



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN INSURANCE DIVISION

[Karachi]

Before Nasreen Rashid, Executive Director (Insurance)

In the matter of

Reliance Insurance Company Limited

Show Cause Notice Date May 3, 2010

Date of Company Reply Letter May 11, 2010

Date of Order June 1, 2010

ORDER

(Under Section 158 of the Insurance Ordinance, 2000)

.....

This Order shall dispose of the proceedings initiated against Reliance Insurance Company Limited ("the Company") for not complying with the provisions of Section 158 of the Insurance Ordinance, 2000 ("the Ordinance").

Background Facts

2. An Onsite Inspection of the Company was conducted under the Order of the Executive Director of the Insurance Division, in exercise of powers conferred under Section 59A(1) of the Ordinance, on February 1, 2010, which commenced on February 15, 2010 and completed on March 30, 2010. The Onsite Inspection Report ("the Report") was issued on April 15, 2010. According to the Report, during the course of the Onsite Inspection, it was found that, among other non-compliances, in various cases of co-insurance business under the lead of EFU General Insurance Limited, claims amounting to Rs. 54.524 million pertaining to the financial year 2008, were reported by EFU General Insurance Limited on March 13, 2009, that is, 18 days before the issuance of financial statements. However, claims, amounting to Rs. 30.692 million, were not included by the Company in the provision for outstanding claims (including IBNR) for the financial year 2008 as required by International Accounting Standard (IAS) 10 "Events after the Reporting Period" which is applicable through Annexure II Part B Regulation 2(2) of the SEC (Insurance) Rules 2002. This non-provisioning of claims resulted in a material over-statement of profits before tax, in the published financial statements for the year ended December 31, 2008, by an amount of Rs. 30.692 million.

3. Para 8 of IAS 10 "Events after the Reporting Period" states that

"An entity shall adjust the amounts recognized in its financial statements to reflect adjusting events after the reporting period."



4. Annexure II Part B Regulation 2(2) of the SEC (Insurance) Rules 2002 states:

"Insurers shall comply, so far as concerns recognition and measurement of assets, liabilities, expenses and revenues, with International Accounting Standards adopted by the Institute of Chartered Accountants in Pakistan and notified by the Commission, other than those standards where these regulations specifically provide for a different treatment."

5. The Report, in its Executive Summary, while referring to the Company as RICL, states:

"During analysis of the claims, it was observed that an intimation of claims amounting to Rs. 54.524 million pertaining to FY 2008, in cases where RICL was co-insurer with EFU General Insurance, was received subsequent to December 31, 2008 (on March 13, 2009), but before the date of authorization (i.e. March 31, 2009) of financial statements for the ended December 31, 2008, for issue. However, the amount of the claims amounting Rs.30.692 million out of that intimation, was not included in the provision of outstanding claim (including IBNR) for the FY 2008. Therefore, the company has not adjusted an event in the financial statements for the financial year ended December 31, 2008 as required by International Accounting Standard (IAS) 10 "Events after the Reporting Period" applicable to the company in spite of the fact that the company has declared in note 3 to the financial statements for the year ended December 31, 2008, a statement of compliance of the financial statements with approved accounting standard as applicable to insurance companies in Pakistan. Accordingly, the company has violated regulation 2 (2) of Part B annexure II read with rule 16 of The Securities and Exchange Commission (Insurance) Rules 2002, which were issued in exercise of powers conferred by subsection (2) of section 167 of the Insurance Ordinance 2000."

6. According to the Report, in its Executive Summary, states:

"Further, the above non-compliance resulted in material overstatement of profits before tax in the published financial statements for the year ended December 31, 2008 by an amount of Rs. 30.692 million."

7. The Report also provides another possible reason for how such an error could have led to the misstatement in the first place, stating:

"It was observed that there is no proper mechanism for estimating IBNR (Claims Incurred but not reported) to be included in Provision for outstanding claims. It is practice of company to base its estimation of IBNR only on claims reported within first forty-five days subsequent to the year ended."

8. The Report states that the inspection team raised the issue with the management of the Company and it was duly confirmed by the management. A table from the Report has been reproduced below:

Detail of Co-Insurance Claims for year 2008 for IBNR

Co- insurance	Booked in FY 2008	Balance
2,570,571	2,320,571	250,000
73,996	73,396	600
3,295,042	3,065,410	229,632
48,535,081	18,322,389	30,212,692
50,208	50,208	-
54,524,898	23,831,974	30,692,924



9. The table above shows the Co-insurance Claims, arising out of the Co-insurance business under the lead of EFU General Insurance Limited, amounting to Rs. 54.524 million. EFU General Insurance Limited had informed the Company on March 13, 2009. Of this, Rs. 23.831 million had been recorded in the published accounts of FY 2008. The Balance was booked in FY 2009. A table, from the Report has been reproduced below, showing that the balance for the FY 2008 had been recorded in FY 2009, under the head of Co-insurance, as shown below:

	Direct	Co-insurance	Total
Fire	2,553,000	250,000	2,803,000
Engineering	1,105,500	600	1,106,100
Marine	1,681,000	229,632	1,910,632
Misc.	1,685,000	30,212,692	31,897,692
Misc.	90,000	-	90,000
Total	7,114,500	30,692,924	37,807,424

10. The applicable penal provision of the Ordinance, Section 158, states:

"Penalty for false statement in document.- Except as otherwise provided in this Ordinance, whoever, in any return, report, certificate, balance-sheet or other document, required by or for the purposes of any of the provisions of this Ordinance, wilfully makes a statement false in any material particular, knowing it to be false, shall be punishable by the Commission with fine which may extend to one million rupees."

Show Cause Notice

10. Accordingly, a Show Cause Notice dated May 3, 2010 under Section 158 of the Ordinance was issued to the Chief Executive and Directors of the Company, calling upon them to show cause as to why the penalty, as provided in Section 158 of the Ordinance, should not be imposed upon them for material over-statement of profits before tax, in the published financial statements for the year ended December 31, 2008, by an amount of Rs. 30.692 million due to non-provisioning of outstanding claims as stated above and provided in the Report.

Company's Response to the Show Cause Notice

11. The Company, via its letter dated May 11, 2010, filed May 12, 2010, response to the abovementioned Show Cause Notice stated that:

"We take due care with regards to the provisioning of IBNR as required by law. You may please appreciate that changes pertaining to IBNR cannot be effected on day to day basis therefore technically a cut-out date had to be fixed. The cut-out date traditionally fixed at Reliance Insurance is 15th February every year ensuring to book claims under the IBNR as the impact inter-alia has in reinsurance accounts and auditors also need sufficient time to verify and to finalize annual accounts."

12. The Company explained that:

"It is pertinent to mention here that we had already booked claims pertaining to year 2008 of about Rs. 25 million on account of co-insurance business under the lead of EFU General Insurance Limited before finalization of Accounts for the year 2008. The agenda was circulated to the Board of Directors meeting scheduled to be held on 31st March 2009. The agenda among others included the approval of audited accounts which had been finalized. We were however informed on March 13th 2009 by the EFU that claims amounting to Rs. 54.524 million stands



against our share. No supporting documents like survey reports, discharge voucher were provided for our verification & record besides also disposal of salvage was also not accounted for."

13. The Company further went on to explain:

"The Board of Directors meeting was fixed, agenda has been circulated and accounts had been finalized, we had no time left for thorough due diligence to check and verify the claims. Further considering the facts that a substantial amount i.e., Rs. 25 million against EFU co-insurance had already been booked and no supporting documents were provided with the last minute intimation; it was very difficult for us to account for the said impact with certainty and accuracy. Subsequently we took up the matter with EFU, obtained all supporting documents and after due verifications the remaining liability was booked for the year 2009. We may also add here that most of business from EFU pertained to Motor insurance under leasing or financing arrangement."

Consideration of Company's Response

I have given due consideration to the written submissions of the respondents. The Onsite inspection found that in various cases of co-insurance business under the lead of EFU General Insurance limited claims amounting to Rs. 54.524 million pertaining to the financial year 2008, were reported by EFU General Insurance Limited on March 13, 2009, that is, 18 days before the deadline for the issuance of financial statements. However, claims, amounting to Rs. 30.692 million, were not included by the Company in the provision for outstanding claims (including IBNR) for the financial year 2008 as required by International Accounting Standard (IAS) 10 "Events after the Reporting Period" which is applicable through Annexure II Part B Regulation 2(2) of the SEC (Insurance) Rules 2002. This non-provisioning of claims resulted in a material over-statement of profits before tax, in the published financial statements for the year ended December 31, 2008, by an amount of Rs. 30.692 million.

15. In response to the subsequent Show Cause Notice issued, the Company claimed that it did not have all the documents from EFU General Insurance Limited pertaining to the co-insurance claims and that they had been intimated at the last minute when the agenda for the Board of Directors meeting had been finalized and circulated.

16. However, IAS 10 has been explicitly provided for such situations. Para 3 of IAS 10 gives the definition of "Events after the Reporting Period" and that the above event was an adjusting event. Para 3 of IAS 10 states:

"The following terms are used in this Standard with the meanings specified:

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorized for issue. Two types of events can be identified:

(a) *those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and*

(b) *those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period)."* (emphasis added)



17. Para 19 of IAS 10 also states that disclosures need to be updated if information after the reporting period is received pertaining to conditions before the reporting period. Para 19 of IAS 10 states:

"If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information."

Conclusion

18. If applied correctly, IAS 10 would have ensured that such a misstatement would not have occurred. However, IAS 10, which is applicable through Annexure II Part B Regulation 2(2) of the SEC (Insurance) Rules 2002, was not applied correctly which resulted in a material over-statement of profits before tax, in the published financial statements for the year ended December 31, 2008, by an amount of Rs. 30.692 million.

19. The Company and/or its officers can be held liable for the material over-statement of profits before tax, in the published financial statements for the year ended December 31, 2008, by an amount of Rs. 30.692 million under Section 158 of the Ordinance.

20. The Company requested that their case be decided sympathetically on the basis of their written submissions. Accordingly, the case was finalized on the basis of their written reply.

Order

21. In view of the foregoing conclusion, I, in exercise of powers conferred on me under Section 158 of the Ordinance, hereby impose a fine of Rupees One Million (Rs. 1,000,000) on the Company.

22. *Reliance Insurance Company Limited* is hereby directed to deposit the aforesaid fine of Rupees One Million (Rs. 1,000,000) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty (30) days from the receipt of this Order and furnish receipted vouchers issued in the name of the Commission for information and record.

(Nasreen Rashid)
Executive Director (Insurance)