

MAJOR ISSUES IN AUDIT OF LIFE INSURANCE COMPANIES

Purushottam Nyati
February 21, 2015

PRESENTATION PATH

- Unique features of Life Insurance Companies
- Significant Audit Areas/Financial Statement Areas
- Key consideration and Major Audit/Accounting Issues
- Auditors' Report

A collection of approximately 12 origami birds, each made from paper with different patterns and colors, scattered across a solid blue background. The birds are in various orientations, some appearing to fly towards the right. The patterns include floral, geometric, and abstract designs in colors like green, red, white, brown, and blue.

**UNIQUE FEATURES OF LIFE
INSURANCE COMPANIES**

UNIQUE FEATURES OF LIFE INSURANCE COMPANIES

- Regulated by Insurance Regulatory Development Authority - IRDA
- All Products duly approved by IRDA - Features, Claims benefits, Commission payments, etc.
- Maintenance of Solvency Margin ratio - similar to Capital Adequacy Ratio mandatory for Banks
- IRDA prescribes the following related to Financial Statements:
 - Format of Financial Statements (Schedule III of the Companies Act 2013 does not apply)
 - Separate Income Statement for Policyholder and Shareholders
 - Recognition and measurement of principles of certain items of financial statements - Investment, Premium, Commission, Free look cancelation,, Benefits paid, etc.)
 - Applicability of Accounting Standards (except 3, 13 and 17)
 - Additional disclosures in the financial statements

UNIQUE FEATURES OF LIFE INSURANCE COMPANIES

- Concept of Mandatory appointment of Joint auditors and cooling period
- Role of Appointed Actuary - Product design, Actuarial Liabilities, etc.
- Contents of Auditors reports has been prescribed
- Income tax calculation under section 44 (Section 28 to 43B is not applicable),
First Schedule and Section 115 B of the Income tax Act, 1961



SIGNIFICANT AUDIT AREAS/FINANCIAL STATEMENT AREAS

SIGNIFICANT AUDIT AREAS / FINANCIAL STATEMENT AREAS

- Premium and Reinsurance
- Commission
- Benefits Paid
- Investments
- Actuarial Liability
- Payroll

KEY CONSIDERATION FOR AUDIT OF LIFE INSURANCE COMPANY - GENERAL

- Audit approach is principally very similar to those of other Sectors such as Banks, Mutual Funds, Manufacturing, etc.
- **Risk Based Audit Approach:** Volume and size requires auditors to use a Risk based approach. This approach emphasizes on coverage of 'all major areas of risk' based on objective assessment of risk factors, their significance, and materiality.
- **Use of In-house experts** for comfort on Information Technology Systems, Tax positions, etc taken by the Company.
- **Business and product understanding and their accounting**
- **Understand issues** existing in the Insurance Industry - Accounting, Taxation, etc.
- **Monitoring of IRDA website** for circulars/orders issued to Company & Peer Companies

KEY CONSIDERATION FOR AUDIT OF LIFE INSURANCE COMPANY - GENERAL

- Coordination /Discussion among the Joint Auditors
 - All the critical matters/observation/issues should be discussed between the auditors and there should be consensus on the issues/observations
 - Allocation of items of Trial balance between the Joint Auditors
 - Rotation of areas among auditors - May be 2 years

COMMISSION – KEY CONSIDERATION

- Understand complete process from recruitment of agents till termination of agents vis-à-vis accounting entries
- Ensure rates at which Commission/Brokerage is paid are duly approved in File & Use guidelines for respective products.
- Ensure that Commission is paid within the prescribed limits as set by IRDA.
- Understand Company's commission policy towards terminated agents, employees earlier working as agents and vice-versa for payment of first year and renewal premium
- Review various other payments made to brokers/agents and assess the compliance under Section 40A

COMMISSION – AUDIT /ACCOUNTING ISSUES

- Can the Contest payouts be considered for compliance with Section 40A of the Insurance Act, 1938?
- Are Companies liable to pay the Renewal Commission to agents who have not renewed the License and if yes, whether it is in compliance with Section 40A?
- Can Companies pay the renewal commission to employees for business generated during agency (relationship) period?
- Whether commitment fees paid by Insurance Companies can be deferred or accounted upfront and whether the same is to be considered for compliance with Section 40A?
- Whether TDS on Commission to be deducted on Gross or Net amounts considering IT Department Circular of 1973?
- Whether payments made under Skill building schemes/arrangements need Auditor's Professional Skepticism?

BENEFITS PAID - KEY CONSIDERATION

- Review the Claims settlement terms agreed upon by the Company in File & Use guidelines
- Understand the nature of claims and process thereof - Death, Maturity, Money-back, Surrender (including partial surrender)
- Review the process of receipt of claims intimation to its final payment
- Understand the Company's policy for investigation of claims
- Verify the calculation of surrender charges and the same should be in line with File & Use.
- Verify adherence to cut off procedures by Company for Claims and Surrender intimation received on last day, its status in policy admin system and its related impact on the Actuarial Liabilities

BENEFITS PAID - KEY CONSIDERATION

- Understand the Internal control over the follow up process for payments towards Policies matured/terminated, etc.
- Review the basis of provision towards cases under litigation and amounts disclosed as contingent liabilities. Ensure that actuarial reserves carried in the books and payments made, if any are to be adjusted against provisions to be made
- Perform data analytics between various systems of the Company and current status of Policies (discussed in detail later)

BENEFITS PAID – AUDIT /ACCOUNTING ISSUES

- Whether the Company has built sufficient controls to restrict pile-up of Unclaimed amount by Policyholders? A steep increase in the unclaimed amount has become a cause of concern for the insurance companies. *(Whether insurance companies are liable for interest payment on such dues as they are earning returns on the same, is a matter of debate.)*
- Whether Cheques issued dated March 31 but not dispatched to policyholder, can be accounted in that period? (To disclose lower liability)
- Whether litigations with Policyholders can be considered for contingent liabilities disclosure?
- Whether provision has been made for all the claims intimated at the end of the year Company and whether corresponding update has been made in the System?

BENEFITS PAID – AUDIT /ACCOUNTING ISSUES

- Whether any adjustment is required in the financial statements for Cheques issued prior to reporting period but converted to stale before sign off the financial statement?
- Whether Death claims can be repudiated on non-receipt of mandatory documents by Insurance Companies?

BROAD LIFE CYCLE OF POLICY IN POLICY ADMIN SYSTEM

Policy Status	Brief Descriptions
IF - Inforce Policy	On issuance of Policy
LA - Lapse Traditional	Non payment of premium for traditional policy within due date including grace period
LU - ULIP Lapse	Non payment of premium for ULIP policy within due date including grace period
LS - Auto foreclosure	Post completion of revival period of ULIP policy
SW - Discontinuance	Non payment of premium for ULIP policy - Policies issued after 2010
PU - Paid Up	Non payment of premium for Traditional policy after 3 years
SU - Surrender	Post completion of 3 years policyholder can come for surrender
RD - Death Register	On receipt of intimation of death of policyholder
MU - Maturity	On completion of Policy period

DATA ANALYTICS - ILLUSTRATIVE

- Whether policy is still under In-force status though the premium is not received within due date including grace period
- Whether policy is still under ULIP Lapse status after completion of its revival period
- Whether Policy gets under Matured status after Risk Cessation date
- Whether all in force policies of a Policyholder has been appropriately dealt post receipt of intimation of death against one policy

ACTUARIAL VALUATION OF LIABILITIES

- All Insurance Companies are required to have an appointed actuary who is responsible for ascertaining the actuarial provisions towards policies in force and under discontinuance stage
- Insurance Reserves certified by the Appointed Actuary (also known as actuarial reserve) form a significant item of Liability in the Financial Statements of Insurance Company.
- An auditor is required to state that reliance has been placed on Appointed Actuary for actuarial valuation of liabilities in their Auditors' Report.

ACTUARIAL VALUATION OF LIABILITIES - AUDIT/ACCOUNTING ISSUES

- Can an auditor step in the shoes of Actuaries and verify the actuarial reserves? Para A34 to Para A48 of Standard on Auditing 500 - "Audit Evidence" requires an auditor to document the reliability of information produced by management's expert. Accordingly, Auditors should follow the below procedures:
 - Auditors must review the assumptions used by Actuaries & benchmark the assumptions used by Peer Companies
 - Validate the inputs received from various systems for calculation of actuarial liability
 - Obtain the list of policies which are not considered for actuarial valuation and reasons thereof

ACTUARIAL VALUATION OF LIABILITIES - AUDIT/ACCOUNTING ISSUES

- Whether the effect has been given in the actuarial liabilities towards provision has been made for Premium will not be received in the grace period based on persistent ratio. (Please also assess the related effect on Commission and Reinsurance)?
- Free Look In Cancellation of Policies and Cheques dishonor for first year & renewal policies after the reporting date but before the signing of the financials?
- Whether the Actuarial Liabilities needs to be presented net of reinsurance reserves or gross?

A close-up photograph of a person's hands signing a document. The person is wearing a light blue long-sleeved shirt. They are holding a dark pen with a gold-colored tip and are in the process of writing a signature on a white document. The document has a line labeled "Signature" and a horizontal line for the signature. The background is a dark wooden desk. The text "AUDITORS' REPORT" is overlaid in green at the bottom right.

AUDITORS' REPORT

AUDITORS' REPORT

- IRDA prescribes matters to be dealt in the **Auditors report** vide IRDA (Preparation of Financial Statements and Auditors Reports of Insurance Companies) Regulation 2002
 - Reliance placed on Actuary for Actuarial Valuation of Liabilities
 - Compliance with IRDA guidelines specifically in respect of investment valuation
 - Review of management report for inconsistencies with the Financial Statements
 - Compliance with the terms and conditions of the registration
 - Verification of cash balances and investment
 - Compliance with the application of assets of policyholders' funds

A photograph of two business people shaking hands. The person on the left is wearing a dark suit jacket and a light blue shirt. The person on the right is wearing a dark suit jacket and a white shirt. The background is a blue-toned world map with a grid pattern. The text "THANK YOU" is centered in white, bold, sans-serif font.

THANK YOU

Email: puru.nyati@gmail.com
Mobile: 9820275224