NÁRODNÁ BANKA SLOVENSKA

SPECIFIC ACCOUNTING POLICY FEATURES OF COMMERCIAL INSURANCE COMPANIES IN THE CZECH REPUBLIC

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Compared to other business sectors, the insurance sector has a number of features that are quite specific. Even though commercial insurance companies are also engaged in activities similar to those of other business entities, such as the purchasing of stamps and vouchers, tangible and intangible assets, inventory, etc., their main line of business consists of insurance and reinsurance activities. Commercial insurance companies' accounting therefore differs from that of other businesses. The accounting of these insurance companies draws upon the Accounting Act No. 563/1991 Sb., as amended by later legislation (the latest amendment to this act, Act No. 353/2001 Sb., has been effective as of 1 January 2002), but unlike other businesses, it is also influenced to a large degree by Act No. 363/1999 Sb. on the Insurance Industry, as amended by later amendments and revisions and also by MoF decrees No. 75/2000 Sb. and No. 502/2002 Sb.

Needless to say the accounting of insurance companies (like that of banks, government subsidised and non-profit organisations and others) certainly respects the basic principles and fundamentals of maintaining accounting records. Nevertheless, a specific (framework) chart of accounts for commercial insurance companies is used for the companies' own accounting.

The framework chart of accounts for insurance companies and the accounting procedures to be used were stipulated by a measure of the MoF. The chart of accounts for commercial insurance companies comprises 9 account classes, namely:

- Account Class 1 – Capitalisation (investments)
- Account Class 2 – Assets
- Account Class 3 – Receivables, payables and suspense accounts
- Account Class 4 – Capital and long-term liabilities account
- Account Class 5 – Expenses
- Account Class 6 – Revenues
- Account Class 7 – Closing and off-balance sheet accounts
- Account Classes 8 & 9 – Intracompany accounting of insurance companies

Account Class 1 includes accounting records on such assets (both tangible and intangible) of an insurance company, by which the company guarantees its obligations (risks) arising from insurance and reinsurance activities. This is the main difference compared to Account Class 2, under which an insurance company records such assets that are not placed on the market. This is because an insurance company does not guarantee its obligations by these assets and may therefore dispose with them as needed (meaning, it may sell or lease them, etc.). Accounting procedures relating to assets recorded in these account classes are no different from the accounting treatment of other business entities. Although the accounts used vary, which is a result of the different chart of accounts applicable to insurance companies, the reasoning behind the accounting treatment is still the same.

The specific features of the chart of accounts for insurance companies do not become fully evident until we reach Account Class 3 and subsequent classes. Although also under these classes the reasoning behind the accounting treatment remains more or less identical with the accounting procedures of other businesses, several specific accounts come into play here, whose role is to capture and present in depth the principal lines of business of insurance companies. Hence the same accounts as for other business entities (of course, differently numbered) appear in these classes, but in addition to these there can also be found several specific accounts there that are not used in other businesses. To illustrate this, an example can be given of the accounts of Account Class 3, Receivables and Payables from Direct Insurance for Policyholders or Receivables from Reinsurance Operations, as well as the account Payables to Intermediaries (Brokers), and so on.

Technical reserves constitute the chief distinctive feature of Account Class 4. These reserves are used to discharge obligations arising from policies concluded.

Considering the scope of its activities, an insurance company must therefore raise, additionally to the classic types of reserves, a number of specific reserves that are not found in other businesses. This for example concerns the unearned premium reserve that is raised by insurance companies in an amount corresponding to the premiums relating to an accounting period in the future, and actually reflects timing differences regarding premiums (accruals

thereof). Likewise, they include claims reserves, bonus reserves, equalisation funds, life assurance reserves, etc. The reserves raised are charged against expenses and to the credit of the respective technical reserves account. However, a strict distinction is made on the expense side between the class of policy to which the given reserve raised is attributable. The relevant expense account is chosen accordingly. Any subsequent drawing on reserves is then recorded under revenues and debited from the respective technical reserves account. Once again, the class of insurance on which the given reserves has originally been raised is strictly distinguished on the side of revenues. The relevant revenue account is then selected accordingly.

The so-called technical accounts in Account Classes 5 – Expenses and 6 – Revenues are an interesting and distinctive feature of insurance companies' accounting policies. In the case of insurance companies, Account Classes 5 and 6 comprise three main parts: a non-life insurance technical account, a life assurance technical account and a non-technical account. Technical accounts are used to account for all expenses and revenues related to the respective class of insurance (a typical example of such expenses and revenues would be the cost and revenue associated with insurance and reinsurance contracts signed and administered, the cost of indemnity, but also the creation and application of respective technical reserves, etc.). The recognition of the class of insurance to which the expense or revenue in question relates is of great relevance in the process of bookkeeping, since the relevant expense or revenue account within the given technical account is selected on the basis of it.

A non-technical account is then used to account for expenses and revenues that cannot be attributed to non-life insurance as opposed to life assurance and also for expenses and revenues that are not related to insurance or do not occur solely in relation to a non-technical account. Expenses and revenues that cannot be differentiated in terms of non-life insurance vs. life assurance, but are demonstrably related to insurance, are nevertheless later transferred to technical accounts for non-life insurance or life assurance in accordance with the internal regulations of insurance companies.

A specific feature of Account Class 7 is on the one hand more precisely defined off-balance sheet accounts, but then particularly the accounts Clearing of Profit (Loss) on Non-Life Insurance Technical Account, Clearing of Profit (Loss) on Life Assurance Technical Account and Clearing of Profit (Loss) on Non-Technical Account, which are used to clear the profit (loss) on the insurance company's individual technical and non-technical accounts.

We thus reach a certain peculiarity of the end-of-year processing in insurance companies. Procedures followed in opening the books of account in insurance companies basically do not differ from those of other business entities. The closing of books though requires specific procedures, especially where this concerns determining the insurance companies' results of operations. To explain this, when the profit (loss) is ascertained by an insurance company, the closing balances of expense and revenue accounts are not directly transferred to the Profit and Loss Account as in ordinary businesses, but the aforementioned closing accounts Clearing of Profit (Loss) on Non-Life Insurance Technical Account, Clearing of Profit (Loss) on Life Assurance Technical Account and Clearing of Profit (Loss) on Non-Technical Account intermediate in the process instead. Closing balances on individual expense and revenue accounts are re-posted to these accounts, and afterwards their closing balances are transferred to the Profit and Loss Account. The accounting profit (loss) of insurance companies can then be determined in a classical way, by the closing balance on the Profit and Loss account, which, as in other businesses, is transferred to the respective side of the Closing Balance Sheet Account.

A brief comment should be made also on Account Classes 8 and 9 – it can be said that these classes come fully within the discretion of individual insurance companies. The framework chart of accounts does not define as mandatory for insurance companies any specific account groups or accounts directly. It is then up to the insurance companies themselves to determine, depending on their needs which accounts of this account class will they use.

Conclusion

We believe that bookkeeping in insurance companies is somewhat more complex than in other business entities. Greater emphasis is given to subledger recording, and the compilation of financial statements is likewise more complex, since insurance companies must render more complex calculations, which do not rely purely on accounting data.

Statutory financial statements of insurance companies must be audited and presented to the Ministry of Finance, the locally competent tax authority of the insurance company's registered office and the central government statistics authority. Insurance companies are obliged to allow anyone to inspect their annual financial statements and annual reports as well as to publish selected data on a yearly basis.

References

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