CHAPTER III

Management of Medium Term Insurance

Medium Term Insurance

Interface With Other Systems

- Medium Term Insurance Pipeline system
- Cash Receipts system
- Claims and Recoveries system
- General Ledger system
- Corporate Tables

Medium Term Insurance

Negotiations with Exporter
⇓
Data into Medium Term Insurance system
⇓
Data transferred to Medium Term Insurance system
⇓
Letter of Offer sent to Exporter
⇓
[Posted to GL] - Cheque received by mailroom, input into Cash Receipts system
⇓
Insurance Policy issued
⇓
[Posted to GL] - Receivable and deferral schedules set up
⇓
[Posted to GL] - Cash receipt validated against receivable schedule and allocated to policy to clear receivable

Premiums

For medium term policies, premiums are taken into income using methods which reflect the exposures over the terms of the policies

Expenses

Direct Expenses

- Generally direct expenses should be expensed in the same period as the related revenue.
- Up front expenses such as broker fees and commissions which do not cover ongoing services and are not recoverable are expensed as incurred.

Indirect Expenses

- Indirect expenses are which cannot be directly allocated to a specific policy (eg general office expenses and salaries)
- Indirect expenses are expensed as incurred.

Medium Term Policy Example

Example 1

EDC issues a Specific Transaction insurance policy with a five year term to insure the export of Canadian goods to Venezuela. Total insured volume is $1 million and total premium is $60,000. The business is done through a broker and the broker fee is $6,000. The expected average loss rate is 50% of net premium income.

*(In this case the broker **dose not provide ongoing service** and the broker fee expense is **not recoverable**. Expense, therefore, is expensed at commencement of coverage)*

Policy Details

Policy Number:	STI-01-00001	Status: Policy Issued
Policy Holder:	ABC Marine	Status Date:
Exporter:	ABC MARINE	Underwriter: Jane Doe
Buyer:	Atlas Ltd.	
Country:	Venezuela	
Classification:	High Risk	
Selection of Act:	Corporate Account	
Insured Amount:	$1,000,000	
Issued Date:	Feb 1, 1997	
Period of Cover From:	Feb 1, 1997	To: Jan 31, 2002
Claims Expiry Date:	April 30, 2002	

Premium Accounting Entries

GL entries created upon issuance of policy

1) Set up of premium receivable

Premiums receivable	60,000	
Deferred Premiums		60,000

2) Set up of broker fee payable and expense broker fee

Broker fee expense	6,000	
Broker fee payable		6,000

3) Receipt of premium

Bank	60,000	
Medium term bank suspense		60,000

4) Allocation of cash receipt

Medium term bank suspense	60,000	
Premiums receivable		60,000

5) Cash disbursement

Broker fee payable	6,000	
Bank		6,000

6) Monthly recognition of premium income

Deferred Premiums	1,000[1]	
Premium income		1,000
(recognition of monthly premium income)		

1. 60,000/5yrs = 12,000/12 = 1,000

7) Monthly recognition of provision expense at 50%

Provision expense	500	
Allowance for claims		500

(1,000 * .50 = 500)

Accounting Reconciliation at End of Policy Term

Bank	
60,000(3)	
	6,000(5)

Medium Term Suspense	
	60.000(3)
60,000(4)	

Premiums Receivable	
60,000(1)	
	60,000(4)

Deferred Premiums	
	60,000(1)
60,000(6)	

Premium Income	
	60,000(6)

Provision Expense	
30,000(7)	

Allowance for Claims	
	30,000(7)

Broker Fee Payable	
	6,000(2)
6,000(5)	

Broker Fee Expense	
6,000(2)	

Financial Statement Presentation

BALANCE SHEET

ASSETS	
Cash	$54,000
Premium	0
TOTAL ASSETS	$54,000
LIABILITIES AND SHAREHOLDER'S EQUITY	
LIABILITIES	
Broker fee payable	0
Deferred Premiums	0
Allowance for Claims	30,000
TOTAL LIABILITIES	30,000
NET INCOME	24,000
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$54,000

INCOME STATEMENT

Premiums and Fees Earned	$60,000
Broker Expense	(6,000)
Net Premiums and Fees Earned	54,000
Provision Expense	(30,000)
NET INCOME	$24,000

Medium Term Insurance

Fee Summary		
Policy No: STI-01-00001 Currency: Cdn		
Installment Type	Total Receivable	Total Received
Risk Premium	60,000	60,000

Cash Receipts						
Document#	Receipt Date	Curr	Receipt Amount	System ID	Unallocated AMT	APP
DDB5820	Feb 11,1997	Cdn	60,000	MTI	0	X

Medium Term Policy Example

Example 2

EDC issues a Specific Transaction insurance policy with a five year term to insure the export of Canadian goods to Venezuela. Total insured volume is $1 million and total premium is $60,000. The business is done through a broker and the broker fee is $6,000. The expected average loss rate is 50% of net premium income.

*(In this case broker **provides ongoing service** and the broker fee expense is **recoverable.** Broker fee is, therefore expensed in the same period as the related premium revenue.)*

Premium Accounting Entries

All journal entries are the same as required for Example 1 except for the following entries:

2) Set up of broker fee payable and deferral

Deferred premiums	**6,000**	
Broker fee payable		6,000

Monthly recognition of broker fee expense

Broker fee expense	100[1]	
Deferred premium		100

1. 6,000/5yrs = 1,200/12 = 100

Medium Term Insurance

Endorsements

- An endorsement is a change in an existing policy which may result in either an additional premium, a return premium, or no premium adjustment. Endorsements may be made at any time during the policy term.
- The accounting for endorsement premiums is the same as accounting for original premiums.
- Examples of endorsements include extending or reducing period of cover, increasing or decreasing insured amounts.
- An endorsement cannot adjust a prior period after the period has been balanced and closed.

Monthly Reconciliations

The Accounting Administrator:

- Reconciles receivable, deferral and revenue balances in the Medium Term Insurance System to ending balances in the General Ledger

- Reconciles unallocated cash receipts in Cash Receipts system to medium term suspense account balance in General Ledger

- Notifies underwriters of all policies with receivable balances

Case Studies

Premiums

Example 1

On October 1, a short - term policy is issued to cover insured volumes of $ 1,000,000 in Algeria. The processing fee is $200.

Required:

Record the journal entries required to account for the following events:

1) On October 1, the processing fee of $20 is received.

2) On November 10 1997, a declaration is received from the exporter with a premium cheque in the amount of $10,000. The expected loss rate is 50% of premium income.

Answer to Example 1

1) Bank	200	
Short term bank suspense		200
(receipt of processing fee)		
short term bank suspense	200	
processing fees		200
(processing fee applied to policy)		
2) Accounts receivable	10,000	
premium income		10,000
(set up of accounts receivable and recognition of premium income)		

Provision expense		
Allowance for claims		5,000
(recognition of provision expense)		
Bank	10,000	
Short term bank suspense		10,000
(receipt of premium)		
Short term bank suspense	10,000	
Accounts receivable		10,000
(allocation of premium to proper policy)		

Example 2

A medium term insurance policy with a premium amount of $ 120,00 is issued to cover insured volumes of $ 2,000,000. The period of cover s from January 1, 1997 to December 31, 2001 and the Claims Expiry date is December 31, 2002. The export's co-insurance ration is 10%. The expected loss rate is 50% of premium income. There is no broker involved.

A) Record the journal entries required to account for the following events:
   1) The policy is issued on January 1, 1997. Record the set up of the receivable and deferred accounts

   2) The premium amount of $120,000 is received on January 10, 1997. Record the allocation of the cash receipt.

   3) Record the premium income and provision expense account entries for the month of January

B) What is the balance remaining in the Deferred Premium account on December 31, 1997?
C) What is the Contingent Liability for this policy?
D) When does the Contingent Liability expire?

Answer to Example 2.

A)

1) Premium receivable	120,000	
Deferred premium		120,000
(to record premium receivable)		
2) Bank	120,000	
Medium term bank suspense		120,000
(to record receipt of premium)		
Medium term bank suspense	120,000	
Premium receivable		120,000
(to allocate receipt)		

3)

Deferred premiums	2,000	
Premium income		2,000
(to record premium income = $ 120,000/5 = $ 24,000/12 = $2,000)		
Provision expense	1,000	
Allowance for claims		1,000
(to record provision expense = $ 2,000*.50)		

B) Deferred Premium at December 31, 1997

Opening Balance	$ 120,000
Less premium earned	(24,000)
Ending Balance	$96,000

C) Contingent Liability = $ 1,800,000

($2,000,000* .90)

E) The Contingent Liability expires on December 31, 2002 which is the claim expiry date

Case Studies

Expenses

Example 3

Refer to example 2.
What additional accounting entires would be required if a broker was involved in providing the business and a non-recoverable fee of $10,000 was charged by the broker?

Answer to Example 3

Broker fee expense	10,000	
Broker fee payable		10,000
(to record set up of broker fee payable and expense)		
Broker fee payable	10,00	
Bank		10,000
(to record payment of broker fee)		

Example 4

If the broker in example 3 provided ongoing services throughout the policy, describe how the accounting treatment would differ from example 3.

Answer
The broker fee would be expended over the life of the policy.

Case Studies

Foreign Exchange

Example 5

On October 3, 1997, premium in the amount of U.S. $ 100,000 is received for an insurance policy. The Financial Statements of the insurer are translated to Canadian dollars.

The daily close exchange rates are as follows:

October 3, 1997	US$ =$1.40 Cdn.
October 31, 1997	US$ = $1.50 Cdn
November 30, 1997	US$ = 1.35 Cdn

1) What is the exchange rate gain or loss on the Income Statement for the period ended October 31, 1997?

2) What is the exchange rate gain or loss on the Income Statement for the period ended November 30, 1997?

Answer to Example 5

1) Assets	**US$**	**Exchange Rate**	**Cdn Equivalent $**
Oct 3, 1997	$100,000	1.4	$140,000
Oct 31 1997	$100,000	1.5	$150,000
	Foreign Exchange Grain		**$10,000**

Note: *In this case the US$ has appreciated in value relative to the Cdn $, therefore since this is an asset account there is a foreign exchange gain on translation.*

2) Assets	**US$**	**Exchange Rate**	**Cdn Equivalent $**
Oct 31,1997	$100,000	1.5	$150,000
Nov 30, 1997	$100,000	1.35	$135,000
	Foreign Exchange Loss		**($ 15,000)**

Note: *In this case the US$ has depreciated in value relative to the Cdn$, therefore since this is an asset account there is a foreign exchange loss on translation.*