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## Insurance-brokerage Accounting

BY SOLOMON FARB

The insurance broker is the middleman between the insured and the insurance company (or its general agent), who obtains for his client the required insurance. He is regarded in most states as the agent of the insured and not of the company as regards all matters pertaining to the application for insurance and the writing of the policy.

It is the duty of the insurance broker to effect the insurance of his client (or as it is known in the field, "to place the risk"); to obtain for him the broadest possible coverage and the most liberal privileges possible, at the lowest possible premium; to obtain for his client the benefit of any reductions in rate that may occur during the term of the policy; to make any changes necessary, as change of location; and in general, to protect the interests of his client at all times.

The compensation of the insurance broker consists of a certain commission, based on the premium, and varies with the different classes of insurance effected. It must be borne in mind that the broker receives his commission from the insurance company, but that this does not change the general rule that he is the insured's, and not the company's, agent.

To obtain from his client the order for insurance, and to perform for him all of the duties enumerated above, to obtain the lowest possible rate, to select sound companies, to keep adequate records of policies, endorsements, etc.; in short, to render the highest possible service to his client, it has become necessary for the insurance broker to maintain a real organization, including such departments as soliciting, inspection, placing and, because of the voluminous detail peculiar to the insurance business, a book-keeping and accounting department.

To bring these departments into complete harmony, thereby permitting an order to flow smoothly from one department to another, from its inception to its completion, should be the work of the accountant, just as much as the installation of the actual books and records.

When an order for certain insurance is received from a client, either by a solicitor or direct, it is usually first presented to one of the principals who passes upon the desirability of the account (if it is a new one) and gives general instructions as to the placing of it. This duty of placing the insurance is turned over to a "placer," after a record of the order is placed in an order book, who obtains the necessary insurance, temporarily covered by a binder. A placer is one who is generally versed in insurance requirements and acquainted with the various companies and companies' agents.

A binder is a temporary contract containing the essential terms of the policy, names of company and assured, effective date, risk covered, location, amount, time, etc., signed by the company or its general agent, and binding it until the policy is issued. Delay in issuing the policy may be due, among other causes, to an investigation of the insured premises or the assured's credit or simply the usual time consumed by the regular office routine.

When the policy is finally issued by the insurance company, it is forwarded to the broker for transmittal to his client. At this stage, the records of the insurance broker commence.

#### SUBSIDIARY RECORDS

The records of an insurance-brokerage office, not unlike those of mercantile organizations, consist of divers statistical records in addition to the financial books. These statistical or subsidiary records do not become a part of the general books, but are maintained for information only. They consist, usually, of the following: account record, expiration cards, life-renewal cards, bills, credit bills.

The policy, when received from the insurance company, is attached to the binder and forwarded to the clerk in charge of checking. This employee, who is called the checker, compares the policy with the order to see that it has been properly made out, verifies the rates and the forms used on the policy, and ascertains that all the required permission and privilege clauses, to which the client is entitled for complete protection, have been included. It is his duty to see that the policy, as written, reflects the protection desired by the client. After satisfying himself that the policy is correct in all particulars, he passes it to the proper persons for recording.

The account record (sometimes called the "line card"), usually in card form, contains an historical record of the total insurance carried by each client. Each client has a separate card on which are entered, in chronological order, the various policies obtained for him. This record is not in full detail, but contains the essential data on all policies, as dates, companies, amounts, property covered, class of risk, rates, expirations and special remarks. Thus, it is possible, by looking at the card, to see at a glance the total amount and the various forms of insurance carried, the total amount of premiums paid, etc. This is desirable as a record, not only for its value to the office itself, but for the service it enables the office to render clients, who, not keeping adequate insurance records of their own, often call upon the brokers for information. In order that this record may reflect the true status of the client's insurance, all changes (known as endorsements), made on existing policies must be recorded; similarly, policies cancelled before the date of expiration must be clearly indicated.

The expiration card is a record performing two functions: First, it is a complete detail record of each policy of insurance for the client, which may be referred to at all times. The account record, it will be recalled, contains merely summary information. The second and main purpose, as its name implies, is to provide a suitable record for renewals of expiring insurance, and to provide it in such a manner that old-fashioned diaries showing the insurance expiring each month need not be kept. The card has a projection along the top, which indicates the month in which the insurance expires. Cards may be obtained with projections for each of the twelve months. Cards containing the January projection are furthest to the left, February, slightly to the right, etc. Thus, when the cards are placed in the cabinet, they will automatically fall in place, the earliest month first, etc. Each policy of insurance is entered on a separate card corresponding with the month in which it expires. Thus, May policies issued for one year expire the following May and will be entered on cards containing a projection marked May. About April 1st of the following year, all May cards are taken from the files and orders for renewals are issued to the various companies. Should a policy be cancelled before it expires, the expiration card should be marked accordingly and removed from the file, as a renewal will not be required. All changes made during the term of the

policy must be entered, so that the insurance may be renewed in accordance with the corrections.

The expiration card described above is used for all forms of insurance except life insurance, for which a special card must be used, the life-renewal card. This card has a projection bearing the name of the month. The months used here are not the expiration dates, but the months in which the premiums are due.

Life-insurance premiums may be paid annually, semi-annually, quarterly or monthly, according to agreement. The broker is allowed a substantial commission on the first year's premium, and a small renewal commission for several succeeding years, depending upon the contract, but usually nine. The purpose of the renewal cards is to show automatically the date on which the premiums are due, so that the commissions due thereon may be collected from the insurance company. A card is made out for each month in which a payment is due. Thus, for a policy issued in January, payable annually, only one card, January, is required. A policy issued in January, payable quarterly, requires four cards, one each of January, April, July and October, as premiums are due in each of these months. The life-insurance companies submit monthly statements showing the amount of renewal commissions due the broker from premiums collected. These statements should be checked with the renewal cards of the month to ascertain if all are included therein. If all are accounted for, the commissions collected are recorded, and the cards are replaced in the cabinet to come up again the following year; if they do not, inquiries should be made to ascertain the cause. It may be that the policy has lapsed, or that the assured has died during the year. A wide-awake insurance office will follow up all lapsed policies to convince the assured that it is against his best interests to drop the policy. Of course, if the policy has been definitely discontinued, or the assured has died, or the term during which the broker is entitled to renewal commissions has expired, the cards covering payments should be removed from the files. As in the case of the records previously mentioned, any changes made during the term of the policy should be recorded. The back of the renewal card contains space for recording all renewal commissions collected thereon.

After they have been checked and verified and the proper statistical records have been made, policies and bills are forwarded to clients. The bills contain the essential particulars of each

policy. They are numbered in consecutive order and made out in duplicate, the second copy remaining in the office for entry upon the books. The duplicates contain, in addition to the information called for on the originals, columns for calculating the amount of commission earned on the policy and the net amount due to the company. This information is required for use in the accounting department and, for obvious reasons, is omitted from the original. The bill may be classed under the main records, since it is the basis of the entries in the invoice register.

Credit bills are similar to the bills in form, but are usually of a different color. They are used only for credits due clients on account of rate reductions, cancellations, etc., and are the source of the entries in the cancellation register and return-premium book.

#### BOOKS OF ACCOUNT

The books used in a modern insurance-brokerage office, where records are kept on an accrual basis and a complete double-entry system is maintained, usually embrace the following:

Invoice register	Miscellaneous-expense book
Cancellation register	Journal
Return-premium book	Petty cash
Cash-receipts book	Payroll book
Cash-payments book	Accounts-receivable ledger
Return-premium ledger	Accounts-payable ledger
Solicitors' ledger	Miscellaneous-accounts-payable ledger

The invoice register is a combination of the sales and purchase books used in the ordinary mercantile concern. It contains a charge to the client for the premium on the policy and a credit to the insurance company for the net amount, premium less commission, the commission being immediately credited to the income account, which is the proper method where books are kept on an accrual basis. Some accountants, however, do not look with favor upon this method, contending that it is improper to treat commission as income until the premiums have actually been paid. They maintain that the cash method is the only proper method for insurance-brokerage houses, as many policies of insurance are placed and put through the books only to be cancelled subsequently.

## *Insurance-brokerage Accounting*

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It is the opinion of the writer that the cash method is entirely inadequate. The work involved in placing the insurance, inspecting the risk and making the proper office records is the most costly part of the service rendered by the broker, and it is manifestly unfair to charge the salaries paid to employees performing these duties in one period and to include the income in another. The number of policies cancelled is usually small in proportion to the number placed, and it is no more logical for the insurance broker to use the cash method because of these cancellations than it is for mercantile firms to use it because goods purchased are subsequently returned. The accrual method is the method used today by some of the largest insurance-brokerage houses and it is being adopted by others, so that it seems only a question of time before it will be used by all firms of consequence. For the benefit of the reader, however, there will be found at the conclusion of the outline of this system a few brief remarks, showing how it may be adapted to meet the objection just discussed.

The bills are entered in the invoice register in numerical order, showing the name of the assured, company, policy number, premium, commission earned and commission due the solicitor. The premium is entered in the accounts-receivable column and posted to the individual accounts in the accounts-receivable ledger; the commission on the policy is carried to the commission column which is segregated into life and general (the latter covering commissions on all insurance other than life); and the net amount is entered in the accounts-payable column, from which it is posted to the individual accounts in the accounts-payable ledger. The posting to the general ledger at the end of the month is:

Accounts receivable

To accounts payable

Commissions earned, life

Commissions earned, general

The invoice register also contains a solicitors' commission column and a subsequent-life-commission column, from each of which double postings are made. In the former is entered the amount of commission due to the solicitor on each policy. Solicitors are usually employed by insurance brokers on a commission basis. A double posting to the general ledger is made from this column, as follows:

Solicitors' commissions

To solicitors' commissions payable  
(or John Doe)

Where the number of solicitors employed is small, separate accounts in the general ledger may be kept for each and the credit posted thereto. If many solicitors are employed, it may be advisable to maintain a subsidiary ledger and keep one controlling account in the general ledger.

Before explaining the use of the subsequent-life-commissions column, it may be well to discuss the accounting for life renewals. As previously explained, there are two sources of income from a life-insurance policy, the substantial commission on the first year's premium and the small renewal commission for a few succeeding years. When a life-insurance policy is entered in the invoice register, the commission on the first payment, not first year's premium, is taken into the commission-life column, and the subsequent renewal commissions into the subsequent-life-commissions column. Thus, on a policy with an annual premium of \$100, assuming a first commission of 40% and a renewal commission of 5% for the succeeding nine years, \$40 would be taken into the commissions-life column, and \$45 into the subsequent-life-commissions column. In the case of a policy payable semi-annually or quarterly, the commissions on the second, third and fourth payments are treated as renewals for purposes of accounting, as they are paid direct to the company and credited by the latter to the broker on the regular monthly statement. Thus, on a policy payable \$25 a quarter, assuming a 40% commission on the first year's premium, and 5% thereafter for nine years, \$10 would be taken into the commissions-life column (40% on first payment of \$25), and \$75 into the subsequent-life-commission column (40% on balance of first year's premium, \$75 equals \$30 plus 36 renewal commissions of 5% on \$25 or \$1.25 equals \$45, making a total of \$75). A double posting is made from the subsequent-life-commissions column to the general ledger, as follows:

Life commissions receivable

To reserve for subsequent life  
commissions

The setting up on the books of the asset, life commissions receivable, does not increase the net worth since it is offset by a reserve of like amount, but it commands attention to the fact that the broker possesses an asset of potential value. Because its value is only potential and is dependent on the continuation of the policies now in existence, good practice does not countenance setting up the asset on the books and crediting it, or even a por-



tion of it, to the income account. To do so would be tantamount to anticipating income, and this is never desirable from any viewpoint.

The asset account is in the nature of a controlling account, since it must agree with the total amount of renewal commissions still uncollected as shown by the renewal cards. These renewal cards, it will be recalled, show the total amount of renewal commissions due on each policy and the amount already collected. The total of the balances on each card must agree with the asset account. The renewal commissions when received from the insurance company are credited to the asset account from the cash-receipts book and are posted in detail to the individual renewal cards. In order to record the income on the books and to keep the reserve account in agreement with the asset account, a journal entry must be made debiting reserve for subsequent life commissions and crediting commissions earned—life. This is a standard monthly journal entry. In the event of the death of an assured or the discontinuance of a policy, no further renewals can be collected. Hence, it becomes necessary to determine the amount of renewals lost thereby and reduce by means of a journal entry the asset and reserve accounts by that amount.

The cancellation register, as the name implies, is a record of all policies cancelled and contains precisely the same information as the invoice register. The duplicate credit bills supply this information and are entered in the cancellation register in numerical order. The postings to the general and subsidiary ledgers, however, are reversed. This book is used for "flat" cancellations only—that is, where the policy is cancelled in its entirety, no earned premium being paid by the insured client. The policy is in effect treated as never having existed, the credit to the client's account wiping out the charge previously posted and the charge to the insurance company's account wiping off the credit previously passed thereto. It must be noted that this book is not used for credits due clients on account of policies cancelled after payment of the premium, rate reductions, etc. The return-premium book is used for such items. The commissions on the cancelled policies are charged to commissions-cancelled accounts and not to the commissions-earned accounts. This is done for the sake of clearness, as to post both cancellations and adjustments to the debit of the income account would render it difficult

to determine at the end of the year the actual amount of commissions cancelled.

The return-premium book contains a record of all credits due to clients on account of policies cancelled after the payment of the premium or on account of rate reductions, etc. The items in the return-premium column are posted to the debit of the individual accounts in the return-premium ledger. The posting to the general ledger from the return-premium book is:

Return-premiums account  
Commissions cancelled, general  
To accounts receivable

The cash-receipts book is similar to that in use in other offices. The items in the accounts-receivable column are posted to the individual accounts in the accounts-receivable ledger; items in the life-commission-receivable column to the renewal cards as previously explained; items in the return-premium column to respective accounts in the return-premium ledger. The general ledger posting at the end of the month is:

Cash  
To accounts receivable  
Life commissions receivable  
Return-premium account  
General

The total bank deposits made from cash received should be entered in the deposit column and should agree with the amount of the net cash column if the desirable practice of depositing all cash receipts is followed.

The cash-payments book is also similar to that in use in other offices. Items in the accounts-payable-insurance-companies column and miscellaneous-accounts-payable column are posted to the debit of the individual accounts in the respective subsidiary ledgers; items in the return-premium column to the credit of the individual accounts in the return-premium ledger. The credit to the return-premium account arises from the fact that there were deducted from the payments made to the insurance companies amounts representing returns due from them and still uncollected. The general-ledger posting from the cash-payment book at the end of the month is:

Accounts payable insurance companies  
Miscellaneous accounts payable  
General  
To cash  
Return-premium account

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The miscellaneous-expense book is a record of miscellaneous expenses incurred, such as stationery, advertising, telephone, entertaining, printing, etc. The writer has found that, in insurance offices, as well as in others, such bills are allowed to accumulate from month to month without being paid. To follow the practice of not charging them until they are paid is inadequate, first, because it prevents the preparation of accurate monthly statements, and, secondly, because there is then no record of the amounts due on such bills.

The bills are entered as they are received, extended into the proper columns, and posted to their individual accounts in the subsidiary ledger. The general-ledger posting at the end of the month is a debit to the various expense accounts and a credit to the controlling account.

The journal, petty cash and payroll books used in an insurance-brokerage office do not differ from those used in other offices, and no discussion of them is necessary.

The accounts-receivable, accounts-payable-insurance-companies and miscellaneous-accounts-payable ledgers do not require discussion, as they are not unlike those found elsewhere. The return-premium ledger contains accounts with insurance companies but is used for return premiums only. The original method of charging the insurance companies' regular accounts with such returns has been found to be cumbersome and inadequate, first, because insurance companies often prefer to make settlement for return premiums rather than to have them deducted from premiums due, and, secondly, because it has been found that merging these items with the regular accounts does not permit of their being watched so closely.

The solicitors'-commissions-payable ledger contains an account with each solicitor, showing on the credit side the commissions due to him on each policy (as per entries in invoice register) and on the debit side commissions charged back on account of cancellations (as per cancellation register) and cash payments made (as per cash-payment book).

The general ledger will contain the following accounts:

### *Assets*

Cash	Commissions receivable, life
Petty cash	insurance
Accounts receivable	Furniture and fixtures

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Return-premium account	Automobile
Notes receivable	

*Liability and Capital Accounts*

Accounts payable insurance companies	Solicitors' commission payable
Miscellaneous accounts payable	Reserve for depreciation
Loans payable	Capital accounts, or capital stock and surplus
Notes payable	

*Income Accounts*

Commissions earned—life	Commissions cancelled—general
Commissions earned—general	
Commissions cancelled—life	Income from adjusting
	Interest received

*Expense Accounts*

Solicitors' commissions	Advertising
Entertaining expense	Heat and light
Advertising expense	Rent
Traveling expense	General expenses
Automobile expense	Examinations and inspections
Officers' salaries	Publications
Office salaries	Repairs
Telephone and telegraph	Donations
Stationery and printing	Licenses
Postage	Interest paid
Professional services	

This system may be adapted to meet the objections of those accountants who feel that commissions should not be taken into income immediately, but only when the premium has been paid. The subsidiary records will not be affected, but the entries upon the books will be changed slightly.

In the invoice register, the commissions will be posted to reserve-for-commissions-deductible accounts, instead of to commissions-earned accounts. In the cash-payments book, new columns for commissions will be provided, in which will be entered the amount of commissions deducted on each payment

made to the insurance company. A double posting will be made from this column, namely:

Reserve for commissions deductible—general  
Reserve for commissions deductible—life  
    To commissions earned—general  
    To commissions earned—life

Thus, the commissions-earned accounts will be credited only with the commissions actually deducted, while the reserve accounts will show at any one time the amount of commissions to be taken into income when all the accounts have been paid.

The posting from the solicitors'-commission column in the invoice register will also be changed. Instead of charging solicitors' commission, a temporary account, such as solicitors' commission deductible, will be charged. An additional column in the cash-payment book will be provided, in which will be entered the commission due to the solicitors as payments are made to the insurance companies. The posting from this column will be a charge to solicitors' commission and a credit to solicitors' commissions deductible. Thus, the solicitors'-commission account will be charged only with commissions actually payable to the solicitors and the solicitors'-commission-deductible account will show at any one time the amount of commissions payable to solicitors if the premiums on which they apply are paid.

These changes may appear somewhat confusing to the reader, but they are in reality simple. Where a strict cash method is desired, a simpler and less involved system can probably be used, but where it is desired to maintain a cash system and all the advantages of an accrual system, the foregoing suggestions will be found satisfactory.