

ACCOUNTING AND TAX IMPLICATIONS OF THE CREATION AND USE OF TECHNICAL PROVISIONS OF COMMERCIAL INSURANCE COMPANIES

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Abstract

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Entities such as commercial insurance companies are obliged to create technical provisions in order to fulfill their activities. Technical provisions are used to cover liabilities of commercial insurance companies arising from insurance and reinsurance activities. The principal aim of this paper is to determine the impact of the creation and use of technical provisions for some important items of the financial statements, which are liabilities, a balance sheet, profit and an income tax base. A prerequisite to fulfill the objective of the paper is to analyze the accounting legislation for technical provisions in an insurance company. The intention of the presented paper can be divided according to its conception into two parts. The first part of the paper is devoted to methodological aspects in relation to the general definition of the accounting principles and their importance in the accounting of commercial insurance companies. The second part deals with the methodological procedure of the accounting of the creation and use of technical provisions and the specifics of how they are reported in the financial statements of commercial insurers. Conclusions of the paper show contemporary issues in the analyzed area in the context of the financial crisis.

accounting, commercial insurance company, technical provision, accounting relationship, precautionary principle, financial statements

The creation of reserves is the practical manifestation of a significant accounting principle, the precautionary principle. The consistent application of the precautionary principle in the financial statements in case of reserves lies in the fact that the reported liabilities and costs should not be underestimated. The reserves should be approached from two perspectives. The primary one is an accounting point of view, as a practical application of accounting principles designed to meet the requirement of the true and fair picture of reality. The secondary view of the reserves based on the Act on reserves for income tax is not significant to the financial statements.

Reserves are recognized in the accounting when they are subject to the following facts: the company has a present obligation as a result of a past

event; the amount of the obligation can be reliably estimated and the settlement of the obligation will result in an outflow of the resources of the company (KOL., 2004). If these facts are not met, the reserves are not recognized. In this sense, Czech accounting adjustment of reserves meets provisions of international accounting standards.

KOVANICOVÁ (2006) states that the reserves represent amounts withheld that are used both to cover potential risks (for foreign exchange losses, the losses in business, etc.) and to cover specific future expenses (e.g. for repairs of tangible assets).

Basically, we can say that if the company expects one-time expense at a significant level in the future, which would adversely affect the profit for the accounting period in which it was created it can make advance provision for the expected purpose.

This reserve may also be created several accounting periods prior to the expected expense, so the company includes a total amount which represents the amount of expected expense in the costs of each accounting period. This way it creates the resources needed for future expenses in the form of a reserve, which is clearly defined by its use, it is very likely that in the future anticipated expenditure will occur, but the exact amount is not known and so the moment of its realization. These facts show that reserves are the foreign source of financing of the enterprise, as items of liabilities are therefore in balance sheet.

SEDLÁČEK (2005) points out that reserves as a foreign source of financing represent debts of an enterprise to the next year, or the next few years. Some reserves are therefore of short-term nature.

Reserves are made generally in the financial statements, i.e., at the end of a reporting period (as the KOL., *Účetnictví podnikatelů*, 2009). It is appropriate in the internal regulation of the entity to specify titles for the creation of reserves, reasons for creation, the amount and the method of their creation and use.

Reserves can be sorted according to several aspects (see KOL., *Podvojně účetnictví*, 2009): for example, through their destination to the general reserves (designed to cover risks and losses from business, to cover business risk) or to special reserves (for repairs of tangible assets, for the income tax, for restructuring, for pensions and similar obligations).

Accounting for reserves should be directed by internal regulation of business, or legal provisions with regard to the statutory reserves (RYNEŠ, 2011). Considering statutory reserves it is therefore recommended to bind their creation and use or cancellation to the end of the reporting period – due to § 3 paragraph 1 of the Act on reserves.

The principal aim of this paper is to determine the impact of the creation and use of technical provisions¹ created in commercial insurance companies for some important items of the financial statements. These items include both items of liabilities in the balance sheet, of such liabilities, equity and assets, and also the same item of the balance sheet and profit and loss account, which is profit. The paper also analyzes the impact of the technical provisions for income tax base in a commercial insurance company. A prerequisite to fulfill the objective of the paper is to analyze the accounting legislation for technical provisions in an insurance company. Furthermore, the paper deals with the methodological procedure of the accounting of the creation and use of technical provisions and the specifics of how they are reported in the financial statements of commercial insurers. Conclusions of the paper show contemporary issues

in the analyzed area in the context of the financial crisis.

METHODS AND RESOURCES

The starting point for exploring the outlined problem is the analysis of laws governing the issues observed in the Czech Republic, in particular the Act No. 563/1991 Coll., on accounting, as amended by subsequent legislation; Act No. 277/2009 Coll., on insurance; Act No. 593/1992 Coll., on provisions for the determination of the income tax base; as well as Decree No. 502/2002 Coll., published by the Ministry of Finance of the Czech Republic, implementing certain regulations of the Accounting Act for accounting entities that are insurance companies, as amended by subsequent legislation, and Czech Accounting Standard No. 207 “Technical provisions for non-life insurance branch and life insurance branch”. The legal standards define both general reserves as one of the practical expressions of the precautionary principle, ordering to the entities valuation methods and accounting practices in the creation and use of reserves.

They also specifically define technical provisions in insurance companies and specify their types. The insurance companies are obliged to report these provisions through a special statement. Legal standards specify methods and conditions for the quantification of the amount of the premium written. Furthermore, they prescribe methods of accounting for the creation and use of provisions, including their reporting in different parts of the financial statements. As a result, they determine what types of provisions created by commercial insurance companies, and how much they influence their tax base. Other sources used during working on the paper are specialized publications dealing with the issues observed in the Czech Republic or in the European Union.

Apart from scientific methods used in the paper, which are methods of description, comparison and analysis, methods based on the principles of reasoning are used in the text as well, especially the method of deduction. In the final part of the paper, the method of synthesis for the formulation of proposals and conclusions is used.

RESULTS AND DISCUSSION

1 Analysis of the accounting legislation

Accounting legislation issue of technical provisions in commercial insurance companies, is currently in the Czech Republic discussed in the following legislation: in the Act No. 563/1991 Coll., on accounting, as amended by subsequent legislation; in the Act No. 277/2009 Coll., on

1 Technical provision is a specific name of reserve obligatory created in commercial insurance companies. Specific technical provisions are given by the Act on insurance.

insurance; in the Act No. 593/1992 Coll. on provisions for the determination of the income tax base; in the Ministry of Finance Decree No. 502/2002 Coll., implementing certain regulations of the Accounting Act for accounting entities that are insurance companies, as amended; and in the Czech Accounting Standard No. 207 "Technical provisions for non-life insurance branch and life insurance branch".

In its provisions the Act on accounting generally addresses the issue of reserves, as shown in Tab. I. The starting point is to identify the specific types of reserves, which represent the financial reserves, creation of which and use affect profit of entities. The reserves include technical provisions of commercial insurance companies, too. The Act is quoting directly the precautionary principle which an entity in its accounting must comply with and which practical manifestation in accounting is just the creation and use of reserves. Specific accounting practices in the creation and use of reserves implementing regulations are given for each group of entities, in the case of insurance companies it is the Decree No. 502/2002 Coll., in the current version. Considering the ways of valuation of the various components of assets and liabilities, the Act on accounting determines the obligation to appreciate the technical provisions of insurance companies at fair value.

The Act on insurance (see Tab. II) consistently defines technical provisions as technical resources necessary to meet the obligations of the insurance or reinsurance activities, which are likely or certain, but their amount or timing incurred is uncertain. It sets

out specific types of technical provisions divided into the classes of life and non-life insurance and obliges insurance companies to account for each technical provision separately from other liabilities of the insurance company.

Insurance companies are required to prepare a statement of creation and the amount of technical provisions and the structure of the financial placement of assets, the source of which are technical provisions, and submit it to the Czech National Bank on June 30 and December 31 of the current year and within 60 days after that date. The Act also directs insurers to determine the amount of premium on the basis of real actuarial assumptions so that the premiums were sufficient and allow insurance companies permanent fulfillment of all its obligations.

One part of the Act on insurance is the exact definition of the basic terms of the creation of technical provisions in the life insurance branch, which includes principles for determining the amount of technical provisions and technical interest rate. The method of calculation of technical provisions shall not be unreasonably and arbitrarily changed. The insurance company is obliged to allow the public to get acquainted with the way the technical provisions are created.

In the conclusion of the regulation on technical provisions the Act on insurance defines the content of individual types of technical provisions, the reasons for their creation, the ways of their formation, and other conditions that must be met in the case of commercial insurance companies as shown in Tab. III.

I: Reserves given by the Act on accounting

Factual definition	Legal purpose	Is determined by
The obligation to follow with the accounting practices in the creation and use of reserves	Specifically regulated by the implementing legislation, i.e., Decree No. 502/2002 Coll.	§ 4 par. 8 g
The obligation to respect the precautionary principle in accounting	The impulse to account for the creation and the use of reserves	§ 25 par. 3
The definition of reserves in the Accounting Act	Accounting reserves, technical provisions and other reserves under the special legislation	§ 26 par. 3
The obligation to evaluate assets and liabilities at fair value	Technical provisions are valued at fair value	§ 27 par. 1 c

Source: own elaborate based on legislation

II: Technical provisions given by the Act on insurance

Factual definition	Legal purpose	Is determined by
Definition of technical provisions	Creating resources to meet its obligations arising from insurance business	§ 13 par. 1
The obligation to create technical provisions in the life / non-life insurance branch	Various types of provisions, their creation in relation to the insurance branch	§ 13 par. 2, 3
Reporting in technical provisions	Assembly a report of the creation and the amount of technical provisions	§ 13 par. 7
The amount of premiums	Methods and conditions for determining the amount of premiums	§ 13a par. 1–3
Technical provisions in life insurance branch	Provides the basic conditions of their creation	§ 13b par. 1–6

Source: own elaborate based on legislation

III: *Types of technical provisions given by the Act on insurance*

Type	Insurance branch	The purpose of its creation and use	Is determined by
Unearned premium provision	Life, non-life	Premiums written related to subsequent accounting period	§ 14
Provision for insurance payments	Life, non-life	To cover insurance claims a) before the balance sheet date incurred and reported but not settled (so called RBNS provision) b) before the balance sheet date incurred but not reported (so called IBNR provision)	§ 15
Provision to guarantee liabilities of the Czech Insurers Bureau	Non-life	To fulfill obligations of the Czech Insurers Bureau corresponding to company's share of total liabilities	§ 15a
Provision for bonuses and rebates	Life, non-life	To cover the cost of bonuses and rebates provided in accordance with insurance contracts	§ 16
Equalisation provision	Non-life	To equalize the increased insurance payment costs caused by circumstances	§ 17
Life insurance premium provision	Life	To cover future liabilities of life insurance	§ 18
Provision for liabilities arising from the applied technical interest rate	Life	If the return of the insurer's assets is insufficient to cover the liabilities arising from the applied technical interest rate	§ 18a
Life insurance provision, if the investment risk is borne by the insurant	Life	To cover the liabilities in the life insurance business based on an insurance contract, if the investment risk is borne by the insurant	§ 19
Non-life insurance premium provision	Non-life	It is created for those classes of insurance for which the premiums are determined by the entry age	§ 20

Source: own elaborate based on legislation

For the purpose of filling the state budget the Act on reserves states precisely what reserves and in what amount can reduce income tax base of entities, i.e., whose creation is concurrently the tax expenditure. In the case of entities that are insurance companies, they are all recognized technical provisions, in accordance with the Accounting Act, defined by the Act on insurance following the methodology of their determination.

This is a rare exception in the Act on reserves, as there are always restrictions on the tax deductibility of provisions recognized in the case of business entities or banks. However, in addition to creating technical provisions, commercial insurance companies create also so called other reserves, in other words accounting reserves, whose creation is not recognized as a tax expense in any amount, in accordance with other types of entities.

The Ministry of Finance Decree No. 502/2002 Coll. gives with the issue of technical provisions and other provisions in an insurance company a relatively great attention, as shown in Tab. IV. The introduction emphasizes that the items of technical provisions in the financial statements, i.e. the state of technical provisions in the balance sheet and the change in the state of the provision in the profit and loss statement cannot be combined in any way. It defines the concept of change of the amount in the actuarial provisions. Specifically it defines the different types of technical provisions and gives a reference to the relevant legislation in the line

of which various types of technical provisions are created.

Furthermore, it concentrates on other provisions, defines provisions including titles for which it is possible to create them. It also lists the items of the profit and loss statement, which includes creation and use of technical provisions and other provisions. The requirements for the content of the annex to the financial statements of commercial insurance companies prescribes mandatory information on the items equalisation provision and other technical provisions and sets out the conditions under which such additional information is given in the annex. The conclusion is devoted to methods of valuation of technical provisions in accounting and accounting practices in the creation and use of other provisions.

The Czech Accounting Standard No. 207, "Technical provisions for non-life insurance branch and life insurance branch", recommends to the commercial insurance companies to set up accounts of technical provisions according to their individual types and separately for the branch of life and non-life insurance. It recommends dividing accounts so that it would be possible to determine the share of the reinsurer on the creation and use of provisions, transfers or transitions of provisions associated with increases or decreases in insurance portfolio and the change in the amount of relevant provision. The Standard also explains the contents of unearned premium provision and the principles used in its creation. In conclusion it identifies the

IV: *Technical provisions given by the Decree No. 502/2002 Coll.*

Factual definition	Legal purpose	Is determined by
Combining the items of financial statements	Technical provisions in the balance sheet and changes in their status in the profit and loss statement cannot be combined	§ 4 par. 4 a, b
Substance of certain items of the balance sheet	The definition of technical provisions, their relation to specific legislation	§ 16 par. 1–8
The definition of other provisions	Other provisions and purposes for which it is possible to create	§ 17 par. 1–4
Substance of some items in the profit and loss statement	The definition of items of changes in technical provisions	§ 19 par. 3, 4
Substance of some items in the profit and loss statement	The creation and use of technical provisions is included in items Other technical income / expenses net of reinsurance	§ 20 par. 1, 2
Substance of some items in the profit and loss statement	The creation and use of other provisions is included in items Other expenses and income	§ 20 par. 3 c, par. 5 d
The content of the annex to the financial statements	More information on the item Equalisation provision, Other technical provisions, under certain conditions	§ 22 par. 1 e, f
Accounting methods and their application	Technical provisions are valued at fair value, the method for its determining	§ 28
The procedure for the creation and use of provisions	Accounting practices in the creation and use of other provisions	§ 34

Source: own elaborate based on legislation

requirements for accounting for the provision for insurance payments in relation to the information provided by the accounting system.

2 Technical provisions in the accounting of commercial insurance companies

Technical provisions for life and non-life insurance are by far the most important item of liabilities in the balance sheet of commercial insurance companies. Technical provisions make up to 80% of the liabilities (HULEŠ, HORNIGOVÁ, 1997). Commercial insurance companies create them to fulfill obligations arising from their activities. The provisions are a source of funding for the company's liabilities to policyholders. For this reason, the technical provisions are calculated so that at all times they are sufficient to the extent in which the insurance company is able to meet its obligations arising from insurance contracts (ČEJKOVÁ, VALOUCH; 2005). Correct calculation (estimation) of technical provisions is based on the correct estimation of insurance risk.

Technical provisions in insurance companies provide commensurability of revenues and expenses and reflect the liability payable in the future to one insurance contract in average (KOL., 2004). Commercial insurance companies create technical reserves particularly in the life insurance branch and non-life insurance branch (see Tab. III). Each provision is accounted separately from other liabilities in individual accounts in account group 44.

Company's accounting records creation and use or cancellation of technical provisions with the gross method, which means that creation is reflected in the costs and use in yields (see Tab. V). All accounting entries relating to the creation and use

of provisions shall be made on the basis of internal accounting documents.

This process must follow basic accounting principles. A significant role here has the accrual principle, i.e. costs and revenues should be recognized in the accounting period to which they relate, regardless of cash flow. The accrual method and also the method of accounting for provisions (see unearned premium provision) meet the practical implementation of this requirement in the accounting (BOHUŠOVÁ, VÁVROVÁ, 2007).

The creation and use of technical provisions are accounted for both their gross amount based on gross premiums written and on a share of reinsurers in these provisions.

The accounts of technical provisions shall be kept in a very detailed analytical evidence.

Provisions are subject to strict book inventory when examining the justification of their existence and especially of their amount. The inventory of provisions is also based on internal guidelines of an insurance company, in which the title of the provision shall be specified as well as the method of determining its amount and methods of its creation and use.

In this context, the test of the adequacy of provisions is performed, in which insurance companies use current estimates of future cash flows from insurance contracts. This test must be performed and reported for each type of insurance in gross amount.

3 The effects of technical provisions on significant items of the financial statements

In the balance sheet, technical provisions are shown in the liabilities as a part of foreign resources. In case of the creation of a technical provision is the amount of equity reduced (accounting debited

V: Accounting on technical provisions

Technical provisions	The creation of a provision	The use of a provision
The valuation	Fair value	Fair value
Accounting method	Gross method	Gross method
The method of accounting for	Debited to cost accounts	Credited to revenue accounts
Account group	50 in the case of non-life insurance, 52 in the case of life insurance	60 in the case of non-life insurance, 62 in the case of life insurance

Source: own elaborate

VI: The effects of technical provisions on significant items of the financial statements

Financial statements item	Part of financial statements	Creation of technical provisions	Use of technical provisions
Equity	Balance sheet	Decrease	Increase
Liabilities	Balance sheet	Increase	Decrease
Total sum of assets	Balance sheet	Not changed	Not changed
Realized profit	Balance sheet and Profit and loss statement	Decrease	Increase

Source: own elaborate

to expenses), i.e. there is a change in the ratio of the company's own and external resources for the benefit of foreign resources. Conversely, using the provision means the increase of the equity of the commercial insurance company (accounting credited to revenues) and reduce liabilities in the item provisions. Total assets of the balance sheet remain unchanged in the total amount (ZWEIFEL, EISEN, 2012), the transfer occurs only between own and external resources (see Tab. VI).

The creation of a technical provision is recognized in the profit and loss statement as a reduction in reported profit or loss, with a corresponding entry in the balance sheet and vice versa using the technical provision increases reported profit just about the amount of provision in part of the profit and loss statement which is called the technical account for life / non-life insurance (see Tab. VI) during the reporting period. In the profit and loss statement technical provisions are listed as a differential value (the difference between the amount of creation and use of a provision) with the relevant provision separately for life and non-life insurance.

According to BOKŠOVÁ (2010) technical provisions are a part of the deferred income (in the sense of reporting lower amount of profit) applicable for future funding and are therefore considered in some publications as the company's own source, mainly due to the method of their creation. Creation of technical provisions, as already mentioned, results to a reduction in profit of the accounting entity (it is debited to cost accounts), it can therefore become an instrument of manipulation with the economic results, so it is necessary to focus on creating technical provisions, particularly on the amount of provisions.

Technical provisions created too high have resulted in reduced profit and consequently reduced tax base, while the provisions created on the contrary too low may cause subsequent insolvency of the commercial insurance company.

These substantial effects caused obligation to measure the fair value of technical provisions (in the Tab. V) in accordance with the Act on accounting.

Therefore, commercial insurance companies must pay a great attention to the determination of technical provisions and their accounting. Based on this, commercial insurance companies are obliged to inform the supervisory authority, the Czech National Bank, biannually of the creation of technical provisions and their financial investments with a Report on the creation and the amount of technical provisions and the structure of financial investments of assets whose source are technical provisions.

4 The effect of technical provisions on the income tax base

As stated above, for purposes of the income tax base the creation of all types of technical provisions, which are defined by the Act on insurance (see Tab. III), is recognized by paragraph 6 of the Act No. 593/1992 Coll., on provisions for the determination of the income tax base, as amended by subsequent legislation, if the technical provisions are recognized in accordance with the Act on accounting in full amount following the methodology of their determination.

Subsequently the technical provisions in commercial insurance companies have exactly the same impact on the tax base as on the profit or loss recognized in the accounts.

Thus the creation of technical provisions will reduce the tax base in the amount of technical provisions created in the tax period in which the creation was accounted for. On the contrary, the use of technical provisions has resulted in an increase in the tax base in the tax year in which it was accounted for. It is the tax period in which the insurance company has recognized claims reported by a policyholder and identified and subsequently

paid the compensation (insurance benefit) to the policyholder within a specified amount.

5 Contemporary development in the analysed area

In the year 2012, a final decision was published on the level of the International Accounting Standards Board (IASB²) from which we can infer the expected form of the Standard IFRS 4. Accounting for insurance contracts was embedded in the International Financial Reporting Standards in 2004, when the Standard IFRS 4 was issued. The Standard is still in force, although from the beginning it was interpreted as temporary. Considering the lack of a unified framework for accounting for commercial insurance companies, it was not possible to ensure comparability across the global financial sector (according to DUCHÁČKOVÁ, DAÑHEL, 2012), so the Standard IFRS 4 has become a basic reporting rule. It introduced the obligation to carry out the adequacy test of actuarial liabilities.

With certain delay the exposure draft of the second phase of the Standard was issued in 2010. Its basic element has become a model for the valuation of technical provisions. Premiums in this model have to be perceived as a loan and in the same spirit it has to be accounted for (see HRDÝ, 2012). The proposed rules can have a significant impact on the perception of commercial insurance companies in the insurance market and on their management itself. The volume of premiums written already would not be so important for the achievement of an insurance company.

Incentive management system of insurance companies will have to switch to emphasize the company profitability, the emphasis on the volume of premiums written will decrease. This will have an impact on controlling and actuarial departments of insurance companies and also on the very creation of insurance products and management of distribution networks. The new pricing model for technical provisions may entail investments in company infrastructure and strengthen the actuarial and IT departments.

The IASB expects publishing a new proposal for a second phase of IFRS 4 in mid-2013. After its final specification, the Standard could be published on 1 January 2015. With regard to the three-year period between the publication of the Standard and its mandatory effective date, it is expected that the second phase of IFRS 4 takes effect in January 2018. The insurance sector in European Union requested in comment procedures to align the effectiveness of the new IFRS 9 focusing on financial instruments with IFRS 4, which will not be possible due to the expected terms.

The consequence of the current economic and financial crisis tendencies is more strict regulation of the financial markets in order to avoid repeating of the crisis. Primarily, these are for tighter regulation of insurance companies and financial institutions in general. As stated in DUCHÁČKOVÁ, DAÑHEL (2012), its weakness is the fact that the new regulatory bodies of the European Union have the power, however responsibility is borne by the national supervisory authorities. The introduction of new regulations for insurance companies is a major source of concern because it represents a new risk. Activities of commercial insurance companies will involve both the implementation of Solvency II regulatory regime and the application of IFRS 4. Since the implementation of Solvency II is expected earlier than the effectiveness of the second phase of IFRS 4, it is necessary to mention the possible complications that can await the insurers.

When analyzing the different requirements arising from Solvency II and IFRS 4, it is necessary to keep in mind the differences in their missions. One of the objectives of Solvency II is to increase the consumer protection, while the reason for IFRS 4 will always be providing relevant information to users of financial statements as the authors stated in the analyzes. The goal of Solvency II is primarily to maintain capital adequacy of insurance companies, in IFRS 4 the goal is a faithful capture of the financial position and profitability of insurance companies (cf. the analysis of accounting legislation in this paper). Nevertheless, in general we can say that the insurance industry in the European Union appears to be in good financial condition. According to certain economists (DUCHÁČKOVÁ, DAÑHEL, 2012; ZWEIFEL, EISEN, 2012; FABOZZI, NEAVE and ZHOU, 2012), it may be assumed that it will absorb shocks from possible new recession caused by the Eurozone debt crisis.

6 Own proposals and conclusions

Based on the analysis of the regulation of technical provisions in commercial insurance companies important facts are revealed significantly affecting the results of the insurance companies, in particular economic result, solvency and tax base, so they deserve attention. Technical provisions in commercial insurance companies as a specific issue in relation to insurance/reinsurance activities in the accounting of the entities are a practical application of the precautionary principle.

The amount to which the technical provisions for various types of life and non-life insurance should be generated seems by far the most important. This is due to the fact that the created amount of technical provisions causes transfer in liabilities, i.e., this will reduce equity and increase foreign sources

2 The *International Accounting Standards Board* (IASB) is the independent, accounting standard-setting body of the IFRS Foundation.

of funding through the established technical provisions.

It is necessary to take into account that commercial insurance companies principally manage just external sources, an essential part of which are the technical provisions. The core capital of an insurance company is the equity capital – the required minimum is determined by the Act on insurance.

If the insurance company creates technical provisions in an excessive amount – in the amount that is not appropriate to the degree of risk (more in FABOZZI, NEAVE, ZHOU, 2012), it will reduce the profit of the entity in disproportionate amount. In the result, the equity will be reduced by the amount of technical provisions created and liabilities will increase. On the contrary, while the technical provisions created on a too low level – in the amount that is lower than the risk accepted, it may be the

cause of subsequent insolvency of the insurance company.

From these findings, the obligation for commercial insurers to determine as accurately as possible the risks arising from the types of life and non-life insurance and determine the corresponding amount of the technical provisions results. To highlight these dependencies, the obligation contributes to measure the fair value of the technical provisions.

The impact of the creation and use of technical provisions on the income tax base of commercial insurance companies is consistent with their impact on economic result in the accounting of insurance companies as they are fully included in the tax base according to the Act on reserves.

In view of the above, in the next research authors will analyze the follow-up issue of determining the appropriate amount of technical provisions in commercial insurance companies.

SUMMARY

Commercial insurance companies as business entities carry out insurance activities and other special operations. For this purpose, a specific chart of accounts was formed in the Czech Republic, including accounting procedures. It was published by the Ministry of Finance in the form of Decree No. 502/2002 Coll., which implements certain regulations of Act No. 563/1991 Coll., on accounting, for accounting entities that are insurance companies, as amended by subsequent legislation.

The paper analyzes the technical provisions in commercial insurance companies particularly in terms of accounting and taxes. Technical provisions represent a specific item in liabilities in the balance sheet of commercial insurance companies. They are used to cover insurance liabilities arising from insurance and reinsurance business. They represent a practical application of the basic accounting principle – the precautionary principle.

In the paper, the authors determine the impact of the creation and use of technical provisions for some important items of the financial statements and the income tax base based on both, the analysis of accounting rules for technical provisions in a commercial insurance company and the analysis of appropriate legislation.

The authors also paid attention to the proper valuation of technical provisions and to the method of accounting for their creation and use including the form of their presentation in the financial statements of commercial insurers. All findings are summarized in tables.

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