

Recognition of Commission on Insurance between Insurance Agent and Insurance Brokerage Company

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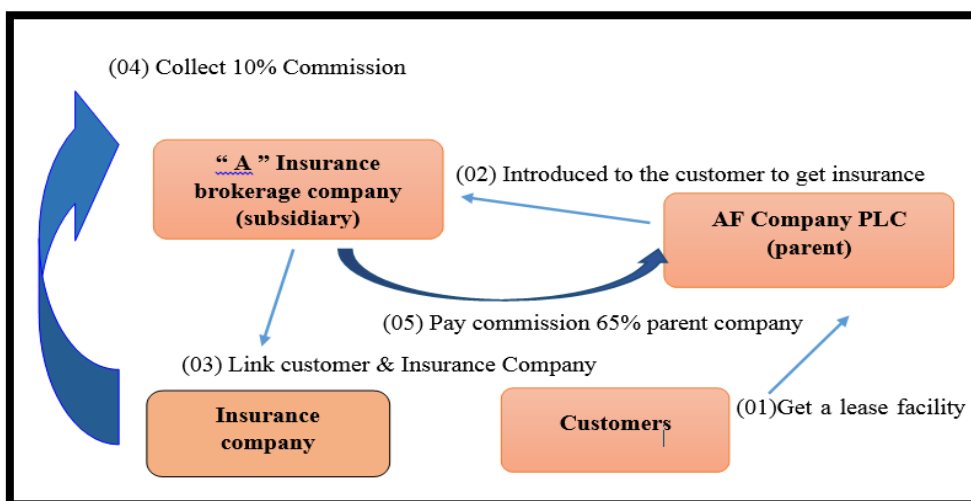
Introduction

AF Company is a public limited company incorporated and domiciled in Sri Lanka under the Companies Act No.07 of 2007 and classified under banking & finance industry by Colombo Stock Exchange. During the financial year 2014/15 AF PLC become a parent company of “A Insurance Brokerage Company” by acquiring their associate company as a subsidiary. The company provided a vast range of financial services which included accepting deposits, leasing, hire purchase, loan facilities, pawn brokering and other financial services.

This issue is relating to the violation of Insurance Act No 3 of 2011 section 88 that given a maximum rate of commission that might be paid by an Insurance broker to an insurance agent.

Discussion of the Issue

During the Audit 2014/15 it was noted that parent company recorded the fee and commission income which was received from the subsidiary company. When the AF PLC entered to the lease contract with customers, AF PLC introduces those customers to the subsidiary company “A” (insurance brokerage company), and they related to insurance company. This brokerage company linked those customers and insurance company together and buildup a relationship. Accordingly company “A” received commission income as a portion of the insurance premium from the insurance company. It is 10% of insurance premium. As per the agreement and practice, parent company entitled



to 65% of total commission for leased vehicles from the company. Because of AF Company PLC act as a role of Insurance agent and “A” insurance brokerage company act as a role of insurance broker.

But during the audit it was noted that this create a disagreement with the Insurance Act provisions relating to the maximum rate of commission that might be paid by an insurance broker to an insurance agent. As at the reporting date parent company has reported as follows,

Credit related fees and commissions

Commission on Insurance - 34,820,989.32

Description	Balances as at 31.3.2015
Total insurance premium	535,707,527.93
Total commission (10%)	53,570,752.79
Parent company (65%) income	34,820,989.32
Subsidiary company (35%) income	18,749,763.47

During the audit it was observed that the subsidiary company’s practice is to pay fixed commission to the parent company which is more than the limits prescribed in Insurance Act section 88 amended Act in No 3 of 2011.

Implication of the Issue

“A” Insurance Brokerage Company this amount presented in their financial statements as “Management fee” but AF company PLC this amount presented in their financial statements as “Commission on Insurance”. As a result of that company “A” income was understated, expenses overstated and income of AF PLC was overstated.

Recommendation

According to the Insurance Act No 43 of 2000 and amended Act No 3 of 2011 section 88 mentioned a maximum rate of commission that might be paid by a broker to an insurance agent. Insurance Act categorized insurance policy mainly as follows,

- **Long term insurance**
- **General insurance**

According to the Insurance Act individual life insurance coming under Long term insurance and give a separately provision of this category. And fire, motor, miscellaneous, marine and non - marine classes of insurance coming under general insurance. According to this classification AF Company PLC and “A” insurance brokerage company has a general insurance relationship. Because “A” insurance brokerage company and AF Company PLC deal with “Motor”

Insurance. According to the Section 88 of Insurance Act General insurance provisions are as follows,

General insurance business

According to the Insurance Act No 43 of 2000 and amended Act No 3 of 2011 section 88,

No broker shall pay or contract to pay to an insurance agent and no insurance agent shall receive or contract to receive, by way of commission or remuneration in any policy of general insurance and effected through an insurance agent an amount exceeding:

- 1. Where the policy relates to fire, motor, miscellaneous and other non-marine classes of insurance 15% of premium payable on the policy.*
- 2. Where the policy relates to marine insurance 10% of premium payable on the policy.*

According to the Insurance Act it is recommended to act in accordance with the provisions of the Insurance Act to overcome consequences from regulatory. So the parent and subsidiary company should be entered into the agreement and must act in accordance with the prescribed provision of the Insurance Act.