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Insurance Expense Accounting

BY W. H. DRAUGHON

This article describes :

- I. A convenient insurance record which shows:
 - (1) The total amount of insurance in force at all times and how distributed;
 - (2) The correct amount of premium to be charged to expense each month on each policy and the total on all policies;
 - (3) The exact amount of unexpired insurance, at any time, on each policy and in total.
- II. A form for the correct departmental distribution of all insurance expense for the current month.

In most accounting systems expenditures for insurance are not given due consideration. A common practice is to charge these expenditures directly to operating expenses. At the close of the fiscal year the policies in force are dug up and the amount of unearned premiums is computed and credited back to operating expenses and carried forward on the balance-sheet into the next period as an asset in the form of prepaid expenses.

This practice might answer if the management were content to wait until the end of the year for all information appertaining to the operation and progress of the business ; but modern methods demand current information and modern accounting seeks to satisfy this demand. To that end, all operating expenses should be brought down to a monthly basis so that each month's operation will be charged only with the expense consumed during that month.

Even in well-planned, modern offices, the monthly insurance charge is usually ascertained by estimation—for instance, one-twelfth of the estimated total for the year. There would be no criticism of this practice if laborious details were required in order to obtain the correct, actual, monthly figures ; but the purpose of this article is to show how easy it is to find the exact amount of monthly insurance charges and, at the same time, present at a glance the other valuable information mentioned above.

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The table on pages 18 and 19 shows the form of record in which each fire insurance policy is entered. Naturally, the best time to start the record would be the beginning of the fiscal year; but it may be started at any time, preferably at the first of a month. Bear in mind that columns 15 to 26 must be headed with months corresponding to the fiscal year, no matter in what month the record may be started. That is, column 15 will be the first month of the fiscal year and column 26 the last.

Open the record as follows. Get out all fire insurance policies still in force. Enter the oldest one on the first line. In columns 1 to 13 (omitting columns 5 and 6, which are to be left blank) insert the data called for, all of which is obtained from the policy itself. In column 12 show the full amount of premium as shown in the policy, regardless of the amount of premium already consumed. In column 13 show the term, in months, covered by that premium. Column 12 divided by column 13 will give the amount of monthly premium on that policy. Note the month of expiration, as shown in column 4, and insert the amount of monthly premium in each of the proper monthly columns, beginning with column 15 (if the record is started at the beginning of the fiscal year) and extending up to the month of expiration. The amount in the column for the month of expiration, however, will be a fraction of the monthly premium, unless the policy expires on the last day of the month. For instance, suppose the policy expires May 14th. The premium in the May column will be $\frac{14}{31}$ of the monthly premium. In column 27 enter total of columns 15 to 26. In column 28 write total amount of premiums running over into succeeding periods, if any. This will be the amount of unexpired insurance on that policy at the close of the current fiscal year. In column 14 write the sum of columns 27 and 28. This is the amount of prepaid insurance on this policy at the beginning of the current fiscal year. Column 27 plus column 28 must always equal column 14, in totals as well as in individual entries. In like manner enter each policy.

Having entered all policies in force at the time of beginning the record, total column 14. This is the amount of prepaid insurance that the ledger account must show (assuming, for this example, that fire insurance is the only kind of insurance carried). Proper entry should be made setting up this asset.

FIRE INSURANCE RECORD

Date of policy	NAME OF COMPANY	No. of policy	Date of expiration	Termination entries (in red)		AMOUNT OF POLICY (in Dollars only)					Memoranda		
				Date	How	Total amount	DISTRIBUTION OF POLICY				Raw material	Amt. of prem.	Term (mos.)
							Building	Equip-ment	Finished product	8			
1	2	3	4	5	6	7	8	9	10	11	12	13	
2/ 1/17	Ætna	460718	2/ 1/19	2/ 1/19	Exp.	7,000	1,000	1,000	4,000	1,000	136.00	24	
10/ 5/18	Hartford	36819	10/ 5/20	3/10/19	Can.	6,000	1,000	1,000	3,000	1,000	116.00	24	
11/ 1/18	Glens Falls	46832	11/ 1/20			6,000	1,000	2,000	2,000	1,000	116.00	24	
12/ 3/18	American N. J.	64896	12/ 3/19			7,000	2,000	2,000	2,000	1,000	66.00	12	
	Totals, Jan. 1, 1919					26,000	5,000	6,000	11,000	4,000			
1/15/19	Det. Fire and Marine	648796	1/15/20			4,000			2,000	2,000	40.00		
	Totals, Jan. 31, 1919					30,000	5,000	6,000	13,000	6,000			
2/ 1/17	Ætna	460718	2/ 1/19	2/ 1/19	Exp.	7,000	1,000	1,000	4,000	1,000			
	Totals, Feb. 28, 1919					23,000	4,000	5,000	9,000	5,000			
10/ 5/18	Hartford	36819	10/ 5/20	3/10/19	Can.	6,000	1,000	1,000	3,000	1,000			
	Totals, March 31, 1919					17,000	3,000	4,000	6,000	4,000			

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FIRE INSURANCE RECORD—Continued.

NAME OF COMPANY	"Prepaid insurance" dr.	MONTHLY PREMIUM CHARGES—DEBITS TO EXPENSE CREDITS TO "PREPAID INSURANCE"												"Prepaid insurance" bal. at end of year		
		Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.		Total	
2	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29
Ætna	5.67	4.83	4.84	4.83	4.83	4.83	4.84	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	5.67
Hartford	102.30	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	58.00
Glens Falls	106.49	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	4.83	58.00
American N. J.	61.05	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	5.50	61.05
Totals, Jan 1, 1919	275.51	20.83	15.17	15.17	15.16	15.17	15.17	15.16	15.17	15.17	15.16	15.17	15.17	10.22	182.72	92.79
Det. Fire & Marine	40.00	1.66	3.33	3.33	3.34	3.33	3.33	3.34	3.33	3.34	3.33	3.33	3.34	3.33	38.33	1.67
Totals, Jan. 31, 1919	315.51	22.49	18.50	18.50	18.50	18.50	18.50	18.50	18.50	18.51	18.49	18.50	13.56	221.05	94.46	
Ætna																
Totals, Feb. 28, 1919	315.51		18.50													
Hartford	69.00			18.80	4.83	4.83	4.84	4.83	4.83	4.84	4.83	4.83	4.83	4.84	24.70	44.30
Totals, Mar. 31, 1919	246.51		37.30	13.67	13.67	13.67	13.67	13.67	13.67	13.67	13.66	13.67	8.72	196.35	50.16	

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As new policies are taken out, treat these purchases in the same manner as any other purchase, charging them to prepaid insurance, and enter each new policy in the record in the same manner as above described. When entering new policies, the full amount of premium as charged by the agency will go in column 14.

When a policy is terminated by cancellation, credit prepaid insurance with the amount of returned premium as per credit memo. from the agency. Enter the cancellation on the first vacant line in the record. Use red ink all the way across the record, copying, in columns 1 to 11, the data appearing in those columns in the original entry of the policy. In column 5 show date of termination. In column 6 write the abbreviation "can." to show that it was terminated by cancellation. In column 14 enter the amount of returned premium credited by the agency (in red, of course). In column 28 enter the same amount shown in that column in the original entry. In column 27, enter the difference between columns 14 and 28. If column 28 should happen to be larger than column 14, the difference in column 27 must be in black (all other entries being in red). In all cases, the algebraic sum of columns 27 and 28 must equal column 14, remembering that figures of dissimilar color subtract instead of adding. Beginning with column 26, and working backward across the record toward the current month, enter, in red, the full monthly premium (as shown in original entry) in each of the intervening columns. In the column for the current month enter such an amount (in black or in red as may be required) as will make the algebraic sum of the amounts in the monthly columns equal to the amount in column 27. In cancellation entries the amount in the column for the current month will always be in black if the policy is cancelled at "short term rates," signifying an extra charge to make up for insufficient charges for prior months. If cancelled "pro rata," the entry will be in red, like the others. In columns 5 and 6, on the line of original entry of the policy, enter, in red, the same data contained in those columns in the cancellation entry beneath.

When a policy terminates by expiration, make an entry in red, as described in the preceding paragraph, except that no entries will be made in columns beyond column 11. Also make termina-

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tion notation in columns 5 and 6 on the line of original entry of the policy, using the abbreviation "exp." in column 6 here, as well as in the cancellation entry.

At the end of each month, if any entries have been made in the record during the month (cancellations included), total all money columns (except column 12), remembering that red figures subtract. Do not rule beneath any total except in the monthly premium column for the month just closed. The total in that column is the correct amount of premium to be charged into expense for the month and credited to prepaid insurance, and cut-off rules may be placed beneath this total, as no more entries will be made in that column. Before making any entry, however, of this charge to expense, the accuracy of all totals in the record should be proven thus: the sum of all monthly columns (closed columns included) must equal column 27, and column 27 plus column 28 must equal column 14. If no entries have been made in the record during the month all totals are already correctly shown.

If no departmental distribution of expense is made in the system, journal entry for the month's insurance expense may be made directly from the insurance record; but if this distribution is desired, the amount of the month's insurance charge is transferred to the insurance distribution sheet, which will be described later.

The fire insurance record described above not only gives the correct monthly charge for fire insurance, but shows any time at a glance just how much insurance is carried and how distributed. The importance of this is evident: it enables the manager to keep everything fully insured and to avoid over-insurance. At any time the correct amount of prepaid fire insurance is shown by the total of column 14 minus the sum of the totals of the closed monthly columns, or by the total of column 28 plus totals of the open monthly columns. The total of column 27 accurately forecasts the total amount of insurance charge for the whole year, provided no further changes are made by additions or cancellations. At the end of the year the total of column 28 gives the exact amount of prepaid fire insurance to be included in the balance-sheet and will agree with the balance of the ledger account prepaid insurance, provided, of course, that the ledger account

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represents fire insurance only. Furthermore, this amount can be quickly verified by listing the amounts in column 28 opposite each policy having blank spaces in columns 5 and 6.

The record for the following year is opened by entering therein those policies still in force. The amount in column 28 of the old record is the correct figure for column 14 of the new record.

Records similar to the fire insurance record may be prepared to take care of other kinds of insurance, such as boiler, plate glass, automobile, etc.; but these records will not require the distribution columns 8, 9, 10 and 11.

For the departmental distribution of all insurance expense, the premium charges for the current month as shown by the totals in the respective insurance records (fire, boiler, etc.) are transferred to the insurance distribution sheet illustrated on page 23. The total premium charge for the month from the fire insurance record is entered in column 7, line 20. Totals from the other insurance records are entered on the same line in the columns corresponding to the respective records, and the grand total (cross-footed) is entered in column 13. This grand total is the total charge for the month for all insurance expense, which is to be distributed over the various departments into which the business is divided. In the proper columns, on line 21, are entered the totals from the policy distribution columns in the fire insurance record. The amount on line 20, column 7, is distributed over columns 3, 4, 5 and 6, on the the same line, in proportion to the amounts in force shown on line 21.

It will now be noted that the amounts thus inserted on line 20 in columns 3, 4, 5 and 6 constitute the totals of the fire insurance charge on building, equipment, merchandise (or finished product) and raw material, respectively. Each of these totals is in turn to be distributed over those departments which should bear a portion of such charge. This distribution is based on the relative value of such property in the departments involved. Having once computed this relative value, it may be expressed in percentages, using the space provided therefor in the margin of each column. Each percentage column must total 100 per cent. The same percentages may be used month after month so long as no important

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		DEPARTMENTAL DISTRIBUTION OF INSURANCE EXPENSE—MONTH OF.....																								
		2		3		4		5		6		7		8		9		10		11		12		13		
		DEPARTMENTS		Building		Equipm't		Mdsc.		Raw material		Totals		Boiler		Plate glass		Auto- mobile		Work- men's compen- sation				Totals		
		%	Am't	%	Am't	%	Am't	%	Am't	%	Am't	%	Am't	%	Am't	%	Am't	%	Am't	%	Am't					%
Dep't Symbol Line No.		FIRE INSURANCE PREMIUMS																								
		Bldg.		Equipm't		Mdsc.		Raw mat'l		Totals		Boiler		Plate glass		Auto- mobile		Work- men's compen- sation		Totals						
Total premiums		Bldg.		Equipm't		Mdsc.		Raw mat'l		Totals		Boiler		Plate glass		Auto- mobile		Work- men's compen- sation		Totals						
Fire insurance in force		Bldg.		Equipm't		Mdsc.		Raw mat'l		Totals		Boiler		Plate glass		Auto- mobile		Work- men's compen- sation		Totals						
1																										
2																										
3																										
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changes occur in the value of the properties in the several departments. In column 7 on each line enter the total of columns 3, 4, 5 and 6 on that line.

Similarly, the totals entered on line 20 in columns 8, 9, 10, etc., should be distributed logically over the proper departments. Quite probably the total of some of these columns (as well as of some of the fire insurance columns) will be chargeable to a single department. The premium for workmen's compensation insurance will be distributed on the basis of payrolls in the several departments. In column 13 on each line enter the total of columns 7, 8, 9, 10, etc. The total of column 13 should then agree with the amount already written in that column on line 20.

Column 13 now shows the total amount of insurance premium chargeable to each department, and prepaid insurance is to be credited with the grand total, line 20, column 13.

This treatment of expenditures for insurance removes all the uncertainties of guess-work and estimates, and places every cent of such expense where it rightfully belongs, even down to the final departmental distribution. Once tried it will prove far more satisfactory than the loose practices now in common use.