INSURANCE REGULATORY AUTHORITY

Financial Reporting and Disclosure by Insurance Companies: Review of contemporary Practices

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for

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TABLE OF CONTENTS

DISCLAIMER I

ACKNOWLEDGMENT II

LIST OF ABBREVIATIONS AND ACRONYMS V

CHAPTER ONE 1

1.1 INTRODUCTION 1

1.2 BACKGROUND 2

1.3 STATEMENT OF THE PROBLEM 3

1.4 OBJECTIVES OF THE STUDY 4

1.5 JUSTIFICATION OF THE STUDY 4

1.6 SCOPE OF THE STUDY 5

1.7 LIMITATIONS OF THE STUDY 5

CHAPTER TWO: RESEARCH METHODOLOGY 6

2.1 INTRODUCTION 6

2.2 RESEARCH DESIGN 6

2.3 DATA COLLECTION METHODS 6

2.4 DATA ANALYSIS AND REPORT WRITING 6

CHAPTER THREE: REVIEW OF PRACTICES 7

3.1 OVERVIEW OF REPORTING 7

3.2 CURRENT FINANCIAL REPORTING REQUIREMENTS 12

3.3 CONTEMPORARY FINANCIAL REPORTING STANDARDS 18

3.4 IFRS ADOPTION IN KENYA 20

3.5 EMERGING TRENDS IN CORPORATE REPORTING STANDARDS 21

CHAPTER FOUR: GAP ANALYSIS 23

CHAPTER FIVE: SUMMARY, CONCLUSION & RECOMMENDATIONS 28

5.1 INTRODUCTION 28

5.2 CONCLUSIONS 28

5.3 RECOMMENDATIONS 31

5.4 AREAS FOR FURTHER RESEARCH 33

REFERENCES 34

List of Abbreviations and Acronyms

ABI - Association of British Insurers
ALM -Asset Liability Management
APM -Achieved Profits Method
CMA - Capital Markets Authority
CFO Forum - Chief Financial Officers Forum
DSOP - Draft Statement of Principles on Insurance Contracts
ERM -Enterprise Risk Management
ESG –Environmental Social and Governance
EV - Embedded Value
EEV - European Embedded Value
FASB - Financial Accounting Standards Board
FSAP - Financial Sector Assessment Programme
GAAP - Generally Accepted Accounting Principles
IAIS – International Association of Insurance Supervisors
IAS - International Accounting Standards
IASB - International Accounting Standards Board
IASC - International Accounting Standards Committee
ICP - Insurance Core Principles
ICPAK - Institute of Certified Public Accountants of Kenya
IFRS - International Financial Reporting Standards
IIRC - International Integrated Reporting Council
IMF -International Monetary Fund
IRA - Insurance Regulatory Authority
MIPs -Medical Insurance Providers
MCEV - Market Consistent Embedded Value
NSE - Nairobi Securities Exchange
UK - United Kingdom

CHAPTER ONE

1.1 Introduction

Although the primary goal of financial reporting[1] by insurance companies is to present financial information in a manner that can enable consumers make informed decisions[2], this noble objective has continued to elude many players. This is because for large number of insurance customers and market participants, the language of insurance business has and continues to remain difficult to understand and evaluate. This coupled with complicated financial statements makes assessment of the financial health of an insurer by the policyholders not only difficult but also farfetched.

To ensure adequacy of financial reporting, there are various bodies such as the International Accounting Standards Board (IASB), International Association of Insurance Supervisors, (IAIS), Financial Accounting Standards Board (FASB) etc that are recognised for their role in setting globally accepted standards.

As a rule of the thumb, standards of information disclosure continue to be predicated on the need for relevance, reliability, comparability and understandability within the context of ensuring high level of transparency. In financial reporting therefore, the ultimate benefit derived therein rests on the value users of the information derive in financial statements and other financial information provided.

When consumers are provided with appropriate information to allow them assess the financial as well as other aspects of an insurance company, thye in turn are able to make informed decisions. In doing this, markets can then act efficiently by rewarding those companies that manage risks efficiently and penalizing those that do not (IAIS, 2004). For this to be realized and market equilibrium attained,

[1] Potential and existing Policyholders have access to all material and relevant information before the conclusion of an insurance contract, to receive advice in a correct and meaningful manner in assessing their insurance requirements, to be informed about their rights and obligations for the duration of the contract, to be confident that they will receive correct and timely compensation in the event of a legitimate claim and in case of doubt to be able to receive supplementary advice and where necessary from a neutral body.

[2] This is also a consumer's fundamental right as enshrined in Article 46 of the Constitution of the Republic of Kenya.

disclosure of information on risk is critical in operation of a sound, fair and efficient market.

The Insurance Act, CAP 487 of the laws of Kenya section 59 to 66 requires disclosure of all relevant information by the insurance companies. The Act envisages that this facilitates both parties in making informed decisions on the intended contractual relationship.

Section 54 to 56 requires insurance companies to prepare financial statements and submit the same in a prescribed format and within pre specified timelines[3] failure to which attracts a penalty. Despite these provisions, difficulties in assessing user information disclosure needs systematically in line with accounting standard setting bodies in terms of reliability and comparability is still prevalent.

Although reliability and comparability can be contextually assessed *a priori* relevance depends on what users consider as beneficial and on what markets judge as significant in helping them shape their expectations about the industry or individual company performance

1.2 Background

The extent of information disclosure is increasingly becoming one of the most common sources of market failure in insurance (Kruno, 1998). Because of risks associated with competitive pressure and dynamism of the market, disclosure of information remains a useful instrument for self regulation and market conduct of regulated entities.

Reporting adequately on the performance of an insurance company is critical not only to consumers of insurance services but also to investors as this enables them make informed judgment. This judgement is critical to insurance company's' ability to attract capital.

[3] Insurance companies are required to submit annual audited accounts four months upon end of the year in consideration. In addition, information is submitted quarterly and on a monthly basis.

Without sufficient information to aid in decision making, the various players in insurance demand and supply chain may make in-optimal decisions. This can have negative individual, market and social implications. This problem is exacerbated when silos of information collected do not demonstrate their interconnectedness, and consistency.

Anecdotal evidence suggests that insurers have in their financial reporting tended to be compliance driven and not the needs of consumers. However, reporting should be driven by the needs of consumers and investors, who are increasingly asking for information that links the organization's strategy, governance and financial performance to the economic, social and environmental context within which it operates and not for mere conformance with regulations.

The fast evolving nature of financial reporting field coupled with this the technical nature of the financial reporting requires that professionals in the field continually update their skills and knowledge. In addition to this, this presents us with the challenge of the ensuring that the regulatory framework (legal, guidance documents) moves in tandem with the changes in the financial reporting standards.

1.3 Statement of the Problem

The insurance industry in Kenya has great potential for growth. Such growth is highly dependent on the efficiency of the key players in terms mitigating any forms of market failure. For this to be realized, quality of information, market practice and quality of services offered remain key decisive factors.

To enhance this efficiency and help address information asymmetry, insurance companies are required as per the insurance act to disclose a certain minimum level of information to its stakeholders. This is because insurance as an intangible good therefore consumers cannot easily determine the quality of the good before they spend the money. It operates on the principle of utmost good faith until one launches a claim.

However, what constitutes 'relevant information' still remains a matter of conjecture. Different jurisdictions have varying thresholds in terms of adequacy

of disclosure. This is further complicated by a lack of comparability, reliability and consistency of the information disclosed in terms of products, ownership, financial performance etc.

This research therefore sought to identify any gaps in reporting in order the recommend ways of ensuring that the domestic insurance industry adopts international best practice reporting.

1.4 Objectives of the Study

This study sought to review current financial reporting and disclosure practices by insurance companies in Kenya in order to identify any gaps based on standards set by international standards setting bodies.

Specifically, the study sought to:

i. Identify current legal requirements for disclosure of information by insurance companies

ii. Identify the pros and cons of existing requirements on information disclosure

iii. Identify convergences and divergences with best practices in financial reporting and disclosure

iv. Propose policy recommendations on ways of enhancing disclosure of information.

1.5 Justification of the Study

The quality, consistency and reliability of information are key facets that a policyholder or investor will assess in their bid to invest or save. Given that the society remains dynamic and consumer expectations and wants keeps shifting, so will be the need to periodically seek to satisfy the information needs of consumers of insurance services.

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1.6 Scope of the Study

Given the challenges of assessing what users want and the difficulty accounting standards setters face in systematically assessing user needs, this assessment focused on a gap analysis in terms of divergences and convergences of the Kenyan context with best practice. The study although covering a number of insurance companies mainly focussed on financial reporting although it appreciated the changing scope of information disclosure;.

1.7 Limitations of the Study

There were also perceptions that probing questions with regard to disclosure requirements bordered on invading the privacy of business especially in strategic issues which in a competitive environment was seen as exposing players to rivals. ..

CHAPTER TWO: RESEARCH METHODOLOGY

2.1 Introduction

This chapter provides procedures used for carrying out the study and how data and information was collected and analyzed. It provides the details of research design, study population, sampling design, sampling procedures, data collection instruments and procedure, data processing and analysis.

2.2 Research Design

Desk top research design was used the design helped to establish the adequacy of disclosure of information by insurance companies.
This section details the approach to be undertaken in executing the assignment.

Activity	**Tasks**
Review of relevant literature and documentation	• Compiled a list of necessary documents • Reviewed existing IFRSs, Regulatory reporting requirements and other relevant materials • Determined a criteria for merging and synchronising relevant information
Identify the Gaps in financial reporting against best practice.	• Carried out a comprehensive desk-top review of best practice • Qualitative and quantitative data analysis •
Identify best practice options customized to suit Kenyan industry specific setting	• Identified and prioritise emerging areas in financial reporting that will enhance information disclosure in Kenya • Assessment of industry policy implications

2.3 Data Collection Methods

Both qualitative and quantitative data collection techniques were used in the study. Relevant reports, IFRS, Corporate Governance Guidelines, The Companies and Insurance ACTs, Prudential Guidelines and ICPs were reviewed.

2.4 Data Analysis and Report Writing

The reviewed data was aggregated and subjected to content analysis and a report prepared

CHAPTER THREE: REVIEW OF PRACTICES

3.1 Overview of Reporting

Examination of reporting over the past two decades has shown varying stakeholder preferences for what was often presented as opposites, such as:

i. historical information versus forward looking information;
ii. quantitative versus qualitative;
iii. core indicators versus additional indicators;
iv. input indicators versus output indicators;
v. process indicators versus performance indicators;
vi. physical metrics versus financial metrics;
vii. micro level, local site versus macro level, aggregated data;
viii. direct versus indirect impact or dependence values;
ix. tangible versus intangible asset values; and
x. internal (private) versus external (public) information.

The current debate on corporate reporting and integrated information management is seeking more suitable midways between these opposites. The debate takes place against the background of a world in which advances in information and communication technology (ICT) are opening up new ways of digital communication and participation never imagined before. This poses a challenge for established professions such as accounting and law, which still show a preference for historical facts, established currencies and documentation with clear boundaries.

Debate about reporting and its future is therefore not only a discussion about content and different ways of communicating with diverse stakeholders, but about re-examining convention in some established professional disciplines.

It is however important to note that reporting cannot be a stand-alone exercise, but that the report and the process behind it need to be part and parcel of management planning, stakeholder engagement, performance management and strategic decision-making.

The evolving debate about corporate reporting also reflects current thinking about corporate governance. The core corporate governance principles of honesty, transparency and accountability are important requirements for effective and credible reporting. The emerging corporate governance emphasis in favour of performance, as opposed to conformance, presents a logical link to reporting. Many companies report to comply with either a voluntary or mandatory standard, while the content of the report itself has to reflect the actual performance of the company.

Increasingly, the credibility of the report does not rely so much on the requirement for the measurement to be accurate, but, to start with, on the relevance of the chosen indicators. Reporting integration can play an important role in bringing these requirements – accuracy and relevance – closer to each other. Getting this right will make a contribution to good corporate governance, both in terms of support for the core governance principles as well as getting the right balance between performance and conformance. There is also a business case for reporting.

Although it is always a secondary activity, reporting is critical in an age of transparency and increased stakeholder interest in the activities of all companies. With regard to reporting therefore it is important to address the following questions;

i. *who* drives reporting,
ii. how frequent should reports be and
iii. how many forms of reports,
iv. what are the most relevant materials issues to address,
v. who are the target readers or users of reports,
vi. Who governs the reporting process and who regulates reporting?

In this regard disclosure requires all the issues to be sufficiently addressed without loss of the intentions upon which the reporting was premised.

The fact remains that if the field must be inclusive and rely on stakeholder engagement, and then there will be diverse views on the questions listed above.

Ideally, reporting by a business should communicate the risks that the business is facing and the impact that such risks could have on its ability to continue operating – thus influencing an assessment of its sustainable value. Realistically, reporting could never have predicted a threat like the Japanese tsunami.

Following the financial crisis, a fair question has been: Why did reporting not bring to light the financial risks to which many companies were exposed? Or closer home, why shouldn't reporting reveal failure of companies early enough? The weaknesses in reporting shown up by the financial crisis and company failures, as well as an increasing awareness of the impact of business on the society and natural environment and the long-term availability of resources, have created the right environment for the advent of integrated reporting and adequate disclosure.

Consequently, integrated reporting and disclosure is gaining rapid acceptance as the way forward for corporate reporting. Initially, financial reports included only statutory financial statements, providing largely backward-looking financial information. Over time, management commentary was added to provide context to the financial information.

Since the 1990s in some Jurisdictions and particular South Africa, additional non-financial information has been introduced, often in a separate sustainability report or annual review, typically including information on employment (e.g. safety records, expenditure on training, etc.), environmental factors (e.g. carbon emissions, electricity and water usage, etc.) and corporate social responsibility activities.

While this triple bottom line or environmental, social and governance (ESG) information is useful to some and serves as a good public relations exercise, not all of it is relevant in predicting the ability to create long-term sustainable value.

The financial statement component of the annual report has become longer and more complex for a number of reasons. These include the complexity and increased disclosure requirements of financial reporting standards, perhaps

combined with the increasing fear of preparers and their auditors for regulators.

The resulting financial statements appear to be influenced by disclosure checklists to ensure compliance with reporting standards, rather than by what is most relevant for the investor.

Some steps have been taken to review the increasing disclosure requirements of annual financial statements, with the publication in July 2011 of *Losing the Excess Baggage – Reducing Disclosures in Financial Statements to What's Important*, wherein a joint working group from the accounting Institutes from New Zealand and Scotland suggests a structured approach to addressing the problem.

Adding more information is not always beneficial, and there is increasing concern that additions may detract from the annual report's usefulness. This problem is exacerbated when different components of the report are prepared by different teams, resulting in repetition (or worse still, contradictions), silos of information that do not demonstrate their interconnectedness, and inconsistent messages on how the governing body of the organization is fulfilling its stewardship obligations.

The report will achieve its purpose when investors understand the strategic direction that the board is following, the successes in exercising the strategy, and the risks the company faces and how these influence strategy. An annual report should provide the information that an investor needs to make decisions about whether or not to invest in that entity, and one should therefore expect a close alignment with the information included in investor presentations given by management.

Anecdotal evidence suggests that this is not the case, with investor presentations focusing on the message that management knows investors need, while aspects of corporate reports are compliance-driven. Reporting and disclosure should be driven by the needs of investors, who are increasingly asking for information that links the organization's strategy, governance and

financial performance to the economic, social and environmental context within which it operates. Integrated reporting is intended to fill those needs.

The integrated report will probably need to be supported with annual financial statements, employment-related information, more detailed governance disclosures, etc., for different stakeholder groups available online. As an integrated report requires management to report on how it manages the business and what may impact on the sustainable value of the business, reporting requirements cannot be prescribed. South African companies with years ending from 31 March 2011 are required to prepare an integrated report, or explain why they have not done so.

Markets can only function effectively when well informed, and a sustainable market economy therefore needs relevant integrated information. Effectively, disclosure needs to provide more robust, more relevant, more reliable, and more readily available performance information, the four 'Rs':

The first R, i.e. more robust, precisely defined information, is critical for to be of use.

The second R, i.e. more relevant information, comes with an understanding of sustainability strategy as an inherent part of business strategy in the short and long term. For a growing number of reporting companies and report information users, a key aspect of relevance therefore comes from relating disclosure to a set of performance information and financial reports. The emerging field of integrated reporting entails the effort to develop the corporate reporting practice to the point where companies plan, manage and evaluate their impacts on the value of all forms of capital – financial, environmental, social, manufactured, intellectual and human. The intention for any regulator is that concise, comparable integrated reports will inform investors including customers and governments on corporate performance and strategy for the short and long term. Regulators need to develop a high-level framework for this purpose, building on and galvanizing the ongoing development of financial and integrated reporting.

The third R, i.e. more reliable information, refers to the importance of the reliability of information. As the relevance of information becomes clearer and its use increases, reporting entities can expect a more critical examination of their data as information users base their business and investment decisions on this content. The assurance integrated reporting will therefore become a key area of development, requiring assurance providers to scale up their professional grasp of content and the process of reporting.

The fourth R, i.e. more readily available information. Market consideration of information, from either integrated or stand-alone reports, requires the systematic and pervasive availability of such information. As with financial reporting, a completely voluntary practice cannot achieve this type of universality at the speed we need for the green economy. This report is intended to address this last 'R' readily available information i.e. information disclosure.

3.2 CURRENT FINANCIAL REPORTING REQUIREMENTS

3.2.1 The Insurance Act

The Insurance Act Cap 487 of the Laws of Kenya, Under Section 54 (1A) requires all Insurance companies to prepare their financial statements in accordance with the International Financial Reporting Standards. This with respect to *the revenue account, balance sheet, profit and loss account and financial statement is prepared in accordance with International Financial Reporting Standards and such accepted Kenyan reporting standards as may be prescribed."*

Section 54 (4) of the Kenyan Insurance Act further prescribes the appropriate financial reporting period of an insurance company licensed in Kenya. The section states *"The revenue account, balance sheet, profit and loss account and financial statement required to be prepared under subsection (1) shall be*

prepared in accordance with International Financial Reporting Standards and such accepted Kenyan reporting standards as may be prescribed."

Section 54 (5) attempts to define what the appropriate financial reporting framework (IFRSs) means. Section 54 (5) states that *"In subsection (1A), "International Financial Reporting Standards" means-*

(a) The standards issued by the International Accounting Standards Board of London; or

(b) Kenyan accepted standards developed by the Institute of Certified Public Accountants of Kenya.

On the regulatory front, Section 56 of the Kenyan Insurance Act requires that the financial statements of an Insurance company are audited on an annual basis. The section also states the matters that the auditor must address in his audit report.

3.2.2 The Companies Act4

The Companies Act Cap 486 of the Laws of Kenya does set specific disclosure requirements for Companies incorporated in Kenya. The requirements of the Act also apply to the Insurance Companies licensed to transact insurance business in Kenya.

Sections 147- 163 of the Companies Act touch on the Accounts and Audits. The Sixth Schedule of the Companies Act (Cap 486) revised 2009 elaborates further on the requirements of the Section 149 of the Act on the form and content of Accounts, section 152 of the Act – on the form and content of group accounts and Section 157 of the Act on the form of the directors report. However, it is worthwhile to note that so as to avoid any conflict with the requirements of the Kenyan Insurance Act, Part III of the Sixth Schedule grants exemptions for licensed and scheduled Banks and Insurance Companies. Paragraph 24 of Part III of the Sixth Schedule of the Insurance Act states that *"An insurance company,*

[4] The Company's Act is currently undergoing a review and is in the parliamentary process- various stakeholders have already made their input. This report shall highlight the key elements of improvement which may have an implication on information disclosure requirements.

as defined in the Insurance Companies Act, which is subject to the requirements of that Act as respects the preparation and deposit with the registrar of insurance companies of a balance sheet and profit and loss account shall not, so long as it complies with those requirements, be subject to the requirements of Part I of this Schedule, other than -

> *(a) as respects its balance sheet, those of paragraphs 2 and 3, paragraph 4 (so far as it relates to fixed and current assets), paragraph 8 (except subparagraph (1) (a)and (d)and sub-paragraph (3)), paragraphs 9 and 10 and paragraph 11 (except subparagraphs (4) to (8) inclusive and (10)); and*
>
> *(b) as respects its profit and loss account, those of subparagraph (1) (h) of paragraph 12, paragraph 13 and subparagraphs (1), (4) and (5) of paragraph 14.*

Some of the other disclosures requirements that must be complied with under the Companies Act with regard to financial reporting are matters of the disclosure of directors' remuneration (S.197). This section of the Companies Act requires *"that any accounts of a company laid before it in general meeting, or in a statement annexed thereto, there shall, subject to and in accordance with the provisions of this section, be shown so far as the information is contained in the company's books and papers or the company has the right to obtain it from the persons concerned -*

> *(a) the aggregate amount of the directors' emoluments;*
>
> *(b) the aggregate amount of directors' or past directors' pensions; and*
>
> *(c) the aggregate amount of any compensation to directors or past directors in respect of loss of office."*

It should be noted that International Accounting Standard (IAS) IAS 24 Related Party Disclosures) under paragraph 18 also requires the disclosure of key management compensation. Key management compensation is defined as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director

(whether executive or otherwise) of that entity. IAS 24 paragraph 18 states that "*an entity shall disclose key management personnel compensation in total*

Other pertinent disclosures required by the Companies Act are disclosures on the auditors remuneration for the year(S.151) depreciation and amortization charge for the year, share capital and reserves but to name a few. Some of the appropriate references, for the related financial statement disclosures numerated above are the Sixed Schedule of the Companies Act, which deals with Share Capital, provision and reserves and taxation matters. Section 198 requires the disclosure of any related party borrowing. Further to this, Schedule 7 of the Companies Act elaborates further on Section 162 of the Companies Act. This section sets out the matters that should be expressly stated on the auditor's report. These matters are:

1. *Whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.*

2. *Whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.*

3. *(1) Whether the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns.*

   (2) Whether, in their opinion and to the best of their information and according to the explanations given them, the said accounts give the information required by this Act in the manner so required and give a true and fair view -

   (a) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and (b)in the case of the profit and loss account, of the profit or loss for its financial year, or, as the case may be, give a true and fair view thereof subject to the non-disclosure of any

matters (to be indicated in the report) which by virtue of Part III of the Sixth Schedule are not required to be disclosed.

4. In the case of a holding company submitting group accounts whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company, or, as the case may be, so as to give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Sixth Schedule are not required to be disclosed."

3.2.3 Corporate Governance Guidelines

The corporate governance guidelines set out the ground rules on the information to be disclosed by the insurer with regard to the risks that they are subject to, management information to be disclosed and other relevant corporate governance structures that the company has put in place. Some of the matters emphasized in this section of the guidelines are:

a. Insurance companies are required to disclose information on their financial position and the risks to which they are subject. Specifically, information disclosed should be relevant to decisions taken by stakeholders and timely so as to be available and up-to-date at the time those decisions are made.
b. Other information required to be disclosed is quantitative and qualitative information on the financial position of the company and the financial performance of the company.

3.2.4 Other Guidelines by IRA

In order to ensure consistency of information published by insurance companies to the general public, IRA has issued specific formats that insurance companies must adopt for the purpose of reporting. This include

circulars on the minimum information that should be contained in a statement of financial position, the statement of movement in deposit administration and investment contract liabilities and the statement of comprehensive income.

Further to this, the guideline gives some of the key ratios that insurance companies should compute like the claims adequacy ratio, the solvency ratio, the claims and expense ratios. This information when published in the local dailies would enable members of the general public to evaluate the financial performance of an insurance company and thus help the public make an objective decision as to which insurer should provide them with the best possible service.

3.2.5 Insurance Core Principles (ICPs)

The Insurance Core Principles (ICPs) developed by the International Association of Insurance Supervisors (IAIS) provide guidance to Insurance Supervisors on how to enhance their individual supervisory systems for their respective jurisdictions[5]. The ICP's apply to all insurance supervisors regardless of their level of development or sophistication. .

ICP 20 *Public Disclosure* is the main standard that deals with disclosure of information. The ICP requires *the supervisor requires insurance companies to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.*

Further, the ICP 20.0.2 touches on the matter of the appropriate financial reporting framework for a jurisdiction it states *"Whereas accounting*

[5] To ensure compliance with ICP's, peer reviews are undertaken under the Financial Sector Assessment Programme (FSAP) jointly with the World Bank and the International Monetary Fund (IMF). For instance, the last review carried out on the financial sector in Kenya was undertaken in the year 2005

standards (including IFRS/IAS and local generally accepted accounting standards) set out disclosure requirements for general purpose financial reporting across sectors, this ICP is only concerned with insurance companies. So far as practicable, information should be presented in accordance with any applicable generally accepted national and international standards and practices so as to aid comparisons between insurance companies."

Another relevant ICP is ICP 14 on Valuation. This ICP requires the supervisor to establish requirements for the valuation of assets and liabilities for solvency purposes. Under section 14.0.1 states that it is most desirable that the methodologies for calculating items in general purpose financial reports are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory requirements.

Differences between general purpose financial reports and published regulatory reports are publicly explained and reconciled. And it is expected that the supervisor shall establish requirements for solvency purposes on the investment activities of insurance companies in order to address the risks faced by insurance companies.

ICP 17 on Capital Adequacy requires the supervisor[6] to establish capital adequacy requirements for solvency purposes so that insurance companies can absorb significant unforeseen losses and to provide for degrees of supervisory intervention. Capital adequacy takes the form of a total balance sheet approach.

3.3 CONTEMPORARY FINANCIAL REPORTING STANDARDS

Annual financial reporting generally does what it says on the label, and for many people it is the most familiar form of corporate reporting. According to the International Accounting Standards Board (IASB), the objective of general

[66] the Insurance Act under Section 23 sets out the capital adequacy requirements applicable in Kenya.

purpose financial reporting is: to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit hence the need for credible reporting.

Work on the development of an accounting standard for insurance accounting can be traced back to 1997. It was during this period that the predecessor to the International Accounting Standards Board (IASB), International Accounting Standards Committee (IASC) commenced work on the fair value measurement of financial instruments. Four years later, a committee set up by the IASC released a report known as the Draft Statement of Principles on Insurance Contracts. (DSOP) The report had the effect of initiating debate on the fair value measurement of insurance contracts. The initial definition of insurance contracts by the committee excluded credit insurance and employment benefit plans.

The initial proposal were met with a lot of resistance from regulatory bodies, international groups etc. (Swiss Re, 2004) This being the case, the IASC Steering Committee on Insurance was disbanded when the IASB was created in the year 2000. The Steering Committee was replaced by an Insurance Advisory Committee. At the same time in 1998, work was underway on the development of IAS 39 and IAS 32 covering financial instruments. The two standards were issued in 1998 with IAS 32 dealing with the *Presentation and Disclosure of Financial Instruments* and IAS39 dealing with *Recognition and Measurement*.

In the year 2001, the Draft Statement of Principles on Insurance Contracts (DSOP) Report was utilized by IASB as a starting point for the development of an IFRS on Insurance Contracts. The report also took on board the comments received from the various stakeholders and thus helped refine the proposals.

To this end, in the year 2002 a two phased approach was adopted with regard to the development of the standard.

Phase I of the project focused on the IAS 32, IAS 39 and the initial IFRS 4. The Initial phase of IFRS 4 became effective as from 1st January, 2005. The initial IFRS 4 defined what an insurance contract is and it also distinguished an insurance contract from an investment contract which was to be accounted for using IAS 32 and IAS 39.

After this initial phase, a Discussion Paper on the Preliminary Views on Insurance Contracts was issued in the year 2007. Comments were received from various stakeholders on the discussion paper. In 2008, the US Financial Accounting Standards Board (FASB) used a discussion paper to further solicit input from constituents. With the feedback received, an Exposure Draft was issued for comments in July 2010 with the comment period ending in November 2010. The main thrust behind Phase II of project is the lack of transparency and comparability of financial information due to the various accounting practices for different contract types and jurisdictions and failure to provide users with relevant information.

3.4 IFRS Adoption in Kenya

The International Financial Reporting Standards' (IFRSs) are the appropriate financial reporting framework for insurance companies in Kenya with the Accountant Act No. 15 of 2008 dealing with accountancy related matters. The Accountants Act under Section 10 authorizes the Council to establish such committees necessary so as to prescribe and set the appropriate accounting standards applicable in Kenya.

Following this provision, IFRSs were adopted by the Council of the Institute of Certified Public Accountants of Kenya (ICPAK) as an appropriate financial reporting framework as from 1st January 1999 for companies. Further to this aim, a guidance/clarification on the matters of the appropriate financial

reporting standards for the insurance sector was given in 2009, where all publicly accountable institutions, those holding funds in a fiduciary capacity and listed entities were required to prepare their financial statements in accordance with the full IFRS. Insurance companies being publicly accountable are therefore no exception.

Despite this, the financial reporting standards field for insurance contracts has been evolving albeit slowly. IFRS 4 which is the main accounting standard that deals with accounting for insurance contracts has been undergoing a review by the International Accounting Standards Board. (IASB) IASB has presented proposals on the amendment of the standard with the last being an exposure draft that had been released for comment in July 2010. After the end of the comment period, IASB had received a diverse number of views from various stakeholders like the preparers, regulatory bodies, accounting firms etc. In addition to the above, as part of the convergence between IASB and the US based Financial Accounting Standards Board (FASB), the two accounting setting bodies have held meetings to resolve the main outstanding points in the IFRS 4 review. It is thought that a new standard on insurance contracts will be effective by 2015.

3.5 Emerging Trends in Corporate Reporting Standards

As consumer protection frameworks take shape, so is information disclosure evolving with focus now shifting to corporate reporting or what is called sustainability reporting. In essence, sustainability reporting is another form of corporate reporting that has evolved from the environmental and social reporting experiments of the early to mid-1990s.

It is a more broadly focused accountability tool defined as *the practice of measuring, disclosing, and being accountable to internal and external stakeholders …).* It is synonymous with others used to describe reporting on economic, environmental, and social impacts (e.g., triple bottom line, corporate responsibility reporting, etc.).

Essentially, a sustainability report should provide a balanced and reasonable representation of the sustainability performance of a reporting organization – including both positive and negative contributions.

Its integrated reporting nature links n organization's strategy, its governance and financial performance with the social, environmental and economic context within which it operates. This connection does help companies to take more sustainable decisions and enable investors and other stakeholders to understand how an organization is really performing.

CHAPTER FOUR: GAP ANALYSIS

Comparison with banking sector

COMPARISON BETWEEN TWO SECTORS REGULATIONS ON FINANCIAL REPORTING		
SUBJECT	**INSURANCE SECTOR**	**BANKING SECTOR**
Appropriate financial reporting framework	Section 54(1A) of the Insurance Act addresses the matter stating that the IFRSs are the appropriate basis for the preparation of the financial statements	Contained in the prudential guideline CBK/PG10 which requires that the financial statements are prepared in accordance with IFRSs.
Auditor's Independence	Captured in section 7.2 of the IRA Corporate Governance Guidelines. The auditor is required to make a declaration that he is independent and that there are no conflicts of interest that would compromise his/her objectivity.	This is covered in the Prudential Guidelines CBK/PG/09 section 3.13 on evaluation of audit firms which touches on some aspects of independence like the overall percentage of fees derived from one single client. It also touches on the matters of business association between the client and the auditor. Business interests between the partners of the firm and the directors of the client are also evaluated. In this section.
Auditors Rotation	Under section 7.2.4 of the IRA Corporate Governance Guidelines states that an	The Prudential Guideline CBK/PG/09 states that the lead audit partner should be rotated after a period of five years after

	independent auditor shall be engaged for a maximum duration of ten years. The auditor is then required to adhere to a two year cooling off requirement and may then resume the audit of the insurer. The guideline then gives example of what constitutes a conflict of interest scenario. For example, former internal auditors, for employees that served in the insurer.	serving as the engagement partner.
Auditors Appointment	The appointment of the auditor is done at the annual general meeting of the shareholders of the insurer after the appropriate recommendation of the Boards, audit committee.	This dealt in Prudential Guideline CBK/PG/09 with elaborates further on the matters that a firm must fulfill the banking regulator of matters like the capacity, the experience and independence of the firm from its potential or continuing client. The regulator is actively involved in the appointment.
Timelines for submission of audited financial statements and publication of audited financial statements and the prescribed format	This covered in Section 61 of the Kenyan Insurance Act. They give a timeline of 4 months after the end of the financial year. Section 61 states that the audited	This is covered under PG/CBK/10 this requires all institutions licensed and in operation in Kenya to publish a copy of their audited balance sheet and profit and loss in a national paper. In this case, The financial statements and other disclosures

	balance sheet should be published in two papers of national circulation within 30 days of receipt by the commissioner.	so published must fully conform to the format prescribed by the Central Bank of Kenya from time to time. All the audited financial statements and other disclosures to be published should first be submitted to the Central Bank of Kenya for clearance at least two weeks before publication. The financial statements must be signed by the Chief Executive Officer and at least one director of the institution.
Appointment of key finance personnel and key internal audit	Not covered in the Act or in the IRA corporate governance guidelines	This is covered in Prudential Guideline CBK/PG/02 under the specific requirements for management personnel. Section 4.2.1 requires that the person responsible for the finance function and the internal audit function are members of ICPAK. For the secretary, they are required to be members of ICPSK (Institute of Certified Public Secretaries
Corporate Governance Regulations	Covered in the Corporate Governance Guidelines issued by IRA in 2011. The guidance is provided on the board of the insurer, the various committees and their duties and responsibilities.	Prudential Guideline CBK/PG/02 elaborates on the functions of the various committees like the audit committee, the asset and liability committee, the risk management committee, the Board Audit committee. It also elaborates on the duties and the responsibility of the Chief

	Finally, it gives guidance on the auditor and the actuary and their specific roles and responsibilities.	Executive. The role of the shareholder and the directors are also given in the guidelines and so are the procedures of appointment, removal and resignation of directors. The guideline also contains a Code of Conduct that serves to guide the directors and management of financial institutions.
Returns	Section 59 deals with the requirement to furnish the commissioner with returns. They must be in the format prescribed. For life insurance companies, Insurance Regulations Part IV on Accounts, Balance Sheet, Audit and Actuarial Valuations requires annual returns from these companies within 4 months after the year end. Also required are quarterly returns of admitted assets and liabilities within 45 days after the end of the period to which they relate. Other returns and returns required are in Forms 59(IA) – Forms 59-12. These forms were	External Auditors shall also continue submitting within three months of the end of every financial year audited financial statements in the Central Bank's prescribed format i.e. CBK-BSM (A), PR4-1A, PR21A, PR3A and any other return to the Central Bank of Kenya. The returns should be certified by the external auditors of the institution. The Management Letter of the institution should also be submitted not later than 31st March of every year. External Auditors shall also continue submitting within three months of the end of every financial year audited financial statements in the Central Bank's prescribed format i.e. CBK-BSM (A), PR4-1A, PR21A, PR3A and any other return to the Central Bank of Kenya. The returns should be certified by the external auditors of the institution. The Management Letter of the institution should also be submitted not later than 31st March

	revised in 2009.	of every year.

The banking sector was selected for comparison given the move by Insurance Industry in Kenya to use banks as a channel to upscale the uptake of insurance products. From the analysis above, once can notice points of convergence and divergence between the two industries that would inform some of the conclusions enumerated in the next section of the report.

CHAPTER FIVE: SUMMARY, CONCLUSION & RECOMMENDATIONS

5.1 INTRODUCTION

This chapter presents the discussions drawn from the information analyzed and presented in the chapter four. The chapter is structured into summary of findings, conclusions, recommendations and areas for further research.

5.2 CONCLUSIONS

This study has identified gaps in reporting and disclosure of information by insurers particularly various facets of qualitative and quantitative information. Its findings are also complemented in part by the outcome of the peer review undertaken by the Technical Committee of the East African Insurance Supervisors Association (EAISA). Despite these gaps, it may be important to note that significant progress has been made towards enhancing levels of information disclosure by insurers through amendments of the insurance act as well as issuance of prudential guidelines

In as much as insurance is so distinct it should have its own reporting model, it is important to recognize that there is a general dissatisfaction with insurance companies' current primary financial disclosure statements and the form of financial reporting in terms of usefulness and adequacy. This coupled with findings from a study undertaken by Pricewaterhouse and Coopers and targeting investments analysts show that the future of financial reporting of insurance companies should reflect the key economic realities of the day and underpin the underlying business model of insurance companies.

In this same realm, it is important to note that the financial reporting framework, in this case (IFRSs) is evolving faster than the underlying legal and regulatory framework governing conduct of insurance business in Kenya. Consequently, there is need for regular reviews in order to keep pace with

evolving standards that can be replicated locally for purposes of enhancing disclosure.

The need sensitize consumers of insurance services to scrutinize financial statement directly or through proxy whenever they are published so as to help understand the financial soundness of an insurer.

Currently, Section 61 of the Insurance Act requires that the audited statement of financial position of insurance companies is published in at least two leading local dailies within four months from the year end; for listed entities, capital market regulations require that audited financial statements are made to investors within three months after the end of the financial period.

In recent times institutions and regulators alike have embraced electronic/digital communication as an increasingly effective communication channel. During the study only one insurer had published its financial statements in their website.

Independence of the auditor is a key tenet of reliability of information. This is recognized by the IRA corporate governance guidelines which require that auditors be rotated after ten years and the same auditors would be eligible after a cooling off stint of two years. Ten years is a long time in corporate governance cycle. The import of rotation is to break familiarity which may impair objectivity in the conduct of audit work. The study proposes that since auditors are members of a professional body in this case ICPAK, which requires them to adhere to a Code of Ethics for Professional Accountants. The Code of Ethics for Professional Accountants also elaborates on the issue of independence and partner rotation. Partner rotation and the independence requirements for auditors contained in the Insurance Act should be aligned to the requirements of the Code of Ethics for Professional Accountants.
The Companies Act recognizes that the directors are ultimately responsible for the preparation of financial statements of the company and the Insurance

Act goes to further place this responsibility on the principal officer and another one director on behalf of the rest of the board. The principal officer is expected to demonstrate proficiency of insurance business to pass the fit and proper test. The other director is not necessarily required to attend proficiency lessons. On the other hand the accountancy profession places onerous responsibilities on the chief finance officer. The Chief Financial Officer is required to be professionally competent and adhere to the professions code of conduct. In addition to this, the Capital Markets Authority guidelines require that the Chief Finance Officer be a member of ICPAK in good standing.

The Capital Markets Authority Guidelines recognizes the key role that the internal auditor plays with regard to internal controls over the process of financial statements preparation. The CMA requires that the Head of Audit to be a member of the Institute of Certified Public Accountants of Kenya In good standing.

Performance indicators provide users of the financial statements with concise and precise information on the performance of a business. In the insurance sector, the regulator, IRA had in the past given guidance on the key performance indicators that an insurer should compute. However, these key ratios on the solvency, claims ratios etc are not disclosed to the public when they are publishing their audited financial statements. For example in the banking sector key financial indicators are part and parcel of financial reporting disclosures. The regulator provides benchmarks which guide the public. These indicators assist public to quickly assess the financial health of an institution.

There is need for more frequent financial reports are presented to the public. Frequency should be revised to quarterly given that other players for example the banks report on a quarterly basis.

Brokers play a fundamental role in information disclosure being representatives of the insurance companies. As a matter of fact many policy holders are obvious the existence of insurance companies.

5.3 Recommendations

Consider making the following amendments to the Insurance Act:

i. Amendment of the definition of the International Financial Reporting Standards given in section 54 (1A) which has been expanded to include Kenyan Accounting Standards.
ii. To define what auditing standards will be utilized in the performance of an audit.
iii. Section 61 of Act to include the publishing of the statement of comprehensive income for members of the public to get a complete picture of the Insurance companies' performance.

- With regard to the guidelines, For example, under the Corporate Governance Guidelines issued by IRA, Section 7.2.1 on the independence requirements for the auditor reference should be made to the Code of ethics for Professional Accountants as issued by the accounting regulator.

- The need sensitize consumers of insurance services to scrutinize financial statement directly or through proxy whenever they are published so as to help understand the financial soundness of an insurer.

- To ensure consistency in the various regulations across the various sectors and given provision of Section 61 of the Insurance Act, the reporting timelines be reviewed from four months to three months. This will also take cognizance of the fact that modern information and communication technology facilitates timely disclosure.

- In addition to publishing in the daily newspapers of wide circulation, insurers should for effective disclosure also be required to make their audited financial reports readily available in their websites. This

requirement should be reinforced by the regulator through the revision of the reporting guidelines[7].

- Partner rotation and the independence requirements for auditors contained in the Insurance Act should be aligned to the requirements of the Code of Ethics for Professional Accountants. The Code of Ethics for Professional Accountants requires engagement partner rotation after seven years. ICPAK has adopted the IFAC code of ethics.

- The accountancy profession places onerous responsibilities on the chief finance officer. The Chief Finance Officer is required to be professionally competent and adhere to the professions code of conduct. It may be important to amend the corporate governance guidelines to recognize the need for the CFO to attest to the financial statements. In addition CFO's of Insurance Companies be required to be members of ICPAK in good standing.

- In addition, the Head of Internal Audit in Insurance Companies should be required to be a member of ICPAK and in good standing. With regard to the guidelines, For example, under the Corporate Governance Guidelines issued by IRA, Section 7.2.1 on the independence requirements for the auditor reference should be made to the Code of ethics for Professional Accountants as issued by the accounting regulator

- The study proposes that that with the agreement of all stakeholders, more frequent financial reports are presented to the public. Frequency should be revised to quarterly given that other players for example the banks report on a quarterly basis.

- Disclosure requirements need to be extended to the brokers as they are key players. As a beginning a threshold for the purpose of disclosure may be set.

[7] It is however, worthwhile to note that for listed entities this requirement has been included in the Companies Bill December 2011, which is currently before Parliament for approval

5.4 Areas for Further Research

- There urgent need to review and rationalise returns in form and materiality to avoid information overload. It important to note that the returns were reviewed recently but those that relate to the format of financial presentation should be updated constantly.

- There is need to bring to disclosure Insurance brokers who play a key role in providing information to public. A study is necessary in coming up with disclosure framework.

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