

A Teaching Note for the Risk Management and Insurance Students and Instructors: SAP Accounting Example for a Property and Casualty Firm

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Abstract

There are a limited number of textbooks that explains the steps of SAP accounting entries with clarity to the students who are taking risk management and insurance classes.. We provide a teaching note for the instructors who are teaching Risk Management and Insurance courses. The note provides a simple example for the entries of a property & casualty balance sheet using reasonable assumptions to make the understanding easy.

Introduction

American Property and Casualty Corporation (APCC) starts its operations at the inception as the following:

Proceeds from the Stocks issue (\$20 with 10,000 shares):	\$200,000
2,000 policies issued each with \$500 premium	\$1,000,000
Assumptions: 1. Policies are issued once at the beginning of each year 2. Losses and all expenses are paid out every 6 months 3. Expected losses for net premium is 60% 4. Loss Adjustment Expenses on the average is 20% of net premiums 5. Agents and brokers commissions make up 10% of net premiums 6. Investment income of \$100,000 after 1 year (interest and dividends)	

Property & Casualty Firm Entries for Balance Sheet

1. APCC before starting its operations.
 December 31, 2013

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$1,200,000	Unearned premiums	\$1,000,000
		Loss Reserves	\$0
		Loss Adjustment Expenses	\$0
		Commissions to Agents and Brokers	\$0
		Capital	\$200,000
		Surplus	\$0

TOTAL ASSETS		TOTAL LIABILITIES AND SURPLUS	
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2. APCC's balance sheet after 6 months before paying out its expenses.

June 30, 2014

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$1,200,000	Unearned premiums	\$500,000
		Loss Reserves	\$300,000
		Loss Adjustment Expenses	\$100,000
		Commissions to Agents and Brokers	\$50,000
		Capital	\$200,000
		Surplus	\$50,000
TOTAL ASSETS	\$1,200,000	TOTAL LIABILITIES AND SURPLUS	\$1,200,000

3. APCC's balance sheet after 6 months after paying out its expenses

June 30, 2014

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$750,000	Unearned premiums	\$500,000
		Loss Reserves	\$0
		Loss Adjustment Expenses	\$0
		Commissions to Agents and Brokers	\$0
		Capital	\$200,000
		Surplus	\$50,000
TOTAL ASSETS	\$750,000	TOTAL LIABILITIES AND SURPLUS	\$750,000

4. APCC's balance sheet after 1 year period and before paying out its expenses

December 31, 2014

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$750,000	Unearned premiums	\$0
		Loss Reserves	\$300,000
		Loss Adjustment Expenses	\$100,000
		Commissions to Agents and Brokers	\$50,000
		Capital	\$200,000
		Surplus	\$100,000
TOTAL ASSETS	\$750,000	TOTAL LIABILITIES AND SURPLUS	\$750,000

5. APCC's balance sheet after 1 year period and after paying out its expenses

December 31, 2014

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$300,000	Unearned premiums	\$0
		Loss Reserves	\$0
		Loss Adjustment Expenses	\$0

		Commissions to Agents and Brokers	\$0
		Capital	\$200,000
		Surplus	\$100,000
TOTAL ASSETS	\$300,000	TOTAL LIABILITIES AND SURPLUS	\$300,000

Property & Casualty Firm Entries for Income Statement

December 31, 2014

REVENUES	
Premium Earned	\$1,000,000
Investment Income	\$100,000
EXPENSES	
Net Losses Incurred	\$600,000
Loss Adjustment Expenses	\$200,000
Commissions	\$100,000
Premium taxes (5%)	\$50,000
GENERAL EXPENSES	
Earnings Before Taxes (EBT)	\$150,000
Federal Taxes (30%)	\$45,000
Net Income	\$105,000
Dividends	\$55,000
Retained Earnings	50,000

6. APCC's balance sheet after starting to next year and issuing new policies worth of \$1,000,000 Investment income added.

December 31, 2014

ASSETS		LIABILITIES AND SURPLUS	
Cash and Investments	\$1,350,000	Unearned premiums	\$1,000,000
		Loss Reserves	\$0
		Loss Adjustment Expenses	\$0
		Commissions to Agents and Brokers	\$0
		Capital	\$200,000
		Surplus	\$150,000
TOTAL ASSETS	\$1,350,000	TOTAL LIABILITIES AND SURPLUS	\$1,350,000

Conclusion

References

Mooney, Sean, Cohen, Larry, and Shuster Addison, Basic Concepts of Accounting and Taxation of Property/Casualty Insurance Companies, Fourth Edition, Insurance Information Institute, New York, 1995.

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Vaughan, Emmett J., Vaughan, Therese, Fundamentals of Risk and Insurance, John Wiley & Sons, Inc., Tenth Edition, 2008.