Regulations and Accounting Applications in Insurance Sector of Turkey

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Abstract: Insurance is a contract with a premium payment based on the principle of paying claims when the risk, that is the reason of insurance for an interest, is realized. Trust is the base of insurance business. This sector especially in developing countries has a potential to raise new funds for economic development. In Turkey, 61 firms and 16,069 employees work in life, non-life, life/pension and pension branches of insurance sector in 2008. This sector is one of the developing areas in Turkey with 73 brokers and 13,250 agencies. Insurance agencies are working according to the Insurance Law and the regulations of the General Directorate of Insurance and Insurance Supervisory Board both of which organized under Turkish Treasury. These regulations are about establishment processes, insurance activities, the way of using funds collected from premiums, and adequacy of capital and liability compensations. Accounting activities are executed according to these regulations. In addition, Capital Markets Board (CMB) and Turkish Accounting Standards Board (TASB) describe standards and accounting applications have to obey these standards too. The name of this standard is Turkish Financial Reporting Standards (TFRS) 4 – Insurance Contracts that is arranged parallel to International Financial Reporting Standards (IFRS) 4 – Insurance Contracts. This study aims to describe the characteristics of insurance sector in Turkey and also to analyze some specific regulations and accounting applications.

Introduction

Insurance industry performs two important functions in economic life; one is micro and the other one is macro. Insurance companies create benefits in microeconomic sense by undertaking the risks faced by individuals as well as companies. Moreover, they contribute to the functioning of the financial markets by supplying the premiums they collected from their customers as funds to the financial system. Supplying the much needed long term funds for the real sector is critically important for the countries with limited capital accumulation. Insurance activities in Turkey are carried out according to Insurance Law No. 5684 and the regulations of the General Directorate of Insurance and Insurance Supervisory Board, both of which operate under the authority of the Undersecretariat of Treasury. These arrangements cover the areas of establishing insurance business and insurance processing activities as well as the use of collected funds, capital and liability coverage adequacy issues.

Accounting practices, on the other hand, are conducted under the above mentioned arrangements as well as standards prepared by Capital Markets Board (CMB) and Turkish Accounting Standards Board (TASB). Turkish Financial Reporting Standard 4-Insurance Contracts prepared by TASB is the same as the International Financial Reporting Standard 4- Insurance Contracts prepared by the IASB. Some special arrangements and their accounting practices are going to be analyzed after providing a profile picture of the fast developing insurance sector in Turkey.

Definition and Importance of the Insurance Sector

Insurance is an organization which brings people, who is facing the same risk that is determined by a contract, together in order to pay for the expected damages (Pekiner, 1974, 17). Insurance is the act of guaranteeing that the payments for damages will be paid in case of the risk under contract is realized (Çaldağ, 1979, 9). The concept of insurance came to life when people who face the same threat of danger come together to pay for the damages with the conscious decision that it is not possible to completely eliminating physical dangers.

Insurance companies try to eliminate negative consequences of the risk for the individuals with the help of other individuals who want to avoid the consequences on the basis of an assurance. Trust is the base of insurance business. Insurance sector and its companies are important for the functioning of the financial markets. The insurance companies play an important role in financial markets by directing the funds they collected as premiums.

Insurance Sector in Turkey

Having enjoyed a spectacular growth consistently after the financial crisis in 2001, the insurance industry in Turkey experienced a slight decline at the last quarter of the 2008 and concluded the year with a growth rate below inflation as a result of the global financial crisis (Annual Report 2008, 3). There are total of 61 insurance and pension companies consisting of 36 non-life, 24 life/pension and 1 reinsuring companies in Turkey in 2008 (Annual Report 2008, 25).

There are 13,250 agencies excluding bank insurance, 73 brokers and 901 loss adjusters (natural entity) in insurance and private pension sector as of December 31st, 2008 in Turkey. It is estimated that over 50 thousands of people are employed in the sector including agencies, brokers and loss adjusters with 16,069 employees in insurance companies (Annual Report 2008, 26).

When the year 2008 is evaluated by the end of year figures, we could see that insurance companies concluded 52.4 million contracts and 37.5 million policies during the year. It means that the number of contract and policies increased by 15% in 2008. The total amount of assets of the industry also rose by 19% to 27.9 billion TL compared to 2007 (Annual Report 2008, 3).

Turkish insurance sector took 36th place within 88 countries with a share of 0.21% in global premium production. According to the ratio of premium volume to GDP and premium volume per capita, Turkish insurance market has been ranked 76th and 65th, respectively. Turkey has a rank of 34 over total of 35 European Countries in premium volume per capita (Annual Report 2008, 22).

Legal Regulatory Authorities in Insurance Sector in Turkey

The insurance companies must operate under the guidelines of TFRS, Insurance Law, and the Turkish Commerce Law. At the same time, insurance activities take place inside the framework set by Insurance Supervisory Board and General Directorate of Insurance both of which operate within the Undersecretariat of Treasury.

Regulations by the Undersecretariat of Treasury

The responsibility of regulating and supervising the insurance sector is given to the Undersecretariat of Treasury with Insurance Law. There are two units operating within the Treasury about the insurance activities in Turkey. These are the Insurance Supervisory Board and the General Directorate of Insurance.

Insurance Supervisory Board

The Insurance Supervisory Board was established in 1963 with Law No. 7397 to supervise all activities of insurance companies.

General Directorate of Insurance

Insurance companies must obey the rules by General Directorate of Insurance. This department is established by the law establishing the Undersecretariat of Treasury which is dated December 20th, 1994 and numbered 4059.

Insurance Law

The purpose of the Insurance Law No. 5684 is to develop the insurance sector in general, to protect rights and benefits of insured entities and to make sure that the sector could work efficiently in a safe and stable environment. This law also organizes the start up procedures in the sector and sets the main rules and methods of operations in the industry.

The Turkish Commerce Law Regulations

The fifth chapter of the Turkish Commerce Law is devoted to the topic of insurance. The necessary definitions such as insurance contracts and insurance policy are given and types of insurance are explained in this book.

Turkish Accounting Standards Board (TASB) and TFRS 4 Insurance Contracts Standard

Turkish Accounting Standards Board is a public entity established with law in order to perform duties defined by the Capital Markets Law and has financial and administrative independency. TASB published International Accounting/Financial Reporting Standards as the Turkish Accounting/Financial Reporting Standards on the Official Gazette on several dates and Turkish Accounting/Financial Reporting Standards which are going to guide the Turkish accounting practices became in full harmony with the International Accounting/Financial Reporting Standards.

One of these standards is the TFRS-4 Insurance Contracts Standard, which is published on March 25th, 2006 No. 26119 issue of the Official Gazette for the first time and some changes are officially made on July 15th, 2007 No. 26583 issue of the Official Gazette. Even though these standards set the general framework, they do not include detailed explanations for insurance accounting practices.

However, it is a known fact that the International Accounting Standards Board (IASB) is still working on the issues of “recording” and “valuation” about insurance contract. Various arrangements are made regarding financial reporting activities of insurance companies on the directive about TFRS-4.

The main objective of TFRS-4 is to determine the principles of financial reporting of the insurance companies. TFRS-4 includes all activities of insurance companies including reinsurance (Berk, 2005, 25).

Accounting Practices by Insurance Companies

Accounting practices of insurance companies are quite different from companies in other sectors. The non-physical nature of the insurance business differentiates the insurance company from companies in manufacturing and in commerce. There are other differences for the insurance company in other areas such as capital structure, resource allocation, and working style. Even though the insurance companies locate inside the financial services sector, the structure of assets and liabilities are quite different from other financial companies (Aktaş, 2005, 124).

The differences of insurance companies show themselves also on insurance accounting. These are (Candar, 2001; Uyanık, 2001, 510; Başpınar, 2005, 6);

a) The amount of receivables and payables of insurance companies show uncertainties in many aspects. The main source of this uncertainty arises from the fact it is not known whether the risk under insurance is realized and how big the compensation is going to be if it is realized.

b) In case of insurance companies, it is not possible to determine periodic profit or loss with certainty. Because the price of every service provided is based on certain possibility calculations. These calculations generally include an average value according to the law of big numbers. When the damage is realized above the expected rate, there will be a loss for the insurance company. Otherwise, there will be a profit.

c) A significant portion of premiums collected by insurance companies is paid back to the clients as compensation payments. However, it is not possible to determine the amount, the timing or the identity of the client with certainty.

d) The allowances for uncertainties are allocated from the premiums collected from clients rather than the profit as in the case of other businesses. The financial tables carry some margin or errors since the amount of these allowances depend on possibility calculations.

e) The differences between life insurance and general insurance create some accounting problems in this sector. The above mentioned policies provide coverage for different periods with their different premium structures. The different laws and accounting practices, such as these different policies can not be provided by the same company, led to developments of these two branches completely separately.

f) The probability of determining the revenues and expenses with certainty is low since financial flows of the insurance companies goes beyond a single period. However, it is assumed that the revenues collected and compensations made during the same calendar year are assumed to belong to the same calculation period. Profit and loss calculations in case of commercial and industrial companies, on the other hand, generally belong to the same calculation period.

Moreover since the insurance sector functions on the principle of trust and the governments feel the need for protecting the rights and benefits of clients, the sector faced very important legal restrictions and regulations in many countries. Establishing technical provisions, giving a bigger weight to the liquid assets in total assets, requirement of establishing funds, extra capital requirements to make sure they have the compensation payment adequacy are some examples of the regulations faced by the insurance industry.

Technical Provisions

Technical insurance provision is defined as the funds separated by the insurance companies established as corporations by the Insurance Law to cover the responsibilities of policies not expiring by the last day of the period and allowed to subtract from the revenues as an expense according to the Corporate Taxation Law (Arslanhan, 1996, 12).

Insurance technical provisions is the amount separated by the insurance companies because of responsibilities they carry due risks covered by the policies they prepared. The most important function of these provisions is guaranteeing the compensation payment must be made by the insurance company when the insured risk is occurred. Moreover, the provisions show the degree of risk the company faces for the financial information users.

Insurance Law lists the technical insurance provisions as:

- unearned premium provisions
- unexpired provisions
- equalization provisions
- mathematical provisions
- outstanding claims provisions
- promotion and discount provisions

Technical provisions are located on the balance sheet as a liability. In order to understand whether the technical provisions adequately cover the risk they face, liability adequacy test is performed. The liability adequacy test for life and non-life insurance companies could be summarized as the following table (Sarıaslan, 2008, 20-21).

A. Future Cash Flows	
Expected losses	(+)
Related expenses of losses	(+)
Related management expenses	(+)
B. Insurance Liabilities	
Unearned premium provisions	(+)
Premium production expense	(-)
Related non-physical assets	(-)

Table 1. Non Life Insurance Company

A. Future Cash Flows	
Expected losses	(+)
Related expenses of losses	(+)
Related management expenses	(+)
Embedded options and warranty	(+)
B. Insurance Liabilities	
Actuarial mathematical provisions	(+)
Unearned premium provisions	(+)
Premium production expense	(-)
Related non-physical assets	(-)

Table 2. Life Insurance Company

TFRS 4 finds such a test outlined above as sufficient for the insurance companies (Sarıaslan, 2008, 21). Liability adequacy test in Turkey is formulated by the regulations of the Turkish Treasury as the following:

Years	**2005**	**2006**	**2007**	**2008**	**2009**	**Total**	**2010**
I) Allocated Provisions							
A. Accrued	150	130	120	200	220	820	210
B. Not reported	40	30	20	50	70	210	
C. Expense share	10	8	12	15	20	65	
II) Realized							
D. Accrued	120	140	130	190	310	890	
E. Not reported	50	20	25	45	80	220	
F. Expense share	15	13	10	10	20	68	
III) Adequacy ratio							
Accrued (A/D) * 100						92,1	
Not reported (B/E) * 100						95,4	
Expense share (C/F) * 100						95,5	
IV) Difference in adequacy Ratio (The legal adequacy ratio is 95%)							
1.Accrued						95-92,1 = 2,9	(210+6,09*) = 216,09
2.Not reported						-	-
3.Expense share						-	-

* 210 x %2,9

Standards allow discounting the general insurance provisions but this practice is not required at this stage. At the same time, standards do not ban the use of rate of return of insurance assets as the discount rate. Up until the completion of second stage of establishing insurance standards by IASB, premium production expenses could be deferred (Aktaş, 2005, 124-125).

Conclusion

Insurance industry performs two important functions, one micro and the other one is macro, in economic life. The insurance sector in Turkey operating in the branches of non-life, life, life/pension, and pension with 61 companies and 16,069 employees by 2008 is fast growing sector. Insurance activities in Turkey are carried out according to Insurance Law and the regulations of the General Directorate of Insurance Business and Insurance Supervisory Board, both of which operate under the authority of the Undersecretariat of Treasury.

Turkish Financial Reporting Standard 4-Insurance Contracts prepared by TASB is the same as the International Financial Reporting Standard 4- Insurance Contracts by the IASB. Regulations prepared by the legal authorities in Turkey satisfy the minimum requirements set by the TFRS-4. There are going to be serious changes in insurance accounting practices in Turkey when the second stage of Insurance Contracts Standards is completed.

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