QuickBooks Accounting

Is It Adequate for P&C Insurance Premium Transactions?

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*O*wners of some agency management systems recommend customers use QuickBooks for their financial accounting. While QuickBooks performs optimally for an agency's business operating funds, questions regarding its adequacy for insurance "trust" operations continue to arise. This article covers the QuickBooks accounting adequacy for premium and return premium transactions.

Fiduciary duty

P&C insurance agencies receiving and maintaining premium funds in trust are bound by law to assume fiduciary responsibilities. Insurance agency owners in most states are mandated by State Insurance Codes to receive premium funds in a "fiduciary capacity" and manage their financial solvency as "trustees" ("fiduciaries" or "custodians") for the benefit of carriers and other trust beneficiaries. Fiduciary duty is a licensed insurance broker's personal responsibility.

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The authority to receive and maintain premium funds in "trust" is granted to agencies by insurance carriers under "Broker-Carrier Agreements." These agreements stipulate agencies' obligations to remit transacted premiums, net of commissions, whether or not they are able to receive such premiums from insureds. Exceptions are made when the agency asks a carrier to cancel the policy for non-payment of premium.

Earmarked funds

As custodians of carriers' premium funds, insurance brokers are prohibited from using premiums received under the policy underwritten by one carrier to remit them to another carrier under a different policy. Premium funds are legally earmarked for distribution only to their legal owners (carriers). Compliance with this requirement compels insurance agency trustees to have the trust accounting procedures tailored at the policy level.

An insurance agent's fiduciary duty entails three major obligations: (1) maintenance of premium funds in a trust account, separate from the agency's business operating funds, (2) management of premium funds' financial solvency policy by policy, and (3) identification and reporting of the trust beneficiaries (owners of premium funds) on a daily or as-need basis.

Premium transaction

Can QuickBooks create accounting records of premium transactions? No, it cannot despite the fact that policy transactions are "sales" transactions, legally binding underwriting carriers to insureds.

In merchandise/service accounting, invoices are "sales" documents. In premium trust accounting, invoices are only reminders to insureds of premium payments coming due, definitely not sales documents.

As in general ledger accounting, premium trust accounting must begin with the sales document, (i.e., insurance policy). But QuickBooks cannot create accounting records of policy transactions because QuickBooks cannot invoice them. QuickBooks' functionality remains, therefore, limited to business operating funds.

> "Due to fiduciary regulatory mandates and the different nature of insurance premium transactions, QuickBooks accounting is inadequate for premium transactions."

Policy transaction accounting records ensure full integration of premium data records with accounting records. Agency production will be properly reported based on sales, not invoices. Additionally, agency trustees will have their attention redirected to the big picture of agency business: sales, not invoices. Premium invoices will naturally lose their tracking value because trust accounting focuses on premium transactions, not invoices.

Return premium transaction

Can QuickBooks create accounting records of return premiums? The answer is definitely negative; general ledger accounting treats return premiums as "returned merchandise." Return premium accounting should be similar to that of premium transactions, as they also generate receivables (return net premiums from carriers and return commissions from the agency operating account) and payables (premium refunds to insureds).

In current practice, return premiums are recorded as "negative receivables" and "negative income." The agency balance sheet has them concealed as reductions of receivables rather than premium liabilities. This inadequate accounting not only distorts the balance sheet totals but also misinforms the agency trustee on actual trust liabilities.

Trust balance sheet

Can QuickBooks generate a trust balance sheet? No, because in premium invoice accounting the invoice commission is not recognized as trust liability but agency income. Trust balance sheets can be generated only if premium funds are separated from business operating funds into a different ledger of accounts. Currently, they are in the agency's general ledger.

Trust balance sheets will enable trustees to analyze the trust financial solvency, both cash and account current, in the same way an agency analyzes its overall financial solvency using a balance sheet. With no trust balance sheets available, CPAs approximate trust account solvency by determining what is currently referred to as "trust position" or "trust ratio." They still are unable to determine trust cash solvency.

Receipts & disbursements (R&D) statement

Can QuickBooks generate R&D statements? No, it cannot, primarily because its concept does not even exist in current practice. An R&D statement is similar to the P&L statement used in general ledger accounting. While the latter reports the agency's profit performance (profit or loss), the R&D statement reports the trust "premium float" and its beneficiaries.

Without an R&D statement, the agency trustee cannot verify the accuracy of the trust account cash balance. Currently, the latter is verified as a difference between bank deposits and withdrawals rather than difference between premium receipts and legal disbursements. When accurate, the trust account cash balance must equal the trust premium float calculated and reported in the R&D statement.

Accounting records of premium receipts and disbursements are similar to the income and expense accounts in general ledger accounting. They are created to enable agency trustee to monitor and control transacted premiums.

Insurance agents are not direct sellers; they are intermediaries between sellers (carriers) and consumers (insureds). Their fiduciary position allows them to receive and maintain premium funds in trust but only for the benefit of insurance carriers and other legal trust owners.

Regulatory compliance and the need for fiduciary controls make insurance trust accounting quite different from general ledger accounting. A $10,000 merchandise invoice creates two accounting records in the seller's general ledger: $10,000 assets, cash or receivable, and $10,000 income (see JE #1):

Journal entry #1 is invalid in insurance trust accounting because insurance brokers are not direct sellers. Since the "Broker-Carrier Agreement" makes a broker financially liable for premium payment delinquencies, reliable controls over the receivables process must be created in the accounting system to protect the trustee. Earned premium liabilities are of great concern to all insurance brokers; they may easily become operating losses.

To avoid fiduciary duty violations, insurance brokers require reliable accounting controls over the premium disbursement process. To protect agency trustees against fiduciary duty violations, two fiduciary control accounts must be used in trust accounting: business owner to control receivables (Fiduciary-Owner) and owner custodian to control disbursements (Fiduciary-Custodian).

JE #1	04-17-XX		Debit	Credit
		Cash/Receivable	10,000	
		Income		10,000

JE #2	04-17-XX	Insured	10,000	
		Fiduciary-Owner		10,000
JE #3	04-17-XX	Fiduciary-Custodian	10,000	
		Carrier		9,000
		Agency		1,000

In trust accounting a $10,000 premium transaction requires two journal entries (see JE #2 and JE #3).

JE #2 establishes (a) the insured's obligation to pay the broker $10,000 and (b) the agency owner's right to receive $10,000 in a fiduciary capacity.

JE #3 establishes (a) the agency owner's fiduciary obligation to disburse $10,000 and (b) the carrier's right to receive $9,000 net premium and (b) the agency's right to receive $1,000 commission (10% policy commission is assumed).

Fiduciary controls

The two accounts, Fiduciary-Owner and Fiduciary-Custodian, are fiduciary control accounts. They enable agency trustees to monitor and control both receivables fund disbursements to legal owners. Insurance trust operations have a very dynamic character due the high volume of daily receipts and disbursements.

The absence of controls in current accounting practice explains why so many insurance agencies operate out of trust without even knowing it.

The fiduciary control process is quite simple. To make it easy to follow, accounting transactions are illustrated using the T-account format. For example, a $2,500 down payment on the $10,000 premium transaction will be recorded in the ledger with four journal entries: (see JE #3, JE #4, JE #5, and JE #6—a 10% commission rate is assumed).

While $2,500 is recorded as "Receipts," the balance of the Fiduciary-Owner account shows an unpaid balance of $7,500. While the agency earns $250 commission, the Fiduciary-Custodian account balance continues to show a $10,000 balance, as no commission transfer has occurred.

	Insured			Fiduciary-Owner	
	Debit	Credit		Debit	Credit
JE #1	$10,000				$10,000
JE #3		$2,500			
JE #4				$2,500	

	Cash in Trust			Receipts	
	Debit	Credit		Debit	Credit
JE #3	$2,500				
JE #4					$2,500

	Fiduciary-Custodian			Carrier			Agy Commission	
	Debit	Credit		Debit	Credit		Debit	Credit
JE #2	$10,000				$9,000			$1,000
JE #5				$2,250				
JE #6							$250	

				Carrier			Earned Commission	
				Debit	Credit		Debit	Credit
JE #5					$2,250			
JE #6								$250

Fiduciary accounting

Does QuickBooks meet fiduciary requirements? No, it does not, because QuickBooks is general ledger accounting. Fiduciary accounting is insurance trust accounting. Due to fiduciary mandates, trust accounting in the P&C insurance brokerage industry is policy accounting. Insurance brokers cannot carry out fiduciary duty without strict controls over the receipt and disbursement of premium funds.

New insurance fiduciary accounting procedures have been developed by Paulmar Group to help P&C insurance agencies comply with Insurance Code-mandated fiduciary duty.

Conclusion

QuickBooks accounting is general ledger accounting with reliable functionality in the area of financial solvency management of business operating funds. Due to fiduciary regulatory mandates and the different nature of insurance premium transactions, QuickBooks accounting is inadequate for premium transactions.

The eight reasons why QuickBooks does not work for premium and return premium funds are because QuickBooks:

1. Cannot create accounting records of premium transactions.

2. Wrongly treats return premiums as returned merchandise.

3. Does not separate premium funds from the agency's business operating funds.

4. Cannot generate a trust balance sheet of premium funds.

5. Does not report trust financial solvency.

6. Cannot generate a trust R&D statement.

7. Cannot determine the trust premium float.

8. Cannot report trust beneficiaries. ❖

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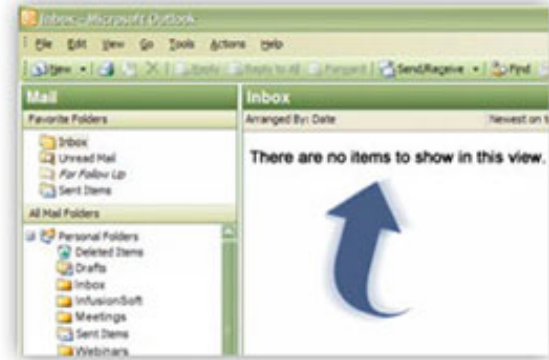
Will Your Email Inbox Be Empty by the End of Today?

If yes, stop reading because you don't need my help.

If not, ask yourself these three questions...

1. Do you ever dread looking at your email inbox even after being gone only a couple of hours?

2. Do you have hundreds (or even more!) of emails in your "in" box because that's the easiest way to search for the information you might need?

3. Do you ever wish you could take time to get your inbox manageable but are overwhelmed with the prospect of what it might take?

If the answer to any of these questions is yes, rest assured you are not alone! And fortunately, there is a solution that is much simpler and easier to implement than you might think.

I knew there had to be a better way so I began to research and study the most effective ways to manage email from the best experts I could find. I then translated what I learned into what would work best for agents and came up with a five-day online course, which will train you step-by-step on the best ways to gain control over your Outlook inbox again.

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