Query No. 10

Subject: Presentation of financials of Capital Redemption and Annuity Certain (CRAC) Business, in the financials of the Corporation.[1]

A. Facts of the Case

1. A Corporation (hereinafter referred to as 'the Corporation') was established under the Life Insurance Corporation Act, 1956 and is engaged in the business of life insurance in and outside India. The Corporation is governed by the provisions of the Act under which it is formed and notifications there under (the Governing Act); it is also registered with the Insurance Regulatory and Development Authority of India (IRDAI) and is subject to such provisions of IRDAI Act and regulations there under which are not inconsistent with the provisions of the Corporation's Governing Act. The equity shares of the Corporation are listed on National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) (w.e.f. 17th May, 2022).

2. The Corporation offers a range of individual and group insurance solutions including participating, non-participating and unit linked lines of businesses. The portfolio comprises of various insurance and investment products, such as, Protection, Pension, Savings, Investment, Annuity, Health, Variable and Capital Redemption and Annuity Certain (CRAC).

3. The Corporation prepares its Standalone Financial Statements (SFS) as per the requirements of Life Insurance Corporation Act, 1956 (LIC Act), the Insurance Act, 1938 (Insurance Act), the Insurance Regulatory and Development Authority of India Act, 1999 (IRDAI Act), the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002 (Regulations), Securities and Exchange Board of India Act, 1992 (SEBI Act) and as per the applicable framework of Accounting Standards (AS), issued by the Institute of Chartered Accountants of India (ICAI).

4. The Corporation's financial statements comprise of Balance Sheet for Life Insurance Business, Health Business, Pension Business, the related Revenue Accounts (also called the Policyholders' Account or the Technical Account) for the life insurance business, health business, pension business, the Profit and Loss Account (also called the Shareholders' Account or the Non-Technical Account) and Receipts and Payments Account (also called as the Cash Flow Statement) and notes to the standalone financial statements, including a summary of significant accounting policies and other explanatory information as required. The financial statements of CRAC are separately presented and disclosed along with the standalone financials of the Corporation.

5. The Corporation also prepares its consolidated financial statements (CFS) which comprise of financial statements of the Corporation and its subsidiaries and associate companies. These Consolidated Financial Statements for the Group are prepared in accordance with the principles and procedures for preparation and presentation of consolidated financial statements as laid down under the Accounting Standard (AS) 21, 'Consolidated Financial Statements' and are presented in the same format as that of the Corporation. Corporation in its consolidated financial statements has also consolidated the financials of CRAC.

[1] Opinion finalised by the Committee on 19.5.2023.

6. The Corporation is seeking opinion from the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI) for the presentation of financials of CRAC business in the financials of the Corporation**.** The financial statements of CRAC are separately presented and disclosed along with the standalone financials in the Annual Report and are submitted to the Insurance Regulatory and Development Authority of India (IRDAI). The accounts of the CRAC business are consolidated by the Corporation while preparing its consolidated financial statements and separate reporting under 'Segment Reporting' is carried out by the Corporation.

7. The Corporation operates business of Capital Redemption and Annuity Certain (CRAC). The Scheme was treated as non-life business, i.e., as part of general insurance business. Hence, the Scheme is managed by the Corporation as separate segment of its operations. The brief history of the Scheme is as follows:-

a) From the inception of the Corporation till 1964, separate books of account were maintained for CRAC and separate revenue account and Balance Sheet were being prepared.
b) From 1964 onwards, when the Corporation started doing General Insurance Business, CRAC was treated as a part of general insurance business and CRAC accounts appeared in the Principal Ledger of the General Department.
c) In 1972, General Insurance was separated from the Corporation although CRAC continued with the Corporation and as per the Board Decision, it was decided to separate the investments for CRAC. Therefore, CRAC accounts were maintained and presented separately.

The CRAC fund is kept separate and distinct from the main Life Fund and separate Revenue Account and Balance Sheet are published in the Annual Report. The entire surplus under CRAC Business is payable to the Shareholders.

8. Three plans were launched under this business as under:

a) Capital Redemption Assurance plan (Without Profit):- This plan provides for payment of a sum of money on a specified future date, in consideration of payment of periodical premiums by the policyholder during the term of the policy. Any person owning an asset to be redeemed is eligible for assurance under the plan.

b) Immediate Annuity Certain:- Under this plan, the purchase price is paid in a lump sum, whereupon a fixed amount of Annuity becomes payable periodically for a specified number of years, independent of duration of life of the Annuitant.

c) Deferred Annuity Certain:- Under this plan, the purchase price is paid either in a lump sum at the commencement of the deferment period or by way of premium instalments during the deferment period. The payment of annuity instalments would commence on expiry of the deferment period and shall be payable independent of the duration of life of the Annuitant.

9. All the three plans do not cover any risk on the life of the assured. Any person owning an asset to be redeemed is eligible for assurance under the plan. There is no mortality factor involved in the computation of premiums under this business since they are independent of the duration of human life. Therefore, there is no life assurance element under this plan. However, this line of business has now been closed for new business.

10. The querist has separately clarified that there is no provision/requirement with regard to maintenance and presentation of CRAC or General Insurance Business in the LIC Act, IRDAI Act or Regulations or any other applicable order/instruction/communication from regulator or competent authorities.

B. Query

11. In view of the above, the matter is being referred to Expert Advisory Committee of the ICAI to obtain its opinion on following points:

(i) Whether the financial statements of the CRAC business should be part of the standalone financial statements of the Corporation as a separate business segment; or

(ii) Whether to continue with the present practice of considering accounts of this business in the consolidated financial statements and separately presenting and disclosing along with the standalone financials of the Corporation in the Annual Report; or

(iii) Any other methodology as suggested by the Expert Advisory Committee.

C. Points considered by the Committee

12. The Committee notes that the basic issue raised by the querist relates to the presentation of financials of Capital Redemption and Annuity Certain (CRAC) business in the financials of the Corporation prepared in accordance with the Accounting Standards, issued by the ICAI. The Committee has, therefore, considered only this issue and has not examined any other issues that may arise from the Facts of the Case, such as, accounting for various plans/schemes under the CRAC business and for other businesses of the Corporation, compliance with the formats prescribed under the LIC Act, Insurance Act, IRDA Guidelines, whether the CRAC business is covered under the General Insurance business as per the regulatory requirements, compliance with any legal/regulatory requirements with regard to maintenance of separate accounts of CRAC business, etc. The Committee notes that the query has been raised under Accounting Standards issued by the Institute of Chartered Accountants of India and, therefore, the opinion expressed hereinafter is in the context of these standards only. Further, the opinion expressed hereinafter is purely from accounting perspective and the Committee has not looked into the regulatory or legal requirements including classification and implications arising under Income-tax Act, Insurance Act, IRDA regulations, SEBI Regulations, LIC Act, etc.

13. At the outset, the Committee notes the following features of the CRAC business and the treatment adopted by the Corporation for the same:

a) The Corporation operates and manages the business of Capital Redemption and Annuity Certain as a separate segment of its operations. The Scheme was treated as non-life business, i.e., as part of general insurance business.

b) The CRAC fund is kept separate and distinct from the main Life Fund and separate Revenue Account and Balance Sheet are prepared and published in the Annual Report.

c) The entire surplus under CRAC business is payable to the Shareholders of the Corporation.

d) Under various plans operated under the CRAC business, the assured or the policyholder/annuitant is entitled to a fixed sum of money on specified future date(s) in consideration of payment of periodical premiums or a lump sum purchase price.

e) In 1972, when General Insurance was separated from the Corporation, as per the Board Decision, it was decided to separate the investments for CRAC. Therefore, CRAC accounts were maintained and presented separately.

f) The accounts of the CRAC business are consolidated by the Corporation while preparing consolidated financial statements of the Corporation and separate reporting under 'Segment Reporting' is carried out by the Corporation.

From the above, the Committee notes that the CRAC business is an integral part of the operations or businesses of the Corporation. The assured or the policyholder/annuitant is entitled to a fixed sum of money on specified future date(s) and any surplus or deficit generated under the CRAC business belongs to its shareholders. Therefore, the Corporation is exposed to substantially all of the risks and rewards of the funds managed in such business. Further, the Corporation manages the funds/assets of the CRAC business as per its own discretion for the benefit of its policyholders and shareholders and thus, exercises control over them.

14. In the above context, the Committee notes that the Framework for Preparation and Presentation of Financial Statements, issued by the ICAI states as follows:

> "49. The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:
>
> (a) An *asset* is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise.
>
> (b) A *liability* is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
>
> (c) *Equity* is the residual interest in the assets of the enterprise after deducting all its liabilities."
>
> "54. The future economic benefits embodied in an asset may flow to the enterprise in a number of ways. For example, an asset may be:
>
> (a) used singly or in combination with other assets in the production of goods or services to be sold by the enterprise;
>
> (b) exchanged for other assets;
>
> (c) used to settle a liability; or
>
> (d) distributed to the owners of the enterprise."
>
> "69. Income and expenses are defined as follows:

(a) *Income* is increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

(b) *Expenses* are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants."

The Committee notes that an essential feature of the definition of the term 'asset' is that the resource is controlled by the entity and future economic benefits from such resource are expected to flow to the enterprise. In the extant case, as discussed above, the Corporation controls the funds/assets of CRAC business and future economic benefits from such funds also flow to the Corporation. Any residual interest in the assets of the CRAC business after deducting all its liabilities shall flow to the shareholders of the Corporation. The Corporation can also take the benefits of the increase in value of the funds/assets under the CRAC business and any decrease in value due to depletion of assets also belongs to the Corporation. Therefore, the funds/assets, liabilities, income and expenses of the business should be recognised in the standalone or separate financial statements of the Corporation. In other words, financials of the CRAC business should be part of the standalone or separate financial statements of the Corporation.

Further, since the financials of the CRAC business have already been incorporated in the standalone or separate financial statements, the question of consolidating the same as a separate component in the consolidated financial statements does not arise.

15. The next issue that arises in the extant case is the reporting and presentation of the CRAC business in the consolidated or standalone/separate financial statements of the Corporation as its separate segment, the Committee notes the following requirements of Accounting Standard (AS) 17, 'Segment Reporting':

"4. If a single financial report contains both consolidated financial statements and the separate financial statements of the parent, segment information need be presented only on the basis of the consolidated financial statements. In the context of reporting of segment information in consolidated financial statements, the references in this Standard to any financial statement items should construed to be the relevant item as appearing in the consolidated financial statements."

In this regard, the Committee also notes that as per the provisions of Accounting Standard (AS) 17, 'Segment Reporting', the components of an enterprise that are required to be reported separately have to first fall within the definitions of the term 'business segment' before being considered as 'reportable segment' as per the threshold criteria laid down in AS 17. In this context, the Committee notes the definitions of the terms 'business segment' as per AS 17, which provide as follows:

"5.1 A <u>business segment</u> is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products or services;

(b) the nature of the production processes;

(c) the type or class of customers for the products or services;

(d) the methods used to distribute the products or provide the services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

"7. A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors listed in the definition of business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors."

"11. Determining the composition of a business or geographical segment involves a certain amount of judgement. In making that judgement, enterprise management takes into account the objective of reporting financial information by segment as set forth in this Standard and the qualitative characteristics of financial statements as identified in the Framework for the Preparation and Presentation of Financial Statements issued by the Institute of Chartered Accountants of India. The qualitative characteristics include the relevance, reliability, and comparability over time of financial information that is reported about the different groups of products and services of an enterprise and about its operations in particular geographical areas, and the usefulness of that information for assessing the risks and returns of the enterprise as a whole.

12. The predominant sources of risks affect how most enterprises are organised and managed. Therefore, the organisational structure of an enterprise and its internal financial reporting system are normally the basis for identifying its segments."

"24. Business and geographical segments of an enterprise for external reporting purposes should be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's performance and for making decisions about future allocations of resources, except as provided in paragraph 25."

"Reportable Segments

27. A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of –

(i) the combined result of all segments in profit, or

(ii) the combined result of all segments in loss,

whichever is greater in absolute amount; or

(c) ***its segment assets are 10 per cent or more of the total assets of all segments.***

28. A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item."

The Committee notes from the above that to identify business segments, the undertaking needs to evaluate whether the risks and returns of various components of an enterprise are different as per the factors stated in the definition of the term 'business segment'. Where the organisational structure and internal financial reporting system of various components are different, it suggests that the risks and returns are different. Further, the factors specified in the definition, which need to be considered in determining whether product or services are related involves a certain amount of judgement.

The Committee notes from the Facts of the Case that CRAC is being considered as a part of general insurance business by the Corporation and as per its Board decision, it was decided to separate the investments for CRAC. Therefore, CRAC accounts were maintained and presented separately. Further, the querist has stated that the CRAC plans do not cover any risk on the life of the assured. Any person owning an asset to be redeemed is eligible for assurance under the plan. There is no mortality factor involved in the computation of premiums under this business since they are independent of the duration of human life and thus, there is no life assurance element under this plan. Thus, it appears from the Facts of the Case that the risks and returns of CRAC business are different from life insurance business of the Corporation and therefore, the same should be identified as a separate business segment. Further, the Committee is of the view that if this segment meets the threshold criteria as prescribed in AS 17, the Corporation should report the same as per the requirements of AS 17. Furthermore, as per paragraph 28 of the Standard, even if a business is not a reportable segment as per paragraph 27, it may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. Thus, irrespective of whether CRAC business meets the criteria of reportable segment or not, as per the discretion of the management, CRAC business may be reported as a separate segment, as per the requirements of AS 17 in the financial statements of the Corporation. Further, in the context of reporting of segment information, requirements of paragraph 4 of AS 17 should also be complied with.

D. Opinion

16. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 10 above:

(i) The financials of the CRAC business should form part of the standalone or separate financial statements of the Corporation, as discussed in paragraphs 13 and 14 above. Further, if CRAC business meets the threshold criteria as prescribed in AS 17, the Corporation should report the same as a separate reportable segment. Furthermore, as per paragraph 28 of the Standard, irrespective of whether CRAC business meets the criteria of reportable segment or not, as per the discretion of the management, it may be reported as a separate segment, as discussed in paragraph 15 above. Also, in the context of reporting of segment information, requirements of paragraph 4 of AS 17 should also be complied with.

(ii) The present practice being followed by the Corporation of considering accounts of this business only in the consolidated financial statements in the Annual Report is not appropriate.

(iii) In view of (i) and (ii) above, the answer to this question does not arise.

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