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## RESERVE BANK OF VANUATU

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INSURANCE COMPANIES AND INTERMEDIARIES

PRUDENTIAL GUIDELINE NO. 4

### GUIDANCE NOTES FOR ACCOUNTING AND AUDIT PROCEDURES

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#### **Statement of Objectives**

This guideline sets out the annual audited reporting requirements for all insurers and insurance brokers which is submitted not later than six months after the end of the licensee's financial year. This is essential for RBV to gather the necessary information to conduct effective off-site monitoring, as well as providing an understanding of the insurance market.

#### **Audit opinion**

30 April 2010

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It is incumbent on the directors and/or management of a company to prepare annual accounts in accordance with generally accepted principles or international standards and an audit report.

In preparing annual accounts management is responsible for;

1. Adopting sound accounting policies
2. Maintaining an adequate and effective system of accounts
3. Establishing and maintaining internal control over financial reporting which will provide reasonable assurance that assets are safeguarded against losses from unauthorized use or disposition
4. Ensuring that transactions are properly recorded in order to permit the preparation of financial statements in accordance with the accepted insurance accounting practice

RBV considers an audit to be an independent examination of the financial statements of an insurance company licensed in compliance with the Insurance Law. The RBV has a distinct preference for such audits to be carried out by accounting firms who have personnel with sufficient experience in both preparation and audit of insurance company accounts. A standard reporting format enables the supervisor to analyse the return and ensure that the company's performance is reviewed in accordance with international standards.

Auditing practices differ between accounting practices and overseas based companies will comply with either, USGAAP, UKGAAP or Internationally Accounting Standards. RBV accepts these practices. Reliance is placed on the auditors to comply fully with the practice and the RBV expects the audit report to cite the practice that has been applied.

It is expected that, in carrying out their work auditors will;

1. Assess the company's accounting systems and their adequacy as a basis for the business, **safeguarding assets** and **compliance with legislation.**
2. Obtain sufficient audit evidence to arrive at their opinion. Sources would include underlying documentation, management, **insured's policies,** **reinsurance and other insurance agreements,**
3. Review the financial statements as a whole to have a reasonable expectation of detecting material misstatements whether caused by fraud, other regularities or errors.

4. Express any qualification in their opinion.

It is understood and accepted that selective testing of data will be employed and that certain errors or irregularities may not be identified. In addition procedures that are effective for detecting errors may be ineffective in detecting other irregularities.

It is for these reasons that regulators request that the audit is managed by a manager experienced in insurance accounting.

## **NOTES TO THE ACCOUNTS**

In addition to the auditor's opinion, the RBV relies to a great extent on the notes to the accounts.

The notes will be used to verify information already existing on RBV's file for the company and will cover such areas as;

1. any change in the ultimate ownership of the company
2. the classes of insurance and business undertaken
3. the existence of subsidiary or associated companies
4. accountancy practices adopted
5. foreign currency transactions
6. Share capital, share premium, unpaid calls, paid in surplus, retained earnings and any movements in these items.

This list is by no means exhaustive and is used by regulators to check whether there have been any material changes during the company's year of account.

The accounting practices review will contain important information relating to;

1. Method of accounting for insurance and reinsurance premiums, fully earned or pro-rata
2. Acquisition costs – whether written off or deferred
3. Claims incurred ( paid and outstanding )for the current and prior years
4. Methodology used in setting claims reserves and loss expenses
5. Calculation of IBNR

6. Invested assets by category showing book and market values
7. Use of estimates

Point 4 is particularly critical in view of the constant danger to any insurance operation of under-reserving. Under this heading the RBV seeks information on who sets the claims reserves and IBNR or ultimate net loss and whether actuaries are employed.

In the latter case the regulator should see information regarding the level of confidence used and the discount rate applied.

Point 5 is important in judging the company's exposure to equity investments, bonds and other instruments which may not conform to standard insurance practice.

Other notes that regulators require relate to such items as;

1. Any adjustments to prior year items
2. related party transactions, including investments or loans
3. Letters of credit in place, collateral and by whom held
4. Shareholder and /or director disputed
5. Significant law suits of a non- insurance nature
6. Off-balance sheet transactions
7. Reliance on other specialists
8. Credit, liquidity and reinsurance risk
9. Post balance sheet items
10. Further explanation of any qualifications contained in the audit opinion, particularly any relating to the company's ability to continue as a going concern

## **SUMMARY**

RBV has expectations of auditors that are divided into two specific areas;

1. The audit opinion, which is based on the financial statements,

2. The notes to the accounts, which provide supplemental information, not always of a purely financial nature, which tends to highlight areas of risk to which the company is exposed.

The RBV does not expect auditors to be infallible and in particular accepts that transactions are tested on a sample basis which may not detect errors and/or irregularities.

The notes to the accounts are important as they are relied upon to provide information of a widely varying nature on the internal controls of the company and the regulator recognizes that it must rely on the judgment of the auditor as to what is a material subject for inclusion in the notes.

**ANNUAL RETURNS INSURANCE REGULATIONS**

**EXAMPLE**

**ABC INSURANCE LIMITED**

**PROFIT AND LOSS ACCOUNT**

	Notes	
GROSS PREMIUMS		XXX
OUTWARD REINSURANCE PREMIUMS		XXX
		-----
NET WRITTEN PREMIUMS		XXX
CHANGE IN UNEARNED PREMIUMS	1	XXX
		-----
PREMIUMS EARNED		XXX
COMMISSIONS RECEIVED		XXX
		-----
PREMIUM INCOME		XXX
LESS;		
CLAIMS INCURRED (NET OF REINSURANCE)	2	XXX
COMMISSION PAID		XXX
INTEREST PAYABLE AD SIMILAR CHARGES		XXX
GENERAL AND ADMINISTRATIVE EXPENSES		XXX
		-----
		XXX
		-----
UNDERWRITING PROFIT		XXX
INVESTMENT AND OTHER INCOME	3	XXX

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PROFIT BEFORE TAXES	XXX
PROVISION FOR TAXES	XXX
	----
PROFIT	XXX
RETAINED PROFIT AT BEGINNING OF YEAR	XXX
TRANSFER TO RESERVE	XXX
RETAINED PROFIT AT END OF YEAR	XXX

**ABC INSURANCE LIMITED**

**BALANCE SHEET**

**TANGIBLE ASSETS**

CASH		XXX
GOVERNMENT BONDS, DEBENTURES		XXX
QUOTED SECURITIES		XXX
PREMIUM RECEIVABLES		XXX
REINSURANCE BALANCE RECEIVABLES		XXX
ACCOUNTS RECEIVABLE (net of bad debt provision)		XXX
IRREVOCABLE LETTER OF CREDIT		XXX

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XXX

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**OTHER ASSETS**

REAL PROPERTY		XXX
MORTGAGES ON REAL PROPERTY		XXX
UNQUOTED STOCK/BONDS		XXX
RECEIVABLES FROM PARENT OR ASSOCIATED COMPANIES	XXX	

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XXX

**LIABILITIES**

UNEARNED PREMIUMS		XXX
CLAIMS RESERVES	4	XXX
DUE TO REINSURERS		XXX

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OTHER LIABILITIES	XXX
	----
	XXX
	----
<b>CAPITAL AND SURPLUS</b>	
INITIAL PAID UP CAPITAL	XXX
ADDITIONAL PAID UP CAPITAL	XXX
RETAINED EARNINGS	XXX
	----
	XXX

Detailed schedules in notes to accounts (Audited)

Note 1

**CHANGES IN UNEARNED PREMIUM**

UNEARNED PREMIUMS FOR PRIOR YEAR (GROSS)	XXX
LESS UNEARNED PREMIUMS CURRENT YEAR (GROSS)	XXX
	----
<b>CHANGES IN UNEARNED PREMIUM (GROSS)</b>	<b>XXX</b>
UNEARNED PREMIUMS PRIOR YEAR (REINSURER)	XXX
LESS UNEARNED PREMIUMS CURRENT YEAR (REINSURER)	XXX
	----
<b>CHANGES IN UNEARNED PREMIUMS (REINSURER)</b>	<b>XXX</b>
CHANGES IN UNEARNED PREMIUMS	XXX

Note 2

**CLAIMS INCURRED**

CLAIMS PAID GROSS	XXX
CLAIMS PAID BY REINSURER	XXX
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<b>NET CLAIMS PAID</b>	<b>XXX</b>
CHANGES IN PROVISION FOR CLAIMS (GROSS)	XXX
CHANGE IN PROVISION FOR CLAIMS (REINSURER)	XXX
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**CHANGES IN PROVISION FOR CLAIMS OUTSTANDING** **XXX**

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CLAIMS INCURRED NET OF REINSURANCE **XXX**

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Note 3.

**INVESTMENTS**

	<b>COST</b>	<b>GROSS UNREALISED GAIN</b>	<b>GROSS UNREALISED LOSS</b>	<b>FAIR VALUE</b>
GOVT. SECURITIES				
GOVT. BONDS				
QUOTED SECURITIES				
UNQUOTED SECURITIES				
	-----	-----	-----	-----
	XXX	XXX	XXX	XXX
	-----	-----	-----	-----

Note 4.

**RESERVES**

BALANCE BROUGHT FORWARD	XXX
LESS REINSURANCE RECOVERABLES	XXX
	----
NET BALANCE	XXX
	----
CLAIMS INCURRED	

CURRENT YEAR	XXX
PRIOR YEAR	XXX
	----
<b>TOTAL CLAIMS INCURRED</b>	<b>XXX</b>
	-----
CLAIMS PAID	
CURRENT YEAR	XXX
PRIOR YEAR	XXX
	----
<b>TOTAL CLAIMS PAID</b>	<b>XXX</b>
	----
NET BALANCE END OF YEAR	XXX
ADD REINSURANCE RECOVERABLE	XXX
	----
<b>CLAIMS LIABILITY</b>	<b>XXX</b>
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### **Guidance notes on the valuation of admissible assets**

There is a trend for captives to have significant assets in non admissible assets in particular, loans to parent, affiliates and associates in the form of notes and investment in unquoted securities. These assets have significant impact on some captive's ability to meet the minimum required margin of solvency which is the benchmark by which all companies are measured for their ability to pay claims if and when they arise.

There may also be some confusion regarding admissible and non admissible assets and its direct relationship to the calculation of the solvency margin. Some companies have expressed concern as to the interpretation by indicating that some of the instruments used in these assets are easily turned into cash.

There is therefore a need to provide a guideline on admissible assets and liabilities and its relation to solvency.

A summary of the requirements follow;

#### **ALLOWABLE ASSETS**

Cash in hand, or on deposit with a financial institution approved by the RBV.

Government securities, debentures and bonds approved by the RBV.

Quoted securities not exceeding 25% of total assets

Premium receivable.

Reinsurance balance receivable

Accounts receivable net of bad debt provision

Irrevocable letter of credit approved by the commission

#### **Non admissible assets**

Investment in and advances to the insurers parent company, subsidiary or affiliates unless specifically approved by the RBV.

Real property or mortgages on real property

Unquoted securities

### **Calculation for liabilities**

All liabilities except liabilities in respect of share capital and contributed surplus

### **Minimum margin of solvency**

The minimum margin of solvency is considered by the commission to be the amount by which the total value of an insurer's assets must exceed the total amount of its liabilities. The value of assets of an insurer for the calculation shall be allowable assets.

#### **In the case of general business:**

20% of the net retained annual premium income.

#### **In the case of life business :**

VT 25,000,000

### **Note on non-admissible assets**

Whilst maintaining the RBV's view on liquid assets and solvency we however wish to maintain a flexible regime to allow Captive companies to operate. At the same time insurance companies must appreciate the RBV's desire to see companies properly capitalized, with investments in proper instruments, taking on sensible and legitimate risks and survive as licensed insurance companies in Vanuatu

For pure captives (parent owned) the RBV may consider the approval of a portion of investments in and advances to the insurer's parent company, subsidiary and affiliates not to exceed 20% of the full value providing that proper documentation is submitted and approved and the approval will not affect the maintenance of solvency.

### **Administration of the loan**

Proper documentation, whilst not limited to, will include, a copy of the agreement and the security attaching to the loan. Unsecured loans will not receive credit. The terms cannot be open ended, i.e. a fixed inception and maturity date must be clearly expressed in the agreement.