amounts due to / due from” other insurance companies.

Balances are settled in periodical meetings and exchange of statements as agreed between the companies. Suitable slot can be provided in the systems to incorporate co-insurance requirements. Most of the practice in accounting and settlement of co-insurance transactions are industry specific and insured specific. Hence, system may suitably be designed to accommodate all the possibilities of co-insurance accounting and settlements.

The auditors should get information from the agreement arrived at the Insurance Council, where the insurance companies may choose to be the members. (Wherever the concept of Insurance Council...
is in place). Members of the Insurance Council could arrive the mutually agreeable terms and norms of entering into coinsurance agreement and the norms for settlement of dues. The Insurance Council may recommend the following norms while entering into coinsurance agreement:

- Settlement of commission Collection and Remittance of service tax
- Standard practices for settlement of dues
- Settlement of claims
- Reinsurance arrangement for the risk booked
- Exceptional booking and the powers thereof deviating from the Council’s understanding.

The auditor should go through the understanding of the Council and ensure that the risks are covered as per the terms and conditions with adequate consideration and proper settlement.

18. **Solvency Margin**: Section 64VA of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015 requires every insurer and re-insurer to maintain an excess of the value of assets over the amount of liabilities at all times which shall not be less than 50% of the amount of minimum capital as stated under section 6 (requirement as to capital) of the Act and arrived at in the manner specified by the regulations.

The Authority, by way of regulation, shall specify a level of solvency margin known as ‘control level of solvency’. However, in certain special circumstances, the authority may direct application of this provision with some modifications provided this shall not result in the control level of solvency being less than what is stipulated in above para.

If, at any time, an insurer or re-insurer does not maintain the required control level of solvency margin, he is required to submit a financial plan to the Authority indicating the plan of action to correct the deficiency. If, on consideration of the plan, the Authority finds it inadequate, the insurer has to modify the financial plan.

Maintenance of solvency margin has a great importance for an insurance company considering their size and nature of business and also involvement of public money. Sub-section (2) of section 64VA states that if an insurer or re-insurer fails to comply with the prescribed requirement of maintaining excess of value of assets over amount of liabilities, it shall deemed to be insolvent and may be wound up by the Court on an application made by the authority.

The Insurance Act requires every insurer to furnish a statement of his assets and liabilities as assessed in the manner laid down by the section 64V.

Every Insurer is required to prepare a statement of value of assets in “Form IRDA-Assets-AA.” A statement of the amount of liabilities in case of general insurance business is to be prepared in “Form HG” and a statement of Solvency Margin in “Form KG” as specified in the Insurance Regulatory and Development Authority (Assets, Liabilities and Solvency Margin of Insurers) Regulations, 2000. The statement of assets, liabilities and solvency margin are to be certified by an auditor and filed by the insurance company with the Authority along with the audited accounts and statements.

"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 as the supplier (domestic risk) or a buyer situated in another country (export risk) against non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due-date (protracted default) or 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.

"Trade Credit Insurance transaction" means a transaction between two persons for supply of goods or services on open and agreed terms.

"Trade Credit insurance policy" is a conditional insurance contract between two parties (insurer and seller) that cannot be traded and is always directly related to an underlying trade transaction, which is either the delivery of goods or of services. The correct fulfilment of this trade transaction and satisfaction of the contract terms is essential for credit cover to exist.

Basic Requirements of a Trade Credit Insurance Product: An insurer shall offer trade credit insurance product only if all requirements mentioned below are met -

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<th>Details</th>
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<td>(i) Policyholder's loss is non-receipt of trade receivable arising out of</td>
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<td>a trade of goods or services.</td>
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<td>(ii) Policyholder is a supplier of goods or services in consideration for</td>
<td>Policyholder is a supplier of goods or services in consideration for a</td>
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<td>a fair market value.</td>
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<td>(iii) Policyholder's trade receivable does not arise out of factoring or</td>
<td>Policyholder's trade receivable does not arise out of factoring or</td>
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<td>reverse factoring arrangement or any other similar arrangement.</td>
<td>reverse factoring arrangement or any other similar arrangement.</td>
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<td>(iv) Policyholder has a customer (i.e. Buyer) who is liable to pay a trade</td>
<td>Policyholder has a customer (i.e. Buyer) who is liable to pay a trade</td>
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<td>receivable to the policyholder in return for the goods and services</td>
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<td>received by him from the policyholder, in accordance with a policy</td>
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<td>document filed with the insurer.</td>
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<td>(v) Policyholder undertakes to pay premium for the entire Policy Period.</td>
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<td>(vi) Any other requirement that may be specified by the Authority from time</td>
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Note: Students may note that procedure for remaining items of balance sheet items may be given on the basis of general audit procedures applied in case of a company.

10. CONTENTS OF AUDITOR’S REPORT

Apart from normal contents of Auditor’s report, as prescribed for ‘Limited Companies’ IRDA has prescribed the certain matters to be dealt with by the Auditors’ in their Report vide Regulation 3 under Schedule C of IRDA (Preparation of Financial Statements and Auditor’s Report of Insurance Companies) Regulations, 2002. The Schedule C is reproduced below -
“The report of the auditors on the financial statements of every insurer shall deal with the specified herein -

1. (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 their audit;

   (d) Whether the Balance Sheet, Revenue Accounts and Profit and Loss Account dealt with by the report and the Receipts and Payments Account 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) (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) [now Companies Act, 2013], to the extent applicable and in the manner so required.

   (c) Investments have been valued in accordance with the provisions of the Act and the 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 that there is no apparent mistake or material inconsistencies with the financial statements; and
   (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 is 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) the extent, if any, to which 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.”

From above, it is clear that the auditor has to examine the contents of the management report with a view to certify that there are no material inconsistencies in the same with the financial statements. The auditor should, based upon the audit conducted and information and explanations gathered during the course of the audit, verify that there are no material misstatements in the management report. As far as certification of compliance with the terms and conditions of the registration stipulated by the Authority is concerned, the auditor should ask for the relevant documents from the management of the company and conduct an examination thereof. Based on his observation, the auditor should certify the aforesaid compliance.

The auditor also has to state in the report that reliance has been placed on the certificate obtained from the appointed Actuary in respect of IBNR/IBNER, PDR and other reserves certified by the appointed Actuary of the company.

The auditor also has to issue a separate certificate on verification of cash, cheques in hand and other securities as required by the Regulations.

10.1 Signatures and Reports to be attached with the Accounts and Statements

Sub-section (3) of section 11 of the Insurance Act, 1938 provides that the accounts and statements referred to in sub-section (1) should be signed, in the case of a company, by the chairman, if any, and two directors and the principal officer of the company. It further provides that the accounts and statements should be accompanied by a statement containing the names, descriptions and occupations of, and the directorships held by, the persons in charge of the management of the business during the period to which such statements refers and by a report on the affairs of the business during that period.
TEST YOUR KNOWLEDGE

Theoretical Questions

1. What are the steps to be taken while verifying the Premium of (a) General Insurance Company; and (b) Life Insurance Company?

2. Enumerate the steps to be taken by an auditor for the verification of Re-insurance outward by a General Insurance Company.


4. As at 31st March 2017 while auditing Safe Insurance Ltd, you observed that a policy has been issued on 25th March 2017 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, 2017. You further noticed that there was a fire accident in the premises of the insured on 31st March 2017 and a claim was lodged for the same. The insurance company also made a provision for claim. Please respond.

5. ABC & Co., Chartered Accountants are the Auditors of Just Care Life Insurance Company Limited. Enumerate the steps to be taken by the auditor while verifying the “Investment”.

6. Briefly explain the term policy lapse and revival in case of Life Insurance Company and role of auditor in verifying the same.

Answers to Theoretical Questions

1. (a) Refer Point no. 1 of Para 9.2.
   (b) Refer Point no 7 of Para 8.2.

2. Refer Point no. 16 of Para 9.2.

3. Refer Point no. 13 of Para 9.2.

4. Provision for Claim: 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 unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such
amount, as may be prescribed, is made in advance 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.

5. Refer Point no 9 of Para 8.2.
6. Refer Point no 5 of Para 8.2.