ADAPTING ACCOUNTING AND TECHNICAL-FINANCIAL REPORTING TO NEW REQUIREMENTS IN THE INSURANCE SECTOR

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Abstract

Despite the ongoing debate on the difficulties of harmonizing national accounting systems belonging to different countries or different areas of national economies and the fact that a large part of accounting standards is still a dynamic process and continual improvement in the IASB, the adoption of IFRS comply with the new policy of the globalization of the world economy, allowing both external partners and representatives of companies involved in this process to have access to a new category of information with a higher level of quality and transparency. While traditional elements concerning the presentation of the profit or loss in accordance with the new requirements remain under IFRS recognition, the mechanism changes significantly from a marginal approach. The harmonization of technical and financial reporting formats is essential for the EU to ensure a consistent implementation of the European regulatory and supervisory framework to support EIOPA and the main purpose of which is to improve efficiency and consistency of supervision of financial institutions in Europe.

Keywords: IFRS, Solvency II, insurance company, insurance market

JEL Classification: G 220, G 320, M 410

1. Background of the accounting system and financial and technical reports for insurance companies in Romania

The current system of accounting regulations applicable to companies operating in the insurance sector in Romania was adopted by the Insurance Supervisory Commission (CSA - former insurance supervisory body) by Order number 3129, published on December 29, 2005, completed and amended by Order Number 7 of 2007.

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The Order came into effect starting on January 1, 2006, has provided - in addition to the accounting harmonization with EU directives specific to insurance - the obligation to audit the annual financial statements for insurance-reinsurance companies and insurance brokers and / or reinsurance (in depending on the achievement of certain size criteria).

In terms of technical and financial reports on all the insurance companies and / or reinsurance in Romania are required to prepare them, they were adopted by the Order No. 2, published on March 20, 2009, supplemented and amended by Order number 18 of 2011.

Order, with applicability since the end of the first quarter of 2009, established the form and content of all technical and financial reports, grouped by reporting period (annual reports, semi-annual, quarterly and monthly). Provided financial and technical reports can be classified by types of reports and according to the results they provide, as follows:

- Accounting reports:

  The financial statements and accounting reports required by accounting regulations in force.

- Reporting on the calculation of technical financial key indicators:

  Reporting calculating the solvency margin, required solvency margin and the safety fund;

  Reporting admissible assets and explanations cover gross technical reserves;

  Reporting on the determination of the liquidity.

- Reporting on detailed presentation or grouped in different categories technical data and financial information.

1.1 Evolution of the current accounting system. Expected impacts of the transition to new accounting standards - IFRS

The provisions currently applicable accounting by insurance and reinsurance market in Romania, adopted since fiscal year 2006 represents a continuation of the process of specialization in insurance and also harmonization with European Directives and international accounting standards, the process started 2001, applicable as of fiscal year 2002 through the adoption of Common Order of the Ministry of Public Finance and C.S.A. number 2328/2390 of 28 December 2001. The implementation of the new provisions of the last mentioned order at that time represented a change of perspective the principle of accounting registration, insurance companies moving from an accounting based on records of financial flows directly related to the accounting records based on accrual accounting principles, which is why we believe that 2002 represents an important step in the evolution modality recording and reporting of financial and technical data due to basic principles of establishing new harmonized globally.

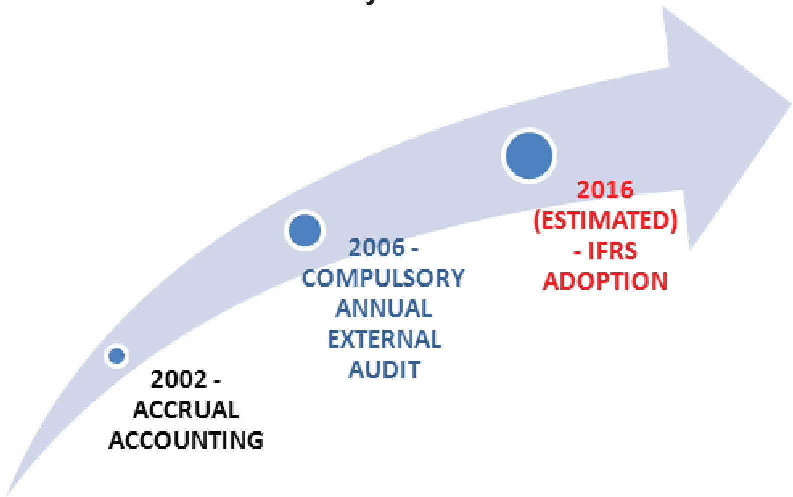
The effects recorded in the financial and technical reports due to implementation of the two acts were mainly the following aspects:

- Order 2328/2390 of 28 December 2001 (for the fiscal year 2002):
  - Changing of the bookkeeping principles, which had the effect of modifying the accounting treatment of technical data (e.g. recording gross written premium income on insurance policies underwritten value / reinsurance / coinsurance compared with past recording in the income accounting accounts for only the collected premiums related to the policies in question);
  - Implementation of a new chart of accounts and some accounting reports and annual/half-yearly financial statements specific for the insurance sector.

- Order number 3129 of December 29, 2005 (supplemented and amended by Order Number 7 of 2007):
  - harmonization of accounting regulations with European directives applicable to the insurance;
  - mandatory audit of the annual financial statements for insurance-reinsurance companies and insurance brokers and / or reinsurance (depending on achieving certain size criteria);
  - improvement of chart of accounts and accounting reports and annual/ half-yearly financial statements for the specific insurance sector.

Figure 1

Evolution of the modernization process in insurance accounting system



Continuing harmonization of accounting system and financial and technical reporting structure in insurance, C.S.A. has started since 2012 the process of applying IFRS to the insurance-reinsurance market by organizing a pilot group made up of the top 10 insurance companies depending on the insurance gross premiums written, which have gone a gradual process of transition to IFRS.

International Financial Reporting Standards (IFRSs) is a set of rules published as standard by the International Accounting Standards Board (IASB). To be applicable to entities in Romania and in other EU countries, accounting standards issued by the IASB are under review in the European Union and the official voting specially constituted committees at this level, the process by issuing ending Community regulations adopting the standards.

Relevance analysis on the type of activity consistent with the market share of these companies in the insurance market in 2011 is that most companies have a composite activity (7 companies which have a market share of 62.64% cumulative). Addressing the new financial reporting standard IFRS reduced significantly in the balance sheet of assets and liabilities only in the case of two of the companies listed: OMNIASIG VIGSA with -12.99%, respectively ASTRA SA, with -10.34%, both companies having a composite activity as a result a high degree of complexity of the business of insurance and market share of 22,63% cumulative. For the entire group of companies analyzed was recorded a reduction in balance sheet assets and liabilities of -3.97%, a level considered low due to the negative impact of adopting new accounting standards.

After analyzing the variations registered by the companies analyzed, it can be concluded that the impact of adopting accounting standards - IFRS was significantly, registering of some insurance company balance sheet assets and liabilities declines of over 10%. Also, changes were recorded in the balance sheet structure through the re-classification of certain elements according to IFRS requirements. Adverse changes balance sheets were due mainly adopting the following standards:

- IFRS 4 - Insurance Contracts
  - *the provisions of this standard had an effect mainly on technical, meaning de-recognition of certain stocks such as catastrophe reserve and equalization reserve in case of general insurance, and claims reserve adjustment due after applying the liability adequacy test;*
  - *application of this standard has had an impact on debt adjustment reinsurance respective debts of insurance;*
  - *in the case of life insurance, IFRS 4 had an impact on the separation of insurance contracts against investment contracts in insurance contracts with investment component of unit-linked.*

- IAS 29 - Financial reporting in hyperinflationary economies - two companies were founded before 2004, considered by this standard as a limit to adjust subscribed capital and other items on equity;

- IFRS 1 - First-time Adoption of IFRS - IFRS 1 is mandatory standard applied by all companies that adopt IFRS, setting rules for evaluation, and presentation of information following the adoption of IFRS;

- IAS 1 - Presentation of Financial Statements - IAS 1 is the mandatory standard applied by all companies that present information under IFRS, establishing rules for the presentation of financial statements, and the structure and composition;

- IAS 39 - Financial Instruments: Recognition and Measurement
    - *This standard has had a major impact on investments and financial instruments held, meaning their recognition and measurement at fair value;*
    - *also, the application of this standard resulted in a change of the presentation structural availability and short term investments balances of two companies, meaning those amounts re-classification of the investments held in the position representing the current availability of cash and current accounts are the amounts placed in a term up to 90 days.*

Despite the ongoing debate on the difficulties of harmonizing national accounting systems from different countries or areas belonging to different national economies and the fact that much of accounting standards is still a dynamic and continuous process of improvement in the IASB the adoption of IFRS are included in the new policy of the globalization of the world economy, allowing both external partners (customers, investors and supervisors) and representatives of companies involved in this process (shareholders, managers, analysts) have access to a new category of information with a higher level of quality and transparency.

In Romania, the project on the adoption of IFRS for insurance-reinsurance market has emerged as a mandatory measure prior and future crossings and because of a new solvency regime, but also as a tool for enhanced surveillance of FSA. Also, the adoption of new standards - involving employment in a transparent and harmonized information in the financial reports financial reporting - provides support for analyzing and interpreting modern technique for major internal and external user groups mentioned above. On the other hand, the adoption of IFRS requires defining policies and universal accounting principles, with a minimum degree of detail of the information presented, and a growing involvement and responsibilities of the managers of the respective companies.

The main standards concerning insurance and reinsurance market, namely:

- *IFRS 4 - Insurance Contracts,*
- *IFRS 7 - Financial Instruments: Disclosures,*

- *IAS 32 - Financial Instruments: Presentation,*
- *IAS 39 - Financial Instruments: Recognition and Measurement,*

aim to increase transparency in order charging, insurance and reinsurance contracts, the profitability of different types of insurance and reinsurance practiced, as well as risk management and investments. Following the adoption of these new standards will redefine competition rules followed by insurance companies because insurers will report under IFRS will be able to understand their financial performance and efficiently manage their affairs in accordance with the revised reporting in a more transparent, hovering eventually in an advantageous position compared to other companies on the market.

In order to achieve optimal framework for adopting IFRS, insurers must take into account the following aspects:

- *Applying IFRS increases operational risk of the companies involved due to the high degree of technical complexity and due to the involvement of various staff categories (not involved in the past financial reporting system), such as actuaries, specialists in risk assessment and investment specialist not least, the company management;*
- *Applying IFRS involves increasing volume of data and information analyzed and also the time required for interpretation and analysis of the results obtained, this having the effect of increasing the involvement of specialized staff; therefore, it requires that a qualified and sufficient in order to cover the minimum requirements of the standard;*
- *Updating and possibly changing systems and databases to ensure sufficient volume and history in order to ensure minimum requirements for analysis and reporting provided; in this regard, the adoption of IFRS may result in the necessity of completing the initial stage of investment in the modernization and harmonization of systems.*

1.2 The influence of the new solvency regime Solvency II under the technical and financial reports

While traditional elements concerning the presentation of the profit or loss in accordance with the new requirements remain IFRS, recognition mechanism changes significantly from a marginal approach. Assigning this theme under Solvency II is similar but profit under IFRS recognition principle (profit being recognized with obligations under the policies in force) is different from the Solvency II recognition principle surplus (at a notional value), this key-difference requiring adequate controls and processes and modeling recognized under IFRS additional profit.

As a result, a number of measures will be undertaken in order to adopt the new standard for success of the new IFRS and Solvency II regime, due to the fact that the data requirements for IFRS and Solvency II overlap (however IFRS enter data that were not considered in Solvency II data model and requires that similar parameters to be calibrated differently):

- Incentives and compensation will be recalibrated its Solvency II frameworks and IFRS, as well as strategy and the entity's governing by broader structures;
- Educate management and staff on how their insurer company have success under both Solvency II and IFRS, will require significant investments which will allow the training of complying with new capital assessment methods and profit;
- More work is required to present the necessary information. Companies recognize the need to improve the information presented, and considering the progress in risk management and capital, along with regulatory initiatives such as Solvency II, is likely to result in greater transparency and added value for users;
- Parallel evolution of IFRS and Solvency II framework, improving presentation will determine the risk management practices and risk margins, thus bringing consistency in risk management looked from the perspective of capital adequacy;
- It is recommended that, when a company is considering implementing an IT solution either for Solvency II, either for IFRS, to be considered together.

Solvency II Directive (Directive 2009/138 / EC) was adopted in November 2009, and amended by Directive 2014/51 / EU of the European Parliament and of the Council of 16 April 2014 (the 'Directive' Omnibus II "). On 10 October 2014 the European Commission (EC) adopted the Commission Delegated Regulation (EU) 2015/35), which contains detailed rules for Solvency II, which was published in the Official Journal on 17 January 2015. In February

2015 it published the first set EIOPA Solvency II guidelines, in all official EU languages.

In March 2015 the European Commission adopted the first set of implementing regulations of Solvency II in connection with establishing implementing technical standards regarding approval procedures for supervision:

- parameters specific to insurance companies;
- auxiliary own funds;
- necessary adjustments;
- vehicles with special destination;
- internal models;
- joint decision of their internal models group.

Managing the implementation of the new solvency regime at European level is achieved through EIOPA - European Insurance and Occupational Pensions Authority, the body that is part of a European System of Financial Supervisors, comprising three European Supervisory Authorities for the banking, securities sector securities and insurance and occupational pensions sector, and the European Systemic Risk Board.

The harmonization of technical and financial reporting formats at EU level is essential to ensure a consistent implementation of the European regulatory and supervisory framework to support EIOPA and the main purpose of which is to improve the efficiency and consistency of supervision of financial institutions in Europe.

Solvency II has created the need for all insurance companies and supervisory authorities in Europe to adapt reporting processes. XBRL is mandatory technical format to be used to report from the national authorities by EIOPA (secondary reporting) and also adaptations of the format for reporting from insurance companies by national authorities (first level reporting).

The main goal of this project is to create a basic tool simply oriented insurance companies of various sizes to create, edit, correct, complete and valid economic data and help insurance companies to implement the new solvency regime.

In conclusion, considering the adoption of A.S.F. Decision No. 47/2013 on the implementation of preparatory guidelines for the implementation of Solvency II supervisory regime and also the procedure for identifying the companies covered by that decision, influence of the implementation of the new solvency regime Solvency II on financial and technical reports lead to a broadening of the spectrum information, extending requests data and information on the following areas:

- Assets and liabilities by currency;
- Derivatives;
- Solvency capital requirement depending on risks: market, counterparty, operational, catastrophe.

2. Solutions and proposals for the modernization of accounting and technical-financial reporting in the insurance sector

As the types of insurance offered and the range of risks covered by insurance companies experienced a sustained growth in recent decades due to increased competition in the insurance and reinsurance sector, financial sector development, and the additional demands investors and executive management of insurance companies were required identification solutions extend the ways of accounting records.

A first step was the transition to accrual accounting, presently followed by the adoption of international accounting standards. Those two steps imposed in the first instance the establishment of accounting principles that can be transposed and implemented in the accounting treatment. Another influence was the definition and reconsideration of both technical and operational risks.

In terms of technical and financial reports, it requires firstly to clarify the reporting system of insurance companies. Due to globalization a growing number of insurance companies are owned by holding companies or other insurance companies (or financial and banking groups) in or from other countries, which is why these companies are obliged to implement a system of internal reporting which is often not adapted to the local reality or specific activity. Moreover, the intensification of monitoring financial risks (due to the negative effects of the recent financial crisis) and successive tests due next implementation of the new solvency regime and new accounting standards resulted in the creation and implementation of a parallel reporting system, which includes also the concurrent reports from the financial and fiscal authorities. Finally, should be considered also the technical reports to the supervisory authority and operational reporting to executive management of insurance companies.

2.1 Solutions for extension of the accrual basis of existing data and information from the insurance companies

The transition to accrual accounting as of fiscal year 2002 accounted for insurance companies a very important step, both in terms of accounting treatment and recognition in terms of technical complexity by implementing a specific chart of accounts tailored to insurance market. Process improvement and specialization in insurance accounting system continued through the adoption of new provisions starting with the financial year of 2006.

From a technical standpoint, the new accounting provisions permitted a clear reflection of data and information available to the companies, while ensuring a continuous and efficient reporting method. Such accounts have been created for all types of underwriting: insurance, coinsurance, reinsurance, ensuring calibration of recording technical data as follows:

- Operating income accounts:

- Revenue from gross premiums written for direct insurance;
- Revenue from gross premiums related to reinsurance acceptances;
- Gross written premiums canceled (-);
- Gross written premiums ceded (-);
- Income from reinsurance commissions;
- Claims - reinsurer part;
- Income from recoveries.

- Operating expenses accounts:

- Claims expenses;
- Reinsurance commissions expenses;
- Commissions expenses (related to direct insurance);
- Change in deferred acquisition costs.

- Technical reserves expenses:

- Technical reserves expenses for direct insurance;
- Technical reserves expenses relating to reinsurance acceptation;
- Technical reserves expenses for direct insurance – reinsurance part (+);
- Technical reserves expenses relating to reinsurance acceptation – reinsurance part (+).

Although current accounting provisions provide a framework for registration and reflection in accounting for insurance companies, future adoption of new accounting standards IFRS and specifically to IFRS 4 - Insurance Contracts - standard dedicated to the insurance industry, impose a need for improvements and additions to the current accounting system, due mainly to the following chapters:

- reinsurance;
- claims management activity - litigation and recovery;
- receivables management activities relating to insurance policies - provisions issued.

In this respect, it is necessary for solutions to be implemented linked with the recommendations mentioned below:

- on reinsurance accounting, treatment should be extended in recognizing all the influences due reinsurance policy, in terms of new accounts technical data sheets for the following (examples):
- Deferred reinsurance commission (-) / (+);
- Recoveries – reinsurers part (-).
- Regarding the activity of management of claims - litigation and recoveries - clarification of issues concerning the obligation of registration in the amounts of claims reserves recorded litigation for damages and also establish a system to offset setbacks between insurance companies;
- With respect to receivables management activities relating to insurance policies - provisions recognized - is it compulsory for insurance companies to record monthly provisions related to insurance policies for due premiums which were not collected according to the insurance conditions.

2.2 Proposals to modernize and streamline the technical and financial reporting in the insurance sector

The current financial and technical reporting framework for insurance companies has been transposed by adopting Order no. 2/2009 to implement the Norms regarding the form and content of the financial and technical reports for insurance and / or reinsurance companies and consisted in the setting of mandatory formats for technical and financial reports in accordance with specific reporting period: annual, semi-annual, quarterly and monthly reports.

The reports mentioned were implemented in order to improve market supervision insurance and reinsurance, however, it is noted that in terms of main financial reports, namely: balance sheet, profit or loss, , are binding only reported in the annual respectively half-yearly reports, the reason being the influence of fiscal and financial reporting methods, system regulated by the Ministry of Finance. Moreover, in the technical reports are provided quarterly and monthly reporting significant patterns (examples: reporting transactions performed, reporting obligations undertaken, reporting admissible assets and explanations on gross technical reserves coverage, reporting on determining liquidity ratio) that it can't be verified and calibrate with the previous financial reports.

Another important aspect is the adoption in the near future of the new solvency regime Solvency II and also the new international financial reporting standards IFRS, changes that will influence policy surveillance and reporting in the insurance field, the ultimate goal being to provide superior information in terms of quality of end-users: existing and potential customers supervisors, senior executives of insurance / reinsurance, prospective investors.

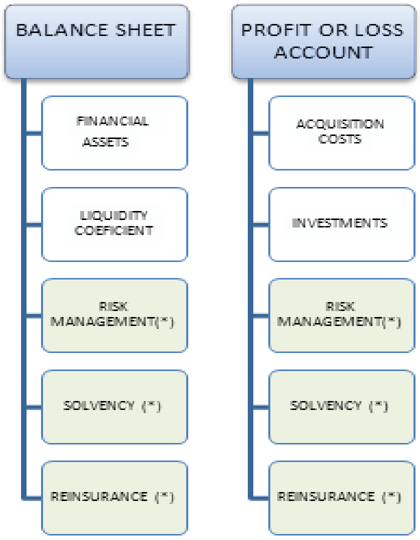
In this respect, it became necessary the creation of a new financial reporting system which respects the financial and technical data calibration principle. The financial and technical reports required to be issued by insurance companies must constitute a whole, starting from a minimum package of technical and financial reporting month. This could have the following structure (technical and financial reports whose data and information are correlated):

- Balance sheet;
- Profit or loss (the data will be presented in detail on insurance classes);
- Reporting on financial assets;
- Reporting on acquisition costs;
- Reporting on investments;
- Reporting on the determination of the liquidity;
- Reporting on risk management;
- Reporting on solvency margin;
- Reporting on reinsurance.

The manner of linking technical and financial data is presented below:

Figure 2

Structure of the monthly package of proposed technical and financial reports (* *joint connections*)



The proposed reporting structure must contain a validation file contained links between reporting and also as the end result a summary of the main financial and technical indicators for insurance-reinsurance activity.

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