

Hih case study

Business



Summary Firstly, an introduction and background relating to HI insurance company will be given. Then the cause of HI collapse is going to be discuss in the following part, mainly focused on the failure of financial risk management, the failure of auditor, the failure of regulation and the lack of independence for non-executive director. Thirdly, according to the analysis of the problem, the paper offers suggestions as to deal with those problems, followed by a brief conclusion at the end of this paper. . 0 Introduction and background Prior to its collapse in 2011, HI Insurance was Australia’s second largest Insurance company. It was placed into provisional ululation on 15 March 2001 due to Its Inability to pay its debts as they fell due.

Two days later, the Royal Commission was established to investigate the reasons for and the circumstances surrounding the failure of HI. The HI collapse Is considered to be the largest corporate failure In Australia’s history, with liquidators estimating that High’s losses can reach up to \$5. 3 billion.

The collapse of HI has a negative Influence on the society and the Interests f the stockholders, general creditors and policy holder are also affected by HI collapse. 3.

0 Causes of HI Collapse 31 Nine Taller AT Atlanta rills management 3. 11 Weak underwriting performance The insurance industry is in the position of high risk, especially for long-tail risk. Three important vehicles for the insurance company to use against the high risk and make a profit, which are risk pricing ability, provision for reserve policy and the investment decision.

The combination of inferior risk pricing ability, under-reserving policy and failure investment decisions finally exhausts the financial resource of HI. Underwriting is the core aspect to general insurer's operations and it reflects the risk pricing ability of the insurance company. According to the investigation report of HI Royal Commission, in the end of year 1997 HI make an underwriting loss of \$33.

8 million and net premium earned was \$1233.5 million. By the contrast, for the year ending 30 June 2000, underwriting loss and net premium earned were \$103. Million and \$1995.4 million respectively. Those figures reveals that during this period, underwriting loss increased sharply, resulted more provision for claims outstanding, underwriting expenses and reinsurance recoveries.

(HI, 2011) 3.12 Under-reserving policy Another reason for HI failing is under-reserving. As the Royal Commission Report noted, "the largest single item on the balance sheet of the general insurer is the provision that sets aside for payment of future claims". HI had a high exposure in areas where superimposed inflation has played a devastating role.

For Workers' Compensation in California, the estimated of the growth was 23% per year (1987-1990) and 10%(1990-1999) which reflected the relatively high inflation rate during that period.

However, the growth estimated by HI was only 3.8% that is far below the market estimation. As a result, HI actual reserve was much lower than the market average. 3.13 Flawed investment decisions There are three major failures in investment, which make a great contribution to its collapse.

<https://assignbuster.com/hih-case-study/>

The first one was the I-J operation in 1993, due to the defect of information management which result in the losses amounted to \$ 1. Billion. The second one happened in the US operation. The losses were \$620 million caused by the board of directors of HI didn't reliable evaluate the potential risk during the operation. The third failure is the FAA acquisition.

Although in the situation of the lack of relevant documents such as HI Reports of financial adviser, HI finalized the acquisition of FAA in 1998 resulted \$590 million losses. As a result, a cash flow crisis became more serious and the acquisition attributed to HI collapse. (Rogers, ND.) 3. Audit are not independent Another reason for HI Collapse is the lack of independent audit institution.

Audit independence is the guarantee to provide a reliable results. HI has both the internal and external audit committee, however, the internal audit committee fail to insider the important factors such as risk management and internal control. For the structure of audit committee, the audit meeting of HI attended by all directors including executive director and the chairman of HI, Geoffrey Cohen, was also the chairman of the audit committee of HI, which make the audit committee lose the independence.

Audit committees, who supervise the management reporting process and communicate with the external auditors, should be consist of a majority of non- executive directors thereby eliminating the conflict of interest.

Furthermore, Andersen as ten AAU It Institution, It accepted ten actuary's reports walkout any query. In particular, Andersen relied extensively on High's internal business audit processes.

(The case, 2007) 3. 3 The failure of regulation Two main regulatory institutions are responsible for the regulation of insurance company in Australia which are PAR and ASIA.

Although PAR did not cause or contribute to the collapse of HI, it failed to detect warning signs, follow up information gaps and make effective use of its powers. The collapse of HI is a chronic process, however ASIA and PAR as the regulation institution fail to fulfill its ability of supervision. 3.

4 The failure of accounting method HI did not provide adequate reserve margin for future claim obligations, but rather it sought reinsurance to cover the risk. Actually, reinsurance can be recognized as loans.

As a result, it could be possibly reduce the reported profit and increase the liability, which could accordingly result in increased DID ration. Moreover, the financial report of HI did not reflect the true of its financial situation. For example, goodwill, deferred acquisition costs and future tax benefit were not serviceable for assessing the real financial position. As they are just occur in the financial statement and in fact, they cannot neither bring cash flows or profits for the company.

As a result, auditors are on a near impossible mission to satisfy the Joint criteria of complying with the accounting standards and attesting to the truth and fairness of financial statements. (HI, n. D) 3. 5 Lack of independence for non-executive director Figurer : Board Committees From the figure above, we can infer that the independence of the non-executive directors deserves to be questioned. Among five non-executive directors, two of them ere

former partner of Andersen, which happened to be the major auditor and advisor of HI.

Just for one year-2000, HI had paid \$1. 7 million to Andersen for auditing services and \$1. 631 million for provision of other non-auditing services. Furthermore, Justine Gardener who was the member of audit committee, used to be the auditor of FAA in sass's. As discussed above, the acquisition of FAA was one of the main reasons for the collapse of HI, as the misjudgment of the financial perspective of FAA.

Justine Gardener must be put in the place where his independence was questioned due to his conflict of interest.

The few independent directors alleged that they were misled as to the true financial positions of the respective companies. (HOW , ND) 4. 0

Recommendations Some recommendations are given based on the analysis of HI case study: In the first place, HI should establish the auditing department independently to improve its ability to analyze financial situation of the company. Auditors must have a state of mind whereby they provide their opinion without compromising their Judgment while acting with integrity, objectivity and professional skepticism.

Second, the company should supervise effectively to ensure adequate solvency.

The ability to pay its debts as they fall due is the indicator to measure the financial situation of the insurance company, at ten same time It Is also ten prerequisite Tort ten sustainable development for the business. Indeed, HI

should strengthen supervision to the board of director and balance the interests between shareholder and corporation. Annual general meetings are necessary to answer reasonable questions from shareholders. . 0 Conclusion
To sum up, the collapse of HI is caused by a number of relatively straightforward corporate governance failures.

Firstly, the weak underwriting performance results in ore provision for claims outstanding, underwriting expenses and reinsurance recoveries are required. Secondly, under-reserving policy makes HI actual reserve was much lower than the market average. Thirdly, three major failures in investment leads to cash flow crisis in HI and worsen the financial situation.