# IMPLEMENTATION OF THE PRINCIPLE OF FULL INSURANCE COVERAGE IN THE INSURANCE OF MUNICIPAL PROPERTY IN POLAND

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https://doi.org/10.31410/itema.2018.626

**Abstract:** *The principle of full insurance coverage was formulated in Soviet insurance literature during the socialist era. In Poland, despite the transformation of the economy from socialized to market, the principle of full insurance coverage is still mentioned as one of the three basic tenets of business insurance by the authorities in insurance law. The most common interpretation of this concept indicates the postulate character of the principle of full insurance coverage as the intended aim of full compensation. Currently defined sum of insurance is listed as one of the factors determining full compensation of losses after damage.*

*The purpose of the conducted research was to verify the assumption that the sum insured corresponding to the gross book value of fixed assets declared for insurance guarantees full insurance coverage. The study was carried out on the basis of a newly purchased municipal property.*

*The scope of the research included general insurance conditions for property in force before and after the implementation of the Insurance Distribution Directive of the European Parliament and of the Council (EU), within selected insurance companies operating in Poland. In addition, the scope of the research included national accounting standards and balance sheet law in the domain of fixed assets, technical literature on the functioning of the local government in Poland and selected legal acts of insurance law and publications regarding property insurance. This analysis was carried out as of 15/10/2018.*

*Qualitative research methods were used, including critical analysis and comparative studies. As a result of the conducted research, it was found that the sum insured of the newly acquired local government property given according to the purchase price and/or production cost is not always a guarantee of receiving full compensation for the material damage suffered. A dysfunction of the general terms and conditions of insurance was observed in relation to the balance sheet law applicable in the local government sector in the interpretation of the gross book value definition to the detriment of the insured.*

*The undertaken research is one of the first attempts to treat the sum insured of municipal property in an interdisciplinary way.*

*In the applied sense, the results of the research may indicate to the Polish legislature a further suggested direction of work to be done on increasing the insured's protection, namely the need to bring coherence in the interpretation of the definition of gross book value in insurance and balance sheet law.*

*In the technical sense, the research signals the need to revise the adopted views on the principle of full insurance coverage of municipal property. The signaled need concerns the inclusion of additional elements (criteria) when assessing the implementation of this principle of full coverage, especially in relation to cost calculation.*

**Keywords:** *principle of full insurance coverage, gross book value, sum insured, payment of compensation, local government in Poland.*

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## 1. INTRODUCTION

The principle of full insurance coverage is mentioned as one of the basic principles of property insurance. The most common view indicates the postulate character of the principle of full insurance coverage, namely the compensation paid should allow the restoration of the property to its pre-injury status. The insurer should pay compensation according to the type of the declared value of property [1], and the insured should prove the value of the damage [2].

**The purpose of the conducted research was to check whether the sum insured according to the gross book value of the fixed asset guarantees the fulfillment of the principle of full insurance coverage.** The survey was carried out on the example of newly acquired local government property as a result of a zero sum purchase (or manufacture), acquisition or otherwise, which had not been entered into the bookkeeping previously.

Qualitative research methods were used, such as elementary and critical analysis of literature presenting municipal and business insurance issues and a comparative study of the gross book value concept as defined in National Accounting Standards No. 11 "Fixed assets" (NAS No. 11) and general insurance conditions [3]. The research was conducted on the basis of 8 selected general conditions of insurance offered by insurance companies[243] operating in Poland as at 15/10/2018. The results were presented in descriptive form, with the formulation of final conclusions.

## 2. THE CONCEPT OF THE PRINCIPLES OF INSURANCE PROTECTION

In the theory of business insurance, the principle of full insurance coverage has not achieved passed to one commonly accepted definition. In the theory of insurance law, it is called the principle of compensation [4]. Generally, the purpose of the insurance is full compensation of the insured person's loss in an amount no higher than the loss suffered [5]. The principle of full coverage of insurance covers the assurance given to the insured persons of such a level of financial compensation for random losses that can be achieved under given circumstances [6].

There are many factors that encourage and discourage the preservation of the principle of full insurance coverage. One of the encouraging factors is the correct valuation of the subject of insurance [7] together with correct process of determining the value [8]. An inherent attribute of the sum insured is the method of determining the sum to be insured by the local government. It can be gross or net book value, replacement value either market or real.

In insurance literature, there are different views concerning the subject of property insurance and gross book value. Views encountered are: that there is a real danger that the sum insured based on the initial book value will be insufficient to cover the loss [9] or that the gross book value is close to the replacement value in new object [10] and even that the book cost of the asset “in the first year is the real value of assets” [11], that is replacement value (new).

[243] The Companies concerned: Compensa Towarzystwo Ubezpieczeń S.A. Vienna Insurance Group, CONCORDIA POLSKA Towarzystwo Ubezpieczeń Wzajemnych, STU Ergo Hestia S.A., InterRisk Towarzystwo Ubezpieczeń S.A. Vienna Insurance Group, Powszechny Zakład Ubezpieczeń S.A., Towarzystwo Ubezpieczeń Wzajemnych Polski Zakład Ubezpieczeń Wzajemnych, Towarzystwo Ubezpieczeń Wzajemnych „TUW”, UNIQA Towarzystwo Ubezpieczeń S.A.

## 3. THE CONCEPT OF GROSS ACCOUNT VALUE OF THE FIXED ASSET

The gross book value of a fixed asset is defined in the Accounting Act [12] and specified in the National Accounting Standard No. 11 "Fixed assets" (NAS No. 11).

**The legislator defined the initial value as the purchase price, production cost or other value according to which the fixed asset was included for the first time in the accounting books of the entity.** At the time of acceptance the initial value of a fixed asset is equal to its gross book value [13]. The purpose of introducing NAS No. 11 was to standardize the application of the provisions of the Accounting Act for the purposes of tax and balance sheet law, but not insurance law.

Consequently, the legislator has not made any regulations in the insurance law provisions regarding the method of determining the sum which fixed assets may be covered by insurance. In practice, after the implementation of the Directive of the European Parliament and the Council on insurance distribution as of 01/10/2018, the position of the insured was strengthened in connection with the obligation to conduct a reliable analysis of the client's needs by the insurance distributor [14]. It does not change the fact that it is the insured person who must comply with the balance sheet law and at the same time be responsible for the proper valuation of the subject of insurance and the type of value.

**The issue of determining what should be understood by the term "gross book value" is left to insurance companies who define it in general terms of insurance. Definitions of gross book value refer to the initial value, and in some general terms of insurance cited as "in accordance with the Act" (by default with the Accounting Act), and "resulting from the records of fixed assets".** Therefore, it should be understood that insurers interpret the definition of gross book value in accordance with the applicable balance sheet laws for municipalities.

## 4. THE SUM INSURED OF THE PROPERTY ACCORDING TO GROSS ACCOUNTING VALUE

In balance sheet law, gross book value is the initial value of a fixed asset, which can be determined in various ways.

The initial value may be the purchase price of the asset, including the amount due to the seller together with other necessary costs, and reduced by rebates, discounts, other similar reductions and recoveries. In this situation, underinsurance may be equal to the value of rebates, discounts and other similar decreases and recoveries because the book value of the fixed asset is equal to the purchase price from the invoice. The law prohibits correcting the value of a fixed asset in the list of fixed assets by the municipality.

If it is not possible to determine the purchase price of an asset, in particular one acquired free of charge, including by donation, its valuation is made at the selling price of the same or similar asset or at fair value. From the point of view of the fulfillment of the principle of full insurance coverage, the method of valuation and the time that has elapsed since the date of manufacture (production) is important. Underestimating the value will result in lowering the sum insured (underinsurance).

It would seem that the purchase price and the cost of producing fixed assets under construction correspond to a new value introduced into the bookkeeping. The initial value includes all costs incurred by the local government for the period of construction, assembly, adaptation and improvement, until the day of its acceptance for use. In this situation, the risk of under-insurance is related to the time that has elapsed since the contract was signed with the contractor for the transfer of fixed assets for use. In the case of multi-million infrastructure investments implemented over many years, local government introduce new fixed assets to the records of fixed assets on the basis of the price of the contract concluded beforehand. Changes in investment price indices, price indicators of construction and assembly works or exchange rate fluctuations in the period from the award of the contract until the order is completed and handed over for use are not taken into account when determining the initial value because the contract price applies.

The situation is even more complicated when constructing a new fixed asset using an existing fixed asset. Then, the initial value of the new fixed asset will be increased by the net value of the existing asset that the underinsurance is not less than the value of depreciation write-offs or write-offs due to permanent loss of value.

The acquisition of a fixed asset from another entity in certain situations results in the recognition of the fixed asset in the register of fixed assets in the net book value. Similarly, as in the case described above, under-indemnity is no less than the value of depreciation or write-offs and write-offs for permanent loss of value.

The risk of underestimating the initial value may also occur when the entity acquires a used fixed asset. The initial value of the used property is the value taken from the receipt of purchase and not from the date of manufacture (year of production). Insurance companies when determining the amount of compensation take into account the year of production and not the date of new acquisition of the fixed asset.

In addition, NAS No. 11 allows intangible assets in certain situations to be assigned to assets with a material form. In the case of software, its inclusion in the initial value of a fixed asset or its separate recognition as an intangible asset is determined by the type of license, not the type of software. An operating system license assigned to one device increases the initial value of the fixed asset, while a multi-seat license is recognized as an intangible asset. The established rules are very important from the point of view of the general insurance conditions offered. Electronic equipment and intangible assets should be covered by insurance protection under special insurance conditions. However, due to the price of such insurance, local government decide on an insurance contract, the terms of which may exclude software from insurance coverage. Although the NAS No. 11 allows the recording of intangible assets together with fixed assets, the general insurance terms and conditions do not take into account the provisions of the balance sheet law. In the case of damage, even the correctly determined sum insured for the fixed asset does not guarantee full compensation after damage due to the exclusions in the insurance cover.

Summing up the considerations, it should be emphasized that **gross accounting value which is the initial value depends on the mode by which the entity acquired the fixed asset together with the type and scope of actions undertaken. Also important is the time that has elapsed since the date of the contract for deliveries or construction works until the date of accepting the fixed asset for use.** As a result, even in the case of newly acquired assets, the initial value will not always match the replacement value.

Insurance companies also introduce **additional criteria** that allow limiting their liability, and thus constitute a **factor discouraging the implementation of the principle of full insurance coverage:**
- the local government may suffer negative financial consequences in the case of partial damage, when the declared value of the subject of insurance on the day of concluding the insurance contract is lower than the value of the subject of insurance on the day of occurrence of the damage. In this situation, some insurance companies apply the principle of proportion that is the compensation paid is in proportion to the sum insured and the object value on the day of the damage. Depending on the insurance conditions, the principle of proportionality may apply only when the value of the item on the day of the damage exceeds 110% to 130% of the sum insured and / or when the amount of damage does not exceed PLN 5,000 to PLN 10,000 or a certain percentage threshold (usually 20%);

- consumption of the sum insured for fixed assets insurance, which consists in reducing the sum insured by the amount of compensation paid, entails the necessity to supplement the sum insured. The authority`s failure to redress the sum insured in the event of the next partial damage usually results in under-insurance and the application of an unfavorable principle of proportion.

## 5. CONCLUSION

As a result of the conducted research, it was found that the sum insured according to the gross book value of the newly acquired property of the commune is not always a guarantee of receiving full compensation for the material damage suffered, thus causing the situation whereby the principle of full insurance coverage is not implemented.

The analysis carried out also allows for the following conclusions:

- In insurance of the property of local government property in Poland, there is a dysfunction in the general insurance conditions with relation to the balance sheet law applicable in the local government sector in the interpretation of the definition of gross book value. This dysfunction also results from the application of the principle of proportion, the principle of consumption of the sum insured and additional insurance conditions that distort the concept of gross book value, which is disadvantageous to the insured;

- It is necessary to ensure consistent interpretation of gross book value in insurance law and balance sheet law, or to refrain from insuring property against gross book value.

According to the author, there should be a revision of the adopted views on the principle of full insurance coverage of property, in particular with regard to municipal property. The signaled need concerns the inclusion of additional criteria when assessing the implementation of this principle, namely attributes of the sum insured, attributes of the subject of insurance and methods of valuation of fixed assets.

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