20 Audit of Insurance Companies

20.1 – Legal and Regulatory Requirements

Legal Framework

1. Insurance Act, 1938
2. IRDA Act, 1999
3. IRDA Regulations
4. Companies Act, 2013
5. IRDA Investment Regulations, 2013; &
6. IRDAI Preparation of F.S. & Auditors Report Regulations 2000.

Reserve for Unexpired Risks

IRDA (General Insurance-Claim Reserving) Regulations, 2013 requires creation of a minimum amount of unexpired risks reserve at a specified percentage of net premium as under:

- For Marine Hull insurance – 100% of net premium
- For Fire, Marine Cargo & Misc. business – 50% of net premium.

Note: Sec. 64V of Insurance Act, 1938 also specifies these percentages. Subsequent to Amendment Act of 2015, these percentages are no more specified in amended Section 64V.

Regulatory Requirements

1 Requirement as to Capital – Sec. 6

Minimum paid-up equity share capital of an Indian insurance company carrying on insurance business should be ₹ 100 crores excluding preliminary expenses incurred in the formation and registration of company.

2 Appointment of Auditors

- Appointment of statutory auditors of GIC, its subsidiaries and divisions are made by the CAG of India.
- In case of others, auditor is appointed at the AGM ensuring compliance of IRDAI Guidelines on Corporate Governance.
- An auditor can conduct audit only for 3 insurance companies and not more than 2 Life or 2 General.
- Guidelines also mandate a mandatory joint audit for all insurance companies.

3 Sufficiency of Assets or Solvency Margin – Sec. 64VA

- **Requirement of solvency margin**: Every insurer and re-insurer shall at all times maintain an excess of value of assets over the amount of liabilities of, not less than 50% of the amount of minimum capital.
- **Non-compliance of solvency margin**: Insurer or re-insurer, who does not comply with requirement of solvency margin shall be deemed to be insolvent & may be wound-up by court on application made by IRDA.
- **Power of authority to prescribe level of solvency**: The Authority shall by way of regulation made for the purpose, specify a level of solvency margin known as control level of solvency on the breach of which the Authority shall act.
- **Submission of Financial Plan**: If, at any time, insurer or re-insurer does not maintain required control level of solvency margin, he shall, in accordance with directions issued by IRDA, submit a financial plan, indicating a plan of action to correct the deficiency within a specified period not exceeding 6 months.
- **Modifications to Financial Plan**: If the authority considers the financial plan inadequate, it shall propose modifications to the plan and shall give directions, including direction in regard to transacting any new business, or, appointment of an administrator or both.
- **Non-submission of financial plan**: An insurer or re-insurer who does not submit financial plan shall be deemed to have made default in complying with the requirements of this section.

4 Inception of Risk – Sec. 64VB

No insurer shall assume any risk in India in respect of any insurance business unless and until the premium payable is received by him 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.

20.2 – Audit of Life Insurance Business (Part I)

	Concept	Role of Auditor
Actuarial Process	Role of Actuaries in life insurance business is to concentrate on following key areas: 1. Product Development and Pricing. 2. Model Development. 3. Statutory Valuations and reserving. 4. Business Planning. 5. Solvency management. 6. Management reporting on various business valuations & profitability models.	• 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, issued by IRDA. • For this purpose, auditors generally rely on the Certificate issued by the Appointed Actuary, certifying the Policy liabilities. However, he may discuss with the Actuaries with respect to process followed and assumptions made by him before certifying the Policy liabilities.
Underwriting	Underwriter assesses the risk and determines the premium to be charged. The function of the underwriter is to: (a) acquire or to "write" business that will bring money to insurance company, & (b) to protect the company's business from risks that they feel will make a loss.	• To review the process of acceptance of risk through the underwriting process. • 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.
Reinsurance	It is a risk mitigating tool adopted by Insurer whereby the risk underwritten by one Insurer is transferred partially to another Insurer.	• To check and confirm that reinsurance premium calculation and payment is in accordance with the agreement with the reinsurer. • To check whether necessary provision has been made for outstanding reinsurance premium and is properly accounted for in books of account. • To verify the agreements entered with the reinsurer. • To verify whether Insurer has adhered to terms and conditions of agreement. • To verify payments made to the reinsurer.
Free Look Cancellation (FLC)	• It is an option wherein policyholder has a period of 15 days from date of receipt of policy document to review the T & C and in case of any disagreement, he/she has the option to return the policy. • FLC requests can be received through any mode. In case of written letters, signature of policy holder should match with the original proposal form. • FLC request is processed when policy holder is not satisfied with the T & C of the policy document. • FLC refund is paid either by cheque or direct transfer to bank account.	• To check and confirm that Free Look Cancellation requests are received within 15 days from receipt of policy document by the policy holder. • To verify signatures of the policy holder and processing of Free look cancellation request within time defined by the insurer. • To check recording of appropriate accounting entries for refund. *Compiled by: CA. Pankaj Garg*
Policy Lapse and Revival	• Discontinuation of policy owing to non-payment of premium dues is known as lapse. A lapsed policy ceases to provide insurance protection to the insured. • Terms & 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.	• 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 grace period. • In case of revival request, check whether adequate checks are in place for receipt of outstanding amounts and adequate documents are obtained before reviving the policy.
Policy Surrender	• Voluntary termination of the insurance contract before expiry of the term of the contract is known as surrender of policy. 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 along with the original policy document and the discharge voucher.	(a) To check and confirm that surrender requests are received from the policy holder only. (b) To check that adequate controls are in place to ensure proper verification process for checking of request, whether premiums are paid on regular basis. (c) To check whether surrender amount is paid only to the policy holder and is paid only as per T & C. (d) To check whether appropriate accounting entries are passed.

20.3 – Audit of Life Insurance Business (Part II)

	Concept	Role of Auditor	
Premium Collection	Premium refers to consideration received by insurance company from the policy holder. Premium 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'.	**Collection of Premium**	• To check existence of appropriate mechanism to ensure all the collections are deposited into the Bank on timely basis. • To check whether there is daily reconciliation process to reconcile the amounts collected, entered into the system and deposited into the bank.
		Calculation of Premium	• Check that accounting system calculates premium amounts & due dates correctly. • Check that system is equipped to calculate all types of premium modes correctly.
		Recognition of Income	• Ensure that premium is recognised only on the basis of 'Issued Policies'. • To check that there is appropriate mechanism in place to conduct reconciliation on daily basis and reconciling items, if any, are rectified.
		Accounting of 'Advance Premium'	• To check, whether system has capability to identify regular and advance premium. • To check whether there is a process of applying advance premium to a contract when premium is due.
Claims	Primary objective of Audit of Life Insurance Companies is checking of accuracy of processing and accounting of claims with focus on the following areas: • Claims lodgement and processing • Authority for approval of claims • Review of payouts and disbursements • Review of compliance to Statutory Requirements and applicable IRDA Regulations. • Review of Reinsurance claims • Review of reporting of claims.	(a) Review policy document to ensure that it prescribes documentary evidence needed to support a claim. (b) Ensure that a register of claims is maintained, in which every claim is entered along with details. (c) Review the reasons for the rejections, in case of rejection of claims. (d) Ensure complete recording of all claims received. (e) Ensure that appropriate provisioning has been carried out, in cases of claims intimated but not paid. (f) Ensure that cost of claims includes the claims settlement cost. (g) Ensure that there is system of regular reconciliation is carried out between claims management system and General ledger. (h) Ensure that liability of claims should be booked net of reinsurance.	
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 prescribed for different categories of investments. • 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.	(a) Review management structure to ensure adequate segregation of duties. (b) To review the operating procedures prescribed by the IRDA Regulations. (c) To review of investment policy. (d) To review the functioning and scope of Investment Committee. (e) To check compliance of Investment regulations. (f) To review cash management system to track funds available for investment considering the settlement obligations and subscription and redemption of units, etc. (g) To review fund wise reconciliation with investment accounts, bank, & custodian records. (h) To ensure that there is split between Shareholders' and Policyholders' funds, and earmarking of securities between various funds namely Life, Pension, Group etc. (i) To review the arrangements and reconciliations of holdings with the insurer's custodian. (j) To review and check insurer's Investment Accounting and valuation policy. (k) To review the controls around personal dealings and insider trading.	
Commission Payable	Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission. Commission is payable towards generation of new business and towards settlement of renewal premium.	(a) Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately and processing the same in timely manner. (b) Review the commission payment system is in sync with the premium collection system. (c) Check whether commission paid is within the limit prescribed under Insurance Act. (d) Check whether commission is clawed-back on the cancelled policies. (e) Check the completeness of commission processing system.	
Operating Expenses	• All administrative expenses are broadly classified under 14 heads as mentioned in Schedule 3 forming part of F.S. • This Schedule is part of the Revenue Account. • Any major expenses (₹ 5 lacs or in excess of 1% of net premium, whichever is higher) are required to be shown separately.	(a) To ensure that operating expenses are first aggregated and then apportioned to the Revenue Account of each class of business on a reasonable and equitable basis. (b) To ensure that 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.	

20.4 – Audit of General Insurance Business (Revenue Items)

Premium Income

1. **Review of Internal Control**:
   - Issue of proper cover notes
   - Serial no. of cover notes
   - Internal check on stamps, stationary etc.
2. **Accounting**:
   - Recognition of premium income for all risks incepted.
   - Proper recording for Fire, Marine, Motor & Other Ins.
   - Accounting for premium received in advance & premium outstanding.
   - Recording at gross figure without providing for reserve.
3. **Inception of Risk**: Sec. 64VA
   - Issue of Policy Documents
   - No risk w.r.t. premiums received in advance and outstanding.
4. **Co-Insurance**:
   Proper booking of share of premium.

Commission

1. Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI.
2. Ensure that commission/brokerage is paid as per rates agreed with the agent and filed with IRDAI.
3. Ensure that commission/brokerage is paid to the agent/broker who has solicited the business.
4. Vouch disbursement entries with commission bills.
5. Check whether all disbursements were properly authorized.
6. Check the calculation of commission amount.
7. Scrutinize agent's ledger for any abnormal entries or balance.
8. Examine whether commission outgo for the period has been properly accounted for.

Claims Paid

1. **Review of Internal Control**:
   - Payment of only bona fide claims.
   - Sanctioned by appropriate authority.
   - Collection of information from branches.
2. **Claims Paid**:
   - Coinsurance: Proper booking
   - Settlement Amount: must include all incidental expenses
   - Claims communicated after year end: accounting for provisions
   - Accounting for Salvage and letter of subrogation: in accordance with procedure.
   - Amount deposits with Court: not treated as claim till final decision.
   - Unqualified Discharge Note: in case of final settlement.
3. **Claims Outstanding at year end**:
   - Provision for all unsettled Claims.
   - Provision for legally enforceable claims.
   - Provisions should not be made in excess.
   - Application of Average Clause.
   - Consideration of salvage value.
4. **Claims Register**:

Claims Intimation Register	Claims Disbursement Book
Claims Paid Register	Claim Dockets
Report of Quality Assurance Team	Salvage Register

Receipt and Payment Account

Sec. 11 of Insurance Act, 1938 – F.S. to include Receipt and Payment Account (R & P).

Auditor Duties:
- report whether the R & P account of the insurer is in agreement with the books of account and returns;
- express an opinion as to whether the R & P account has been prepared in accordance with the provisions of the relevant statutes; and
- express an opinion whether the R & P account give a true and fair view of the receipts and payments of the insurer.

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20.5 – Audit of General Insurance Business (Balance Sheet Items)

Investments

1. Physically verify securities on B/S date or a date as near as possible. Prepare a reconciliation statement where verification is carried out on date other than BS date.
2. Obtain separate lists of securities held physically & those held in demat form.
3. Examine the records for investments held at branches and request the respective branch auditors to issue a certificate to this effect.
4. Examine in detail investments on which income has not been received for a long period.
5. Where certificates are held by other persons such as share transfer agents etc. the auditor should obtain written certificates from such person.
6. Examine that norms relating to valuation and disclosure in F.S. have been complied with.
7. Examine whether income from investments is property accounted for.
8. Ensure that certificates of TDS are properly maintained.
9. Ensure compliance of Sections 27, 27A and 27B of the Insurance Act, 1938 as well as the guidelines.

Outstanding Premium and Agent's balance

1. Inquire reasons for long outstanding credit balances in outstanding premium accounts and examine the reasons for policies not being issued or the outstanding premium not adjusted against amounts due.
2. Scrutinize and review control account debit balances and their nature should be enquired into.
3. Examine in-operative balances and treatment given for old balances.
4. Enquire into the reasons for retaining the old balances.
5. Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
6. Check age-wise, sector-wise analysis of outstanding premium.
7. Verify whether outstanding premiums have been collected.
8. Check the availability of adequate bank guarantee or premium deposit for outstanding premium.

Contingent Liabilities – Disclosure Requirements

1. Partly paid up investments.
2. Underwriting Commitments outstanding.
3. Claims, other than those under policies, not acknowledged as debts.
4. Guarantees given by or on behalf of the Company.
5. Statutory demands / Liabilities in dispute, not provided for.
6. Reinsurance obligations to the extent not provided for in the accounts.
7. Others (to be specified).

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20.6 – Miscellaneous (Part I – Coinsurance and Trade Credit Insurance)

Co-Insurance

Meaning & Concept:
Sharing of Business between more than one insurer at agreed percentages is known as co-insurance. The Lead Insurer issues documents, collects premium and settles claims. Statement of accounts is rendered by the Lead insurer to the other co-insurers.

Incoming Co-Insurance

1. Ensure that the Premium Account is credited on the basis of statements received from the Lead insurer.
2. In case, the statement is not received, the premium is accounted for on the basis of advices to ensure that all premium in respect of risks assumed in any year is booked in the same year.
3. For this purpose, the auditor may examine the communication in the post-audit period and obtain a written confirmation to the effect that all incoming advices have been accounted for.
4. The auditor should also verify claims provisions and claims paid with reference to advice received from the Lead insurer.

Outgoing Co-Insurance

1. The auditor should scrutinise the transactions relating to the outgoing business, i.e. where the company is the Lead Insurer.
2. These should be checked with reference to the relevant risks assumed under policies and correspondingly for debits arising to the co-insurer on account of their share of claims.

Trade Credit Insurance

Trade Credit insurance provides protection to suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country (domestic risk) or 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. Trade credit insurance product is offered subject to following requirements:

1. Policyholder's loss arises due to non-receipt of trade receivable.
2. Policyholder is a supplier of goods or services for a consideration.
3. Buyer is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder.
4. Premium for the entire Policy Period has been paid.
5. Other requirement that may be specified by the Authority from time to time.

20.7 – Miscellaneous (Part II – Reinsurance)

Verification of reinsurance inward

1. Evaluate internal control system to ensure determination of correct amount for reinsurance accepted, proper valuation of assets & liabilities arising out of reinsurance transaction & adherence to legal provisions & regulations.
2. Ascertain whether adequate guidelines and procedures are established with respect to granting reinsurance.
3. Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.
4. Examine whether premium received and commission paid on reinsurance accepted is as per the terms of the agreement with the Principal Insurer.
5. Examine whether claims paid have been accounted on a regular basis.
6. Examine whether remittances from foreign Principal Insurer are as per foreign exchange regulations.
7. Examine whether confirmations have been obtained regarding balances with Principal Insurer.
8. Review individual accounts of Principal Insurers.

Verification of reinsurance outward

1. Evaluate internal control system in the area of reinsurance ceded to ensure determination of correct amount for reinsurance ceded, proper valuation of assets and liabilities arising out of reinsurance transaction and adherence to legal provisions and regulations.
2. Ascertain whether adequate guidelines and procedures are established with respect to obtaining reinsurance.
3. Reconcile reinsurance underwriting returns received from various units with the figures of premium, claims paid and outstanding claims for the company as a whole.
4. Examine whether commission on reinsurance ceded is as per the terms of the agreement with the re-insurers.
5. Examine the computation of profit commission for automatic treaty arrangements in the light of the periodic accounts rendered and in relation to outstanding loss pertaining to the treaty.
6. Examine whether loss recoveries have been claimed and accounted on a regular basis.
7. Examine whether outstanding losses recoverable have been confirmed by re-insurers.
8. Examine whether remittances to foreign re-insurers are as per foreign exchange regulations.
9. Examine whether confirmations have been obtained regarding balances with re-insurers.
10. Review individual accounts of re-insurers to evaluate whether any provision/write off or write back is required.

Facultative and Treaty Reinsurance

<table>
<tr><td>Facultative</td><td colspan="2">Reinsurance whereby contract relates to one particular risk and is expressed in the reinsurance policy. Each transaction has to be negotiated individually. The Insurance is used when:
• Automatic cover has exhausted.
• Risk is excluded from treaties
• Reinsurance treaties have not to be overburdened.
• Insurer has no automatic cover.
• Technical guidance is required at each stage of acceptance of risk.</td></tr>
<tr><td rowspan="3">Treaty

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CA. Pankaj Garg</td><td colspan="2">A treaty type of coverage is in effect for a specified period of time, rather than on a per risk, or contract basis. For the duration of the contract, the reinsurer agrees to cover all or a portion of the risks that may be incurred by the insurance company being covered.</td></tr>
<tr><td>Proportional Treaty</td><td>• The reinsurer will receive a prorated share of the premiums of all the policies sold by the insurance company being covered. Consequently, when claims are made, the reinsurer will also bear a portion of the losses. The proportion of the premiums and losses that will be shared by the reinsurer will be based on an agreed percentage.
• In a proportional coverage, the reinsurance company will also reimburse the insurance company for all processing, business acquisition and writing costs.</td></tr>
<tr><td>Non-Proportional Treaty</td><td>• The reinsurer will only get involved if the insurance company's losses exceed a specified amount, which is referred to as priority or retention limit. Hence, the reinsurer does not have a proportional share in the premiums and losses of the insurance provider.
• The priority or retention limit may be based on a single type of risk or an entire business category.</td></tr>
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