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Project	Insurance contracts		
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Purpose of the paper

1. This paper considers whether an entity should present insurance contract revenue and incurred expenses consistently for all insurance contracts, as proposed in the 2013 Exposure Draft *Insurance Contracts* (2013 ED).
2. This paper should be read with Agenda Paper 2B *Insurance contract revenue – examples* for this meeting, which describes the mechanics for determining insurance contract revenue. It also illustrates the outcome of the insurance contract revenue proposals for some types of contracts and illustrates the related disclosures.
3. This paper considers only insurance contracts that have no participating features. Issues specific to participating contracts will be considered at a later stage, and, at that stage, the staff will consider whether the tentative decisions reached for non-participating contracts need to be revisited.

Staff recommendation

4. The staff recommends that the IASB confirm its 2013 ED proposal that:
   - (a) an entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue;

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(b) entities should be *required* to present insurance contract revenue in the statement of comprehensive income, as proposed in paragraphs 56-59 and B88-B91 of the 2013 ED; and

(c) entities should disclose the following:

(i) a reconciliation that separately reconciles the opening and closing balance of the components of the insurance contract asset or liability (paragraph 76 of the 2013 ED).

(ii) a reconciliation from the premiums received in the period to the insurance contract revenue in the period (paragraph 79 of the 2013 ED);

(iii) the inputs used when determining the insurance contract revenue that is recognised in the period (paragraph 81(a) of the 2013 ED);

(iv) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position (paragraph 81(b) of the 2013 ED); and

Structure of this paper

5. Paragraphs 10-17 include background information on the development of the 2013 ED proposal.

6. Paragraphs 18-59 include feedback received on the 2013 ED proposal and an analysis of the issues identified in the feedback relating to:

(a) the benefits of the information provided (paragraphs 23-45),

(b) the costs and operational difficulties of providing this information (paragraphs 46-54), and

(c) the concerns expressed by some constituents that there might be the possibility of negative insurance contract revenue (paragraphs 55-59).

7. Paragraphs 60-71 set out the staff recommendations and questions to the IASB.

8. Appendix A includes relevant IASB tentative decisions since the 2013 ED.

9. Appendix B and Appendix C sets out relevant paragraphs of the 2013 ED and its Basis for Conclusions.

Background information

Proposals in 2010 ED

10. The 2010 Exposure Draft *Insurance Contracts* (2010 ED) proposed that the presentation approach for the statement of comprehensive income would depend on the approach used to recognise and measure the insurance contract, as follows:

    (a) *for contracts accounted for using the simplified measurement approach*[1]—the entity would use a presentation approach that provided volume information. This would mean that:

        (i) premium revenue[2] would be presented in each accounting period as the obligation for remaining coverage is released: such release would be based on the passage of time or the expected timing of incurred claims and benefits;

        (ii) expenses such as claims incurred, other expenses and amortisation of acquisition costs, would be presented as those expenses were incurred, measured as the change in the liability for incurred claims; and

        (iii) gains and losses from changes in any additional liability for onerous contracts would be presented in the statement of comprehensive income as a separate line item.

    (b) *for contracts accounted for using the general measurement approach*[3]—the entity would use a presentation approach that provided information about margins ('summarised margin approach'). That approach would separately present sources of profit, namely the change in the risk margin, the release of the residual margin[4], experience adjustments and changes in

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[1] This approach is often referred to as premium allocation approach (PAA).

[2] The 2013 ED referred to revenue for all insurance contracts as "insurance contract revenue".

[3] This approach is often referred to as building block approach (BBA).

[4] In 2013 ED the residual margin was renamed the "contractual service margin".

estimates. As a consequence, the insurer would not disaggregate the underwriting margin to separately present premium revenue and claims and other expenses. Information about premiums received and claims paid was proposed to be disclosed in the notes to the financial statements.

11. The summarised margin approach would treat all premiums as receipts of deposits and all claims as repayments of deposits. Such an approach was proposed because it avoids the need for entities to separate deposit receipts from the premiums, as it treats premiums in the same way as deposits. Many long-duration insurance contracts contain investment components (deposits) and many argue that excluding investment components from insurance contract revenue for such contracts might be complex and arbitrary.

12. The IASB concluded that the two different presentation approaches were justified on grounds of simplicity, because the amounts presented in the statement of comprehensive income were directly derived from the changes in the measurement of the insurance contract, measured using two approaches. In addition, because the 2010 ED proposed that the measurement basis for the insurance contract should be mandatory if specified criteria are met, the presentation approach was also mandatory.

Feedback received on 2010 ED

13. Feedback received on the 2010 ED indicated that, for long-duration contracts, information provided by the summarised margin approach is helpful. However, respondents believe that the summarised margin approach would not be useful enough on a stand-alone basis because it would not include any information about volume (such as premiums and expenses). Most respondents argued that information about volume is too important to be limited to disclosure in the notes to the financial statement. As a result, some respondents thought that the summarized margin approach could not replace the key performance indicators that users of financial statements use to evaluate insurers’ performance.

14. Views were mixed regarding the proposal for different presentation approaches depending on the measurement basis. Some respondents thought it would be desirable to present volume information in the same way for all insurance contracts,

regardless of the measurement basis. Others thought that the need for different measurement basis arose from the different economics of insurance contracts, and that different presentation approaches might therefore be appropriate to faithfully represent those different economics.

Proposal in 2013 ED

15. In the deliberations leading to the 2013 ED, the IASB was persuaded that the financial statements of entities that issue insurance contracts would be more useful if the statement of comprehensive income were to provide volume information (ie information about gross performance). In addition, the IASB concluded that if such information is to be understandable, it must be consistent and comparable for insurance contracts and other types of contracts with customers. Accordingly, the 2013 ED proposed that entities should present insurance contract revenue determined in a way that is broadly consistent with the Exposure Draft *Revenue from Contracts with Customers* (the Revenue ED). Consistently with that model, an entity would depict the transfer of promised services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The amount of services provided would be measured as a reduction in the entity's performance obligations. For insurance contracts those performance obligations are the bearing of risk and the provision of coverage and other services. The obligation to repay investment components are not a *performance* obligation for the entity. Accordingly, the ED proposed that the entity would:

    (a) recognise insurance contract revenue in each period as it satisfies the performance obligations arising from the insurance contract; and

    (b) exclude from insurance contract revenue any investment components.

16. Applying the proposals in the 2013 ED, the amount of the insurance contract revenue recognised for the period would represent the price the insurer would charge for that period to cover the expenses for that period, the compensation the entity charged for bearing risk in the period, plus a required profit margin. This price would be established at inception of the contract for each period and would:

(a) take into account the time value of money between the inception of the contract and the time when the service is provided;

(b) reflect any subsequent changes related to the service provided in the period. For example if more policyholders die in the current period than expected, the amount of service provided in the future periods will decrease compared to expectations because there will be fewer policyholders to provide service to; and

(c) exclude repayments of premiums to the policyholders based on the latest information about the investment component repaid during the period.

17. Insurance contract revenue determined as proposed in the 2013 ED would not be significantly different from the revenue currently presented for short-duration contracts measured using the unearned premium reserve method in many GAAPs. However, insurance contract revenue could be significantly different from the information currently presented for long-duration contracts. In particular, there are two major features of the proposal that might differ from the current practice:

(a) The recognition pattern.

(i) According to the 2013 ED proposal, insurance contract revenue is presented in the statement of comprehensive income when the service is provided. This proposal was intended to improve the comparability between all types of insurance contracts, and between insurance and non-insurance contracts.

(ii) Currently, premiums are recognised in the statement of comprehensive income on different bases depending on the jurisdiction and type of the contract (for example, when the contract is signed or when amounts are billed - paragraph 21 explains those approaches in more detail).

(b) The total amount of insurance contract revenue.

(i) According to the 2013 ED proposal, insurance contract revenue:

1. excludes repayments of the investments components (ie implicit and explicit balances) that are repaid to

the policyholder (or beneficiaries). This proposal is intended to improve comparability with deposit-taking institutions (such as banks) which do not present revenue for similar investment components.

2. includes an adjustment (interest accretion) to reflect the effect of the time value of money on premiums received before service is provided. Advance payment of premiums are a common feature of many insurance contracts.

(ii) Currently, premiums recognised in the statement of comprehensive income:

1. include some, but not all, investment components. In some cases, changes in explicit account balances (amounts that are separately identified by the contract to be paid upon death or other event) are not presented as volume information. However, changes in many implicit balances (even if economically similar to explicit account balances) are presented as volume information.

2. often do not adjust premiums recognised in profit or loss to reflect the time value of money. In contrast, premiums are recognised based on a contractual (premiums due) or expected (premiums written) basis.

Feedback received on 2013 ED proposal

18. Many welcomed the IASB’s decision to revisit the summarised margin approach proposed in the 2010 ED for contracts accounted for using the general measurement model. In particular:

(a) Many reiterated views from their comment letters on the 2010 ED that the statement of comprehensive income should provide more information than merely margins.

(b) Most agreed that there are conceptual merits of the insurance contract revenue proposals, and many thought it would be beneficial to align

revenue presented for life insurance contracts, non-life insurance contracts and non-insurance contracts would be beneficial. They agreed that insurance contract revenue will be more comparable with revenue for non-insurance contracts with customers, and to other deposit-taking institutions.

(c) Those who agree with the merits of the proposals included generalist (rather than specialist) users of financial statements, some standard-setters and regulators, some preparers such as composite insurers (because they are interested in simplifying the presentation) and non-life insurers (because the proposals are broadly consistent with current practice). Those constituents believe that the proposals would be helpful in assisting non-specialist investors in making their asset allocation decisions with respect to entities that issue insurance contracts.

19. However, some oppose the insurance contract revenue proposals because:

(a) They do not consider comparability between entities that issue insurance contracts and entities that issue only non-insurance contracts to be a high priority, because analysts typically compare insurance companies only with other insurance companies. They observe that most users of the financial statements of an entity that issues insurance contracts are specialists.

(b) They believe that the IASB should accept the coexistence of two different presentation requirements for life and non-life insurance contracts, because they think different presentations offer the most useful presentation of the different characteristics of those different types of insurance contracts. Those views are mostly expressed by specialist users of financial statements and many preparers who issue mainly long duration contracts.

(c) They are concerned that the exclusion of the investment component from the volume information would mean that the amount of insurance contract revenue would be likely to be smaller than previously presented information and therefore would not be comparable to such previous

information. As a consequence, the proposals would cause the loss of some trend information, and some users of financial statements might regard insurance contracts differently in the light of the apparent reduction in amounts presented in the statement of comprehensive income.

20. Both those who agree and those who disagree with the proposal are concerned about specific aspects of proposal, as follows:

    (a) the benefits of the information provided, in particular:

        (i) what insurance contract revenue represents—analysed in paragraphs 23-26; and

        (ii) whether users of financial statements would have the information they need—analysed in paragraphs 27-45.

    (b) the costs of the information provided, in particular the operational difficulties relating to:

        (i) excluding the investment component—analysed in paragraphs 46-51; and

        (ii) treatment of acquisition costs—analysed in paragraphs 52-54.

    (c) operating issues related to the possibility of negative revenue—analysed in paragraphs 55-59.

Other presentation approaches previously considered and rejected

21. When developing both the 2010 and the 2013 EDs, the IASB considered the other approaches for providing volume information that are currently used in practice:

    (a) a written premium presentation, which would allocate the total expected insurance contract revenue to the period in which the contracts are initially recognised (written). At the same time, an expense would be presented for the total obligation taken on (including expected expenses and margins relating to those contracts);

    (b) a premiums due presentation, which would allocate the total expected insurance contract revenue to the periods in which the premiums become

unconditionally due to the entity. At the same time, the entity would recognise either:

(i) an allocation of the total expected expense on the basis of the amount of the premium recognised compared with the expected total revenue; or

(ii) incurred expenses, and an additional line item often referred to as ‘change in the liability’ to reconcile premiums due to the underwriting margin (the difference between the opening and closing balance of the insurance liability).

22. The IASB rejected those approaches, for the reasons that are reiterated in paragraph 39.

Analysis of specific issues related to the insurance contract revenue proposal

What does insurance contract revenue represent?

23. Many constituents observe that the notion of insurance contract revenue is a new measure for long-duration contracts which they believe to be ‘radical’. As a result many doubt whether users of financial statements will understand the information without a significant education effort. Accordingly, many stated that there is a need for the IASB to educate both preparers and users of financial statements about the proposals and about how key performance indicators would be affected.

Staff analysis

24. As described in paragraph 15, the insurance contract revenue proposal is intended to achieve consistency between revenue information provided for all insurance and non-insurance contracts by measuring insurance contract revenue in a way that is broadly consistent with the general principles in the 2011 Revenue ED. Although the proposed measure of insurance contract revenue differs from volume information for long-duration contracts provided under existing practice (see paragraph 17), it is not a new concept. On the contrary, insurance contract revenue for long-duration contracts would be consistent with revenue for short-duration insurance contracts or non-insurance contracts that are measured using revenue recognition principles. As

a consequence, understanding the concept of the proposal and changes to current practice might require some education for preparers and the specialised users but should not require significant education for generalists or non-insurance specialists. In addition, insurance contract revenue would reduce the risk of the misinterpretation by non-specialist users of the currently used volume information as being the equivalent of revenue.

25. In developing the proposals in the 2013 ED, the IASB noted the transitional difficulties that might occur with the new measure. Therefore, the IASB proposed to help in the transition period by requiring entities:

    (a) to provide a link between insurance contract revenue and existing measures of volume. This would be of interest especially for specialist users of financial statements. Accordingly, paragraph 79 of the 2013 ED proposed a reconciliation of cash inflows to insurance contract revenue.

    (b) to explain the drivers of the recognition of the insurance contract revenue for the period. Accordingly, paragraph 81(a) of the 2013 ED proposed a reconciliation of insurance contract revenue to inputs used to determine insurance contract revenue such as:

        (i) the expected cash outflows for the period (excluding investment components);

        (ii) the acquisition costs that are allocated to the period;

        (iii) the change in risk adjustment in the period; and

        (iv) the amount of the contractual service margin recognised in the period.

26. In the staff's view, these disclosures provide useful information to assist users of financial statements in understanding how insurance contract revenue relates to more familiar metrics, and provides useful information about drivers of insurance contract revenue.

Would users of financial statements have all the information they need?

27. Insurance contract revenue provides information about service provided in the period, regardless of when the contracts were written or premiums were due. As a

result, many believe that insurance contract revenue does not provide the information users of financial statements need, because it does not provide information about the volume sold in the period. Consequently, they believe it does not provide a useful basis for assessing the size (when compared to other companies), level of sales activity (when compared to other companies or previous periods) or growth (when compared to previous periods).

28. Many believe that the information about sales activity and growth are key for investors' decision-making needs. In addition, they believe that existing information provided in the statement of comprehensive income respond to those needs. Consequently, they fear that the insurance contract revenue proposal would lead to a growth of non-GAAP measures to ensure users of financial statements continue to receive currently provided information. Existing information provided is based on the following measures[5]:

    (a) the amount of the expected inflows from the policies sold in the period (premiums written);

    (b) the amount of the unconditional premiums due from the policyholders (premiums due); or

    (c) cash inflows for the period.

29. In addition, some constituents would prefer to maintain the existing volume information used because they believe that:

    (a) such information continues to provide the trend analysis based on those measures;

    (b) premiums due or premiums received are more objective measures, because they are not based on the actuarial assumptions in the model but are instead based on the contract structure or payments received.

30. As a consequence of the reasons in paragraph 19 and paragraphs 27-29 some argue that volume information based on existing measures should be presented in the statement of comprehensive income. In addition, some suggest that such existing measures could be combined with the summarised margin approach. However,

[5] More information about currently used measures are included in paragraph 21.

others are concerned that presenting in the statement of comprehensive income volume measures that are inconsistent with revenue principles might be misleading to users of financial statements. In particular, one accounting firm noted that they had come to share the concern expressed by the IASB that any volume measure presented on the face of the income statement would be viewed as revenue (though this firm supported the summarised margin approach, rather than insurance contract revenue).

31. Furthermore, the response to both Exposure Drafts indicated that, for long-duration contracts, the information provided by the summarised margin approach is helpful in assessing the performance of the entity. Some would prefer this information to be provided in the statement of comprehensive income, and some in disclosures as an addition to the volume information that would be recognised in the statement of comprehensive income.

Staff analysis

32. The analysis below considers on the following issues:

    (a) Assessing sales activity using premiums written;

    (b) Assessing size and growth of the business;

    (c) Providing currently used measures in the statement of comprehensive income; and

    (d) Providing information about changes in margins (summarised margin).

Assessing sales activity using premiums written

33. Some believe that premiums written should be presented in the statement of comprehensive income because it would provide useful information about sales activity. However, in the staff's view, the proposals in the 2013 ED would already provide information that would be useful for assessing sales activity and related information about the additional obligation and expected profit.

34. Paragraph 81(b) of the 2013 ED proposed that entities should disclose the following amounts relating to new business written in the period[6]:

    (a) the expected present value of cash inflows,

    (b) the expected present value of cash outflows, showing separately the amount of acquisition costs,

    (c) the risk adjustment; and

    (d) the contractual service margin.

35. In the staff's view this information would be useful to asses:

    (a) the amount of new obligation related to the business written in the period. It also allows users of financial statements to assess the level of additional risk and therefore the additional strain that this new business places on the capital of the insurer;

    (b) the expectations of the entity relating to future profitability, and the entity's success in covering the acquisition costs with the expected margin from the new business.

36. However, the staff note that information for assessing sales activity is useful for all types of contracts in all industries. In the staff's view, the usefulness of this information for insurance contracts justifies a disclosure requirement, but does not justify its presentation in the statement of comprehensive income.

Assessing size and growth of the business

37. Some support premiums written or premiums due because they think that this information would provide useful information about the size or growth of the business. However, in the staff's view, the volume information currently used in financial statements has limited benefits. This is because it is not measured consistently between different products or jurisdictions. It might be useful to provide information about growth (when comparing the amount from period to period for similar products) but it is not useful for assessing the size (for which

6 The information about premiums written is only required for contracts measured using the general measurement model. It uses the information required for the measurement proposed, so it does not require any additional calculations.

comparability between contracts or entities is important). Consequently, entities try to show comparable amounts by calculating:

(a) the present value of expected premiums for recurring premiums, which is useful if compared to the related expenses because it helps to assess the profitability of new contracts as well as to assess the efficiency of sales forces in comparison to the acquisition costs spent to sign new contracts; or

(b) the amount of the annualised premiums for the premiums paid at inception, which is an attempt to determine in a simple way what premium would be charged if it had been paid annually rather than as a lump sum at inception. Such an amount approximates the insurance contract revenue in a simple way to compare the amount of premiums with the claims incurred for the period.

38. In contrast, the staff believe that insurance contract revenue proposal would improve the usefulness of the information provided for assessing the size of the business by improving comparability between all types of insurance contracts, and between insurance and non-insurance contracts. As a consequence, the user would have an enhanced ability to compare the size of the insurance business and other businesses. Information about the growth of the business would be provided by the disclosures described in paragraph 34. Accordingly, the staff believes that the proposed disclosures would provide users of financial statements with more useful and comparable information to assess size and growth of the business compared to existing practices.

Providing currently used measures in the statement of comprehensive income

39. Some constituents propose alternative presentation approaches that would allow continuing to present other volume measures such as written premiums and premiums due on the face of the financial statements. However, the staff notes in developing both the 2010 and 2013 EDs the IASB rejected written premiums and premiums due for the following reasons:

(a) written premiums and premiums due are not consistent with commonly understood concepts of revenue and therefore could mislead non-specialist

users of financial statements. Misleading information could be provided, for example, if insurance entities and non-insurance entities are compared to assess their relative size using volume measures that are presented on the face of the financial statements;

(b) for both the written premiums and premiums due approaches, the expenses would be either:

  (i) not based on incurred amounts. The IASB concluded that it would confusing or difficult for users of financial statements to understand expenses that are not presented on an incurred basis; or

  (ii) based on incurred amounts only because the entity presents an additional item that reconciles the incurred amounts to the amount of expenses related to the premiums due in the period. This additional item would be necessary to reconcile the premiums due and incurred expenses to underwriting profit. That item might be very significant in practice and it would be difficult to explain what it represents;

(c) if entities used a written premium or premiums due approach only for long-duration contracts, it would mean there would be inconsistent presentation approaches for contracts depending on whether the entity applied the general or the simplified model. This would make it more complex for users of financial statements to understand the performance of an entity that uses both measures, because:

  (i) the statement of comprehensive income would include many line items to accommodate both presentation approaches; or

  (ii) the entity would need to present a separate statement of comprehensive income for each presentation approach.

40. The staff believes that those reasons for rejecting the use of written premiums or premiums due in the statement of comprehensive income are still valid.

41. Many were concerned that insurance contract revenue would not provide objective information but is instead based on the actuarial estimates. However, such an approach is consistent with the revenue for other contracts that are related to

providing service over time. Revenue for such contracts is also based on the entities' estimations of when the service is provided.

42. As noted in paragraph 19, some believe that insurance contract revenue does not need to be comparable with revenue for other types of contract because the different economics of insurance contracts justify a different measure. However, the staff note that the Revenue ED would apply to different types of business including different types of goods sold and different types of services. Consequently, the staff believe that the different economics of the contracts does not justify different bases for revenue.

Providing information about changes in margins (summarised margin)

43. Paragraph 76 of the 2013 ED proposed that entities should disclose a separate reconciliation between the opening and closing balances[7] of:

    (a) the expected present value of the future cash flows;

    (b) the risk adjustment; and

    (c) the contractual service margin.

44. Consistent with the feedback from the 2010 ED, constituents stated that the information about margins is useful to asses[8]:

    (a) the drivers of the entity's profitability for the period, ie the extent to which the entity is released from risk and provides other services;

    (b) changes in circumstances that exceed the contractual service margin, together with any differences between estimates at the end of the previous reporting period and actual outcomes.

45. However, as discussed in the development of the 2013 ED, the summarised margin approach, while providing useful information, is not consistent with the information provided by entities for other types of contracts. Accordingly, the staff continues to believe that the IASB should retain the information provided by the summarised

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7 The information about changes in margins is only required for contracts measured using the general measurement model. It does not require any additional calculations.

[8] This disclosure is also important for other reasons (as described in paragraphs BC84 in the Basis for Conclusions for 2013 ED, see Appendix B.

margin approach as a disclosure, but not require it as the presentation approach for the statement of comprehensive income.

Difficulties related to excluding the investment component

46. Central to the opposition to the notion of insurance contract revenue is the proposed treatment of investment (or deposit) components.

    (a) This is the main concern expressed by some preparers and actuaries, who believe that the investment component is an integral part of an insurance contract and that it would not be meaningful to separate it from the underlying insurance contract. Many are concerned that if components are not required to be separated for the measurement purposes[9] (known also as unbundling), the separation should not be required for presentation purposes.

    (b) Others (especially regulators and standard-setters) accept that there would be a conceptual justification for excluding investment components from insurance contract revenue, but argue that it would be excessively complex to do so. As a consequence, they question whether the cost of excluding an investment component from insurance contract revenue would exceed the benefit of the information provided.

    (c) All users of financial statements that we spoke about this issue agree that an investment component should not be included in the volume information presented in the statement of comprehensive income. This is mainly because it decreases the comparability of volume information by artificially increasing revenue for entities with insurance contracts.

47. In terms of the complexity cited by constituents:

    (a) Some think that separation of the investment component would require the entity to identify the expected investment component cash flows at

[9] Separation of the non-insurance components of the insurance contract for the measurement and presentation purposes (known also as unbundling) is proposed in paragraphs 10-12 of the 2013 ED. The main objective for those requirements is comparability with similar components that are within the scope of different Standards, for example financial instruments, while balancing the complexity of such a separation for highly interrelated cash flows.

inception, and exclude them from the probability-weighted estimate of cash flows. That would be onerous for many contracts, eg if the amount and timing of the investment component could vary. In addition, some believe that this could be a subjective process that could decrease the comparability of revenue.

(b) Some others note that the investment component need not be forecast at the end of each reporting period, but can be determined from the claims incurred in the period. Nonetheless they believe that separating the claims in each period into the amount that would have been paid if the policyholder had surrendered the policy in the period, and the incremental amount related to policyholder's death, would lead to significant costs related to systems because this information is not held as such within existing accounting systems.

Staff analysis

48. The staff continues to believe that if an entity was to present the receipts and repayments of such investment components as insurance contract revenue and incurred claims it would not faithfully represent the amounts reported in profit or loss. To do so would be equivalent to a bank recognising receipt and repayment of an investment as revenue and expense and would be misleading for the reader of financial statements. The feedback from users of financial statements supported the IASB's view in the 2013 ED that the inclusion of investment components in insurance contract revenue was potentially misleading. Accordingly the staff concludes that more meaningful information would be obtained when investment components are excluded from insurance contract revenue.

49. The main criticism of insurance contract revenue relates to the complexity associated with excluding the investment component. This complexity arises from the lack of information about some implicit investment components in many entity's existing accounting and financial systems.

(a) Many existing GAAPs require separation of some explicit account balances (amounts that are separately identified in the contract to be paid

upon death or other event). Consequently, many entities currently capture information needed to separate only explicit account balances.

(b) In contrast, implicit investment components are not currently separated. Implicit investment components may arise, for example, as cash surrender values that accumulate (often fixed) returns on premiums. Cash surrender values are economically similar to explicit account balances because both provide returns that could be claimed at surrender of the policy or that are included implicitly in amounts that are paid upon death. However, when a death benefit is paid, the cash surrender value component of the payment is not specified explicitly. As a consequence, a cash surrender value might be calculated only in the event that a policyholder surrenders the policy before death. Most existing systems do not record the amount of accumulated cash surrender value at each reporting date, and most entities regard the whole of a payment on death as arising from the insured event.

50. Some question whether an investment component that is not unbundled from an insurance contract can be identified for the purpose of determining insurance contract revenue, because the IASB has previously concluded that it would be arbitrary and complex to unbundle highly interrelated amounts. In the staff's view, it is significantly easier to identify the amount to be excluded from insurance contract revenue compared to unbundling an investment component, as follows:

(a) For unbundling, an entity would need to exclude all related cash flows (and its subsequent changes) from the insurance contract. Those cash flows include a portion of premiums and expenses which would then need to be measured using other IFRS at each reporting date. The entity would measure the insurance component on a risk-adjusted probability-weighted basis and the investment component at amortised cost or fair value in accordance with IFRS 9 *Financial Instruments*.

(b) In contrast, to determine the amount to be excluded from insurance contract revenue, an entity need only exclude from the incurred claims and revenue recognised in each period the part of the claims incurred that the entity would be required to pay if the policyholder had surrendered the

policy in that period. That amount would also be excluded from insurance contract revenue in that period.

51. Although the staff believes that determining the investment component to be excluded from insurance contract revenue is significantly simpler than unbundling, it does require the use of information that is not currently captured in existing accounting and financial systems. As a consequence, it would require some additional calculations to be done, based on the information stored in the current accounting system. This might require entities to makes changes to their existing accounting systems. However, the staff believe that this change is not significantly different to other changes that the implementation of the new Standard as a whole would impose on existing financial systems.

Difficulties related to the treatment of the acquisition costs

52. Another source of complexity that arises from the proposal for insurance contract revenue is that, for the purpose of measuring insurance contract revenue, entities would be required to allocate the directly attributable acquisition costs over the coverage period in the systematic way that best reflects the transfer of services provided under the contract. This proposal would impose additional complexity on preparers because the recognition of acquisition costs in the statement of comprehensive income would not be related to the changes in the insurance contract liability. Consequently, an insurer would need to track this information separately so that it can present the appropriate amount of revenue in the statement of comprehensive income for the period. A few respondents believe that such complexity is not justified. They suggest instead that the insurance contract revenue associated with the directly attributable acquisition costs should be recognised when the costs are incurred.

Staff analysis

53. The issue noted in the comment letters was discussed extensively before developing the 2013 ED proposals, in particular during the May 2012 meeting, June 2012 meeting and October 2012 meeting. In the Basis for Conclusions, the IASB noted that in many cases, the cash outflows associated with acquisition costs occur at the

beginning of the contract coverage period, before any coverage or other service has been provided. Because the services provided by a contract would be measured on the basis of changes in the carrying amount of the insurance contract, it might result in recognising insurance contract revenue before the entity has provided any coverage or services under the contract.

54. The 2011 Exposure Draft *Revenue from Contracts with Customers* proposed to prohibit the recognition of revenue before an entity has satisfied any performance obligations. To be consistent with those proposals, and to avoid recognising insurance contract revenue before any coverage has been provided, the 2013 ED proposes that entities should, for presentation purposes, present the insurance contract revenue and expenses associated with such costs over the coverage period in line with the pattern of services provided under the contract, rather than when the costs are incurred. The comment letters did not provide any new information to cause the staff to revise its conclusions in this area.

Issues related to the possibility of negative insurance contract revenue

55. Some comment letters noted concerns about the possibility of negative revenue in the following situations:

    (a) when an unfavourable change in risk adjustment is recognised as a decrease of the insurance contract revenue for the period; and

    (b) when the investment component excluded from insurance contract revenue in the period is higher than expected.

56. Those with this concern believe that these changes in estimates could decrease the amount of insurance contract revenue below zero. However, as discussed below, the staff does not believe these concerns to be valid.

Staff analysis

57. The staff notes that, according to the 2013 ED, negative insurance contract revenue might have arisen when unfavourable changes in risk adjustment were higher than the sum of the expected claims and the profit recognised from the contractual service margin in the period. This is because the 2013 ED proposed that all changes in the

risk adjustment would be immediately recognised in profit or loss as insurance contract revenue. However, in March 2014, the IASB tentatively decided that the change in the risk adjustment would be offset against the contractual service margin as long as those changes are related to the future services (in a similar way that the 2013 ED proposed for changes in expected cash flows). Consequently, such unfavourable changes in the risk adjustment would first decrease the contractual service margin to zero and would then be recognised as an expense (not as insurance contract revenue) in a similar way as an onerous contract accounted for applying the proposals in the Revenue ED. Therefore, the tentative decision from the March 2014 meeting would significantly reduce the possibility of negative insurance contract revenue.

58. Some were concerned that negative insurance contract revenue could occur when the investment component excluded from insurance contract revenue in the period is higher than expected. This would mean that insurance contract revenue would be reduced by the additional amount estimated for the investment component. However, the staff note that an entity would need to update the measure of the insurance contract liability for all changes in the assumptions related to future services (including all investment changes) before determining the amount of insurance contract revenue to recognise. Consequently, insurance contract revenue is determined based on the updated, rather than on the previous, estimates of the investment component. The entity therefore excludes the amounts of the investment at the end of the period from insurance contract revenue. Such an approach prevents the possibility of negative insurance contract revenue.

59. The staff note that according to the current tentative decisions, negative revenue from insurance contracts would be presented in the statement of comprehensive income only if an entity had previously recognised insurance contract revenue for the service it has provided but for which payment would not be received. For insurance contracts, this situation should be rare because most often the premiums are paid before the coverage is provided – either the amount for the whole coverage is paid at inception of the contract or the annual premiums paid in early years are designed to cover higher risk in the future years. The staff therefore believes that concerns about the possibility of negative insurance contract revenue are unfounded.

Staff recommendation to Question 1: Should entities be prohibited from including in the statement of comprehensive income premium amounts that are not consistent with general notions of revenue?

60. The staff believe that entities should be prohibited from presenting premium information in the statement of comprehensive income that is not consistent with that presented for other types of contracts with customers because:

    (a) Non-equivalent amounts provide misleading information for users of financial statements who are not specialists and who use such information for comparisons between companies. In addition, some might use such information for comparisons even understanding the difference, in the absence of comparable information.

    (b) A more understandable format of financial statements might make insurance companies more transparent and accessible for non-specialist users. In contrast, special line items with special meanings in the statement of comprehensive income would perpetuate the inaccessibility of the financial statements of entities that issue insurance contracts for many non-specialist users of financial statements.

    (c) Consistency between information for insurance and non-insurance contracts and between different types of insurance contracts would allow more meaningful comparisons.

61. Consequently, the staff recommend that the IASB should prohibit an entity from presenting premium information in the statement of comprehensive income that is not consistent with commonly understood notions of revenue.

Question 1: Should entities be prohibited from including in the statement of comprehensive income premium amounts that are not consistent with commonly understood notions of revenue?
Does the IASB agree that an entity should be prohibited from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue?

Staff recommendation to Question 2: Is the cost of providing insurance contract revenue justified for all insurance contracts

62. As noted in the recommendation to Question 1, the staff believe that only revenue consistent across all contracts should be presented by insurance companies in the statement of comprehensive income. However, some question whether presenting revenue for all insurance contracts would meet cost-benefit criteria, especially for contracts for which the requirement to separate an investment component would be costly, as described in paragraph 49.

63. As described in paragraph 51, the staff believe that the change in systems required to identify the investment component as proposed in the 2013 ED is not significantly different to other changes that the implementation of the new Standard as a whole would impose on existing financial systems. As a consequence, the staff believe that the IASB should confirm the 2013 ED proposal to present insurance contract revenue (as proposed in paragraphs B88-B91 of the 2013 ED) for all insurance contracts. However, if the IASB does not agree with the staff's assessment that the benefits of requiring the presentation of insurance contract revenue for all insurance contracts outweigh the costs, in particular the costs of excluding the investment component, then the IASB might consider an alternative approach to reduce those costs.

Alternative approaches that the IASB might consider to reduce the costs of requiring insurance contract revenue for all contracts

64. The staff plans to discuss the alternatives below only if the IASB does not agree with the staff's assessment in paragraph 63 that the benefit of presenting insurance contract revenue for all insurance contracts outweighs the costs, in particular the costs of excluding investment component. The alternatives below suggest approaches that IASB could consider to reduce the cost of excluding investment component for those contracts for which it is most complex. In addition, the staff considered the effect of those alternatives on the understandability of the financial statements overall. The staff note that the analysis below is intended to indicate a high-level assessment of the overall advantages or disadvantages of the alternatives to the staff recommendation in Question 2. If the IASB do not agree with the staff's

recommendation in Question 2, the staff would bring further analysis to a future meeting.

65. The staff considered the following alternatives:

(a) Alternative 1 would require entities to present insurance contract revenue but provide relief for specific portfolios when the costs of excluding the investment component would outweigh the benefits:

(i) Alternative 1a: would allow an entity that could not separate the investment component from the total amount of claims to treat all such claims as an investment component on a portfolio basis. As a consequence of this approach, the entity would present lower insurance contract revenue than using the general proposal.

(ii) Alternative 1b: would allow entities a practical expedient to use the summarised margin approach for portfolios where the investment component is too difficult to separate.

(b) Alternative 2 would require a presentation approach dependent on the measurement approach as proposed in 2010 ED, ie it would require entities to present insurance contract revenue only for contracts accounted for using the simplified measurement approach.

(c) Alternative 3 would allow for an accounting policy choice to present insurance contract revenue or a summarised margin approach on either entity level or at the portfolio level.

(d) Alternative 4 would require the summarised margin presentation for all contracts. As a consequence, alternative 4 would prevent an entity from presenting insurance contract revenue even if the entity is able to calculate insurance contract revenue and has currently been doing so under previous accounting practices.

66. The staff note that each of these alternatives could reduce the costs of excluding investment components from insurance contract revenue in some circumstances. However each alternative has disadvantages in terms of comparability because they would require an entity to combine different presentation approaches for different types of contracts, as follows:

(a) Some alternatives could be viewed as creating a free choice over whether insurance contract revenue is presented. This would decrease comparability between the accounting for different types of insurance contracts. This criticism would apply to Alternatives 1a, 1b and 3 to different degrees. To avoid 'cherry picking' the staff would need to develop and specify the additional criteria for those approaches that would restrict the free choice. On the other hand, the staff believes that this issue is mitigated in Alternative 1a, because entities that are able to exclude investment components from insurance contract revenue would have an incentive to do so, while at the same time entities that are unable to determine the investment component would be able to apply a simplified approach.

(b) Most alternatives do not address the issues about the different presentation approaches that would need to be combined in the financial statements of an entity. This would provide limited comparability between contracts or entities and therefore decrease transparency of financial reporting. It would also result in financial statements that are difficult to read because they include different presentation approaches for group reporting and for the single entity. This criticism would apply to alternatives 1b, 2 and 3.

(c) Alternative 2 would mean that entities could choose a different presentation approach by choosing to apply the simplified measurement model rather than the general measurement model. This is a consequence of the IASB's view that the simplified measurement model is a proxy for the general measurement model. Alternative 2 would not improve comparability between similar contracts in different companies.

(d) Alternative 4 would not provide volume information on the face of the financial statements. Providing volume information in the statement of comprehensive income was a main consideration in the response to the 2010 ED. Although volume information could be disclosed in the notes, it would be burdensome to require entities to determine comparable revenue information (as proposed by the 2013 ED) only for disclosure. As a consequence, entities would most likely disclose only currently used

information. That information is not comparable and could mislead non-specialist users.

Staff recommendation

67. The staff believe that, among the alternative approaches considered, Approach 1a seems to best solve the complexity problem, with the fewest disadvantages. Nonetheless, as noted in paragraph 62, the staff believe that the cost of excluding investment component is justified for all contracts because it would increase comparability. Accordingly the staff recommend that all entities should be required to present insurance contract revenue in the statement of comprehensive income.

Question 2: Is the cost of providing insurance contract revenue justified for all insurance contracts?
Does the IASB agree that entities should be *required* to present insurance contract revenue in the statement of comprehensive income as proposed in paragraphs 56-59 and B88-B91 of the 2013 ED?

Staff recommendation to Question 3: Should we retain the disclosures proposed in the 2013 ED related to volume information?

68. For contracts measured using the general model, the 2013 ED proposed disclosures[10] that:

(a) provide explanations of the insurance contract revenue recognised in the period (by a reconciliation with cash inflows for the period and by explaining the drivers for insurance contract revenue recognised for the period). Those disclosures were proposed as an education tool to explain the recognition pattern for insurance contract revenue and the difference between the existing measures and the new measure (please refer to paragraph 25).

(b) provide volume information often used in analysis such as volume sold in the period, including expected premiums, related increase in obligation and expected profit. This disclosure was proposed as a response to

[10] Please refer to Appendix B for the extract of relevant paragraphs from the 2013 ED.

different users' needs regarding volume information (please refer to paragraph 33).

(c) provide reconciliation of the insurance contract balances to show the changes in margins that are recognised in statement of comprehensive income (please refer to paragraph 43).

69. Some believe that disclosure of the reconciliation between insurance contract revenue and existing volume measures would help users of financial statements to understand the difference between those measures. However, others argue that this disclosure is not useful and would not add much value but instead would add to the disclosure burden.

70. Similarly, some were concerned that reconciliations explaining insurance contract revenue recognised for the period are not necessary and would increase the disclosure burden.

71. However, the staff believe, as noted in paragraphs 25-26, that both reconciliations would ease the transition process and increase understanding of insurance contract revenue amongst those that are concerned about the meaning of this information. They would also provide the information that many users of financial statements have told us is important for their analysis of entities that issue insurance contracts as discussed in paragraphs 33-44.

Question 3: Should we retain the disclosures proposed in the 2013 ED related to volume information?

If the IASB agrees in Question 2 that revenue should be presented for insurance contracts, does the IASB confirm its proposals in the 2013 ED disclosures that entities should disclose:

(a) a reconciliation that separately reconciles the opening and closing balance of the components of the insurance contract asset or liability (paragraph 76 of the 2013 ED)?

(b) a reconciliation from the premiums received in the period to the insurance contract revenue in the period (paragraph 79 of the 2013 ED);

(c) the inputs used when determining the insurance contract revenue that is recognised in the period (paragraph 81(a) of the 2013 ED); and

(d) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position (para 81(b) of the 2013 ED)?

Appendix A: Relevant tentative decisions since 2013 ED

A1. The IASB tentatively decided:

(a) to confirm the proposals in the 2013 ED that after inception:

(i) differences between the current and previous estimates of the present value of cash flows related to future coverage and other future services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(ii) differences between the current and previous estimates of the present value of cash flows that do not relate to future coverage and other future services should be recognised immediately in profit or loss.

(b) that favourable changes in estimates that arise after losses were previously recognised in profit or loss should be recognised in profit or loss to the extent that they reverse losses that relate to coverage and other services in the future.

(c) that differences between the current and previous estimates of the risk adjustment that relate to future coverage and other services should be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative. Consequently, changes in the risk adjustment that relate to the coverage and other services provided in the current and past periods should be recognised immediately in profit or loss.

Appendix B: Relevant paragraphs from the 2013 ED

Statement of profit or loss and other comprehensive income

Revenue and expenses

56 **An entity shall present revenue relating to the insurance contracts it issues in the statement of profit or loss and other comprehensive income. Insurance contract revenue shall depict the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. Paragraphs B88–B91 specify how an entity measures insurance contract revenue.**

57 **An entity shall present incurred claims and other expenses relating to an insurance contract it issues in the statement of profit or loss and other comprehensive income.**

58 **Insurance contract revenue and incurred claims presented in the statement of profit or loss and other comprehensive income shall exclude any investment components that, in accordance with paragraph 10(b), have not been separated.**

59 An entity shall present the expense of purchasing reinsurance contracts held, excluding any investment components, in profit or loss as the entity receives reinsurance coverage and other services over the coverage period

Presentation of insurance contract revenue and expenses (paragraphs 56–59)

B88 Paragraph 56 states that insurance contract revenue depicts the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The liability for the remaining coverage at the end of the reporting period represents the remaining obligation to provide services in the future. Consequently, the change in the liability for the remaining coverage during the reporting period represents the coverage or other services that the entity provided in that period, assuming no other changes occur. As a result, the entity measures the amount of insurance contract revenue that is presented in each reporting period at the difference between the opening and closing carrying amounts of the liability for the remaining coverage, excluding changes that do not relate to coverage or other services for which the entity expects to receive consideration. Those changes would include, for example, changes resulting from any cash flows in the period and any amounts that are recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d).

B89 The premium paid by the policyholder includes, in addition to the amount relating to providing coverage and other services:

(a) amounts the entity charged to recover directly attributable acquisition costs. For the purpose of measuring insurance contract revenue, an entity shall allocate the directly attributable acquisition costs over the coverage period in the systematic way that best reflects the transfer of services provided under the contract. However, paragraph 39(a) permits an entity to recognise those costs as an expense when incurred in some circumstances.

(b) amounts that relate to investment components. In accordance with paragraph 58, an entity shall exclude from insurance contract revenue any investment components that have not been separated in accordance with paragraph 10(b).

B90 Accordingly, insurance contract revenue can also be expressed as the sum of:

(a) the latest estimates of the expected claims and expenses relating to coverage for the current period excluding those recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d). That amount relates to the latest estimates of the expected claims and expenses before the claim is incurred and excludes any repayments of investment components that are included in the latest estimates of the expected claims.

(b) the change in the risk adjustment.

(c) the amount of the contractual service margin recognised in profit or loss in the period.

(d) an allocation of the portion of the premium that relates to recovering directly attributable acquisition costs. The entity allocates the part of the premium relating to the recovery of those costs to each accounting period in the systematic way that best reflects the transfer of services provided under that contract.

B91 When an entity applies the premium-allocation approach in paragraphs 38–40 or 42(a), the entity measures the liability for the remaining coverage using the premium-allocation approach specified in paragraph 38, rather than using the fulfilment cash flows and contractual service margin. When an entity applies the premium-allocation approach, insurance contract revenue for the period is determined as the amount of the expected premium receipts allocated in the period. The entity shall allocate the expected premium receipts as insurance contract revenue to each accounting period in the systematic way that best reflects the transfer of services that are provided under the contract.

Disclosure

69 The objective of the disclosure requirements is to enable users of financial statements to understand the nature, amount, timing and uncertainty of future cash flows that arise from contracts within the scope of this [draft] Standard. To achieve that objective, an entity shall disclose qualitative and quantitative information about:

(a) the amounts recognised in its financial statements that arise from insurance contracts (see paragraphs 73–82);

(b) the significant judgements, and changes in those judgements, made when applying the [draft] Standard (see paragraphs 83–85); and

(c) the nature and extent of the risks that arise from contracts within the scope of this [draft] Standard (see paragraphs 86–95).

(…)

76 Subject to paragraph 77, an entity shall disclose a reconciliation that separately reconciles the opening and closing balances of:

(a) the expected present value of the future cash flows;

(b) the risk adjustment; and

(c) the contractual service margin.

77 An entity need not provide the reconciliation in paragraph 76 to the extent that the entity:

(a) applies the measurement exception in paragraphs 33–34 for contracts that require the entity to hold underlying items and specify a link to returns on those underlying items; or

(b) simplifies the measurement of insurance contracts or reinsurance contracts in accordance with paragraphs 38–40 or 42(a).

(…)

79 An entity shall disclose a reconciliation from the premiums received in the period to the insurance contract revenue recognised in the period.

(…)

81 For contracts to which paragraphs 38–40 or 42(a) are not applied, the entity shall disclose:

(a) the following inputs that are used when determining the insurance contract revenue that is recognised in the period:

(i) the expected cash outflows for the period, excluding investment components;

(ii) the acquisition costs that are allocated to the period;

(iii) the change in risk adjustment in the period; and

(iv) the amount of the contractual service margin recognised in the period.

(b) the effect of the insurance contracts that are initially recognised in the period on the amounts that are recognised in the statement of financial position. That disclosure shall separately show the effect of those contracts on:

(i) the expected present value of future cash outflows, showing separately the amount of the acquisition costs;

(ii) the expected present value of future cash inflows;

(iii) the risk adjustment; and

(iv) the contractual service margin.

Appendix C: Relevant paragraphs from the Basis for Conclusions

The need for insurance contract revenue

BC73 The 2010 Exposure Draft proposed a 'summarised-margin presentation' in the statement of profit or loss and other comprehensive income for most insurance contracts with a coverage period of more than one year. The summarised-margin presentation applies deposit accounting to the whole of an insurance contract. In other words, the summarised-margin presentation views all cash inflows associated with an insurance contract as deposits received from a community of policyholders and all the cash outflows as repayments to the community of policyholders. Neither the deposits nor the repayments would have been presented in the statement of profit or loss and other comprehensive income. Instead, the summarised-margin presentation would have presented separately the main sources of profit or loss arising from the change in the insurance contract. For contracts that are eligible for the premium-allocation approach, the 2010 Exposure Draft would have required entities to present insurance contract revenue and expense.

BC74 Many respondents to the 2010 Exposure Draft were concerned that the summarised-margin presentation would omit information about the premiums, claims and expenses from the statement of profit or loss and other comprehensive income for the period. That information would be provided only in the notes to the financial statements. Some stated that information about premiums, claims and expenses for the period was necessary to provide information about the gross performance of the entity (in contrast to information about net performance provided by the summarised-margin approach).

BC75 The IASB was persuaded that the financial statements of entities that issue insurance contracts would be more understandable and more comparable to other entities if the statements of comprehensive income were to provide information about gross performance. A consistent measure of gross performance would also increase comparability between entities that issue insurance contracts. Furthermore, many users of financial statements use measures of revenue to provide information about gross performance. Accordingly, the IASB proposes an approach that aims to provide a revenue measure for insurance contracts. This Exposure Draft refers to that measure as 'insurance contract revenue'.

BC76 The IASB proposes that the measurement of insurance contract revenue should be broadly consistent with the general principles in the 2011 Exposure Draft *Revenue from Contracts with Customers*. Consistently with that model, an entity would depict the transfer of promised coverage and other services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the coverage and other services. This means that the entity would:

(a) exclude from insurance contract revenue any investment components; and

(b) recognise insurance contract revenue in each period as it satisfies the performance obligations arising from the insurance contract.

BC77 The 2010 Exposure Draft noted the inherent challenges for some insurance contracts in identifying and measuring the progress in satisfying the performance obligations during the period. Some suggested that time-based methods for measuring progress, such as those typically used for other contracts, would faithfully depict the entity's progress in satisfying the obligations to provide coverage and other services. However, the IASB concluded that time-based methods would not reflect the fact that the value of the coverage and other services provided in each period may differ. The IASB noted that the liability for the remaining coverage represents the obligation to provide the remaining coverage and other services needed to fulfil the contract. As a result, the IASB concluded that recognising insurance contract revenue to the extent of a reduction in the liability for the remaining coverage, adjusted to eliminate changes that do not relate to the satisfaction of the performance obligation, would depict faithfully the entity's performance in providing coverage and other services. The adjustments to the liability for the remaining coverage exclude from total insurance contract revenue the part of the change in the liability for the remaining coverage that arises from losses on initial recognition or from changes in estimates of expected claims, to the extent that those changes are recognised in profit or loss. They ensure that the total insurance contract revenue presented over the duration of the contract is the same as the premiums received for services, adjusted for the time value of money.

BC78 The IASB considered whether each period's coverage should be treated as a separate performance obligation or whether the coverage for the entire contract should be regarded as a single performance obligation that would be satisfied over time. The conclusion would affect whether the amount of insurance contract revenue recognised in each period would be determined on the basis of initial estimates of the pattern of expected cash flows (see paragraph BC92), or based on the most recent estimates in each period. Applying the principle from the 2011 Exposure Draft *Revenue from Contracts with Customers*, the IASB concluded that the obligation to provide coverage in any particular part of the entire coverage period

would generally not be a separate performance obligation, and the coverage and services provided over the whole duration of the contract would generally be treated as a single performance obligation that is satisfied over time. When that is the case, a change in the pattern of expected cash flows would result in the entity updating its measure of progress and adjusting the amount of revenue recognised accordingly. That approach would also be consistent with the IASB's proposal to adjust the contractual service margin for changes in estimates of cash flows.

BC79 In the IASB's view, the proposals in this Exposure Draft are consistent with the core principle of the 2011 Exposure Draft *Revenue from Contracts with Customers*. In both Exposure Drafts, the statement of financial position reports the contract asset or contract liability, and the statement of profit or loss and other comprehensive income reports the progress towards satisfaction of the performance obligations in the contract:

(a) the 2011 Exposure Draft *Revenue from Contracts with Customers* establishes the amount of revenue that has been recognised each period and adjusts the contract asset or contract liability at the start of the period by the amount of revenue recognised to measure the contract asset or contract liability at the end of the period; and

(b) this Exposure Draft proposes a measurement model that would establish the contract position at the start and end of the reporting period. The amount of insurance contract revenue presented is measured by reference to these two measurements.

Disclosures relating to insurance contract revenue (paragraphs 73–82)

Reconciliation of components of the insurance contract liability (paragraph 74)

BC80 To determine insurance contract revenue on a basis that is consistent with the general measurement model proposed in this Exposure Draft and with the simplified approach in paragraphs 35–40, paragraph B88 requires an entity to disaggregate the insurance contract liability into components as follows:

(a) the liabilities for the remaining coverage, excluding the amounts in (b) below. For liabilities measured using the premium-allocation approach, this will be the unearned premium.

(b) the part of the liabilities for the remaining coverage recognised in profit or loss. This comprises amounts arising from losses on initial recognition and subsequent changes in estimates recognised immediately in profit or loss because they exceeded the amount of the contractual service margin. For liabilities measured using the premium-allocation approach, this will be the additional liability for onerous contracts.

(c) the liabilities for incurred claims.

BC81 The IASB proposes in paragraph 74 that entities should disclose a reconciliation from the opening to the closing balance of each of the components listed in paragraph BC80 in order to explain the amounts presented in the financial statements.

BC82 In addition, paragraph 76 would require an entity to disclose a reconciliation that shows the sources of profit for the period and separately reconciles the opening and closing balances of:

(a) the expected present value of the future cash flows;

(b) the risk adjustment; and

(c) the contractual service margin.

BC83 In response to the 2010 Exposure Draft, many respondents commented that reconciliations that show sources of profit would provide useful insight into an entity's insurance contracts because they would be directly related to the measurement model.

BC84 The IASB agrees. Furthermore, in the IASB's view, information about the change in the period of the components of the liability used in measurement is important in the light of:

(a) the decision to offset in the contractual service margin the effects of changes in estimates of future cash flows (see paragraphs BC26–BC41). As a result, those effects will not appear directly in the statement of profit or loss and other comprehensive income. Consequently, there is a greater need to understand how changes in estimates of cash flows affect the contractual service margin.

(b) the difference between the IASB's and the FASB's models for insurance contracts. Information about the change in the components of the liability provides reconciliations of the movements in

the expected cash flows separately from the movements in the risk adjustment. This information would enable users of financial statements to compare the movements in the fulfilment cash flows of entities who apply the IASB's model to the movements in the fulfilment cash flows of entities applying the FASB's proposed model. Under the FASB model, the measurement of the insurance contract liability does not include an explicit adjustment for risk.

BC85 The proposals to require reconciliations derived from the information that is generated by the measurement model, in addition to the reconciliation of the components of the insurance contract used to determine insurance contract revenue, would mean that entities would need to disclose two types of reconciliations from opening to closing carrying amounts in the statement of financial position. The information to provide both reconciliations would be needed in order for the entity to comply with the measurement and presentation requirements, and respondents to the 2010 Exposure Draft generally indicated that both would be useful. Consequently, the IASB concludes that the benefits of providing such information outweigh the costs of preparing two reconciliations.

The effect of new contracts issued in the period (paragraph 81(b))

BC86 Many believe that it would be useful for entities to disclose more than one measure of gross performance relating to insurance contracts. A measure of insurance contract revenue by itself does not provide all the information that users of financial statements seek, and may provide a misleading view of whether an entity's insurance contracts business is growing or shrinking. In particular, many users of financial statements find information about the amount of new business written in each period to be important when assessing the future prospects of an entity.

BC87 Some were concerned about the impression that would be given if the amount of insurance contract revenue were to increase while the amount of new contracts written decreased. They believe that, for contracts other than insurance contracts, the revenue would generally be recognised in a pattern that is more consistent with the pattern of cash received, because entities generally do not charge for services in advance. Thus they were concerned that users of financial statements would misinterpret insurance contract revenue if that amount is not consistent with the pattern of cash received. However, this effect occurs generally in accruals-based accounting for any contract that specifies payment in advance of services provided.

BC88 The IASB agrees that information about different measures of gross performance would provide useful information for users of financial statements, even though those measures might not be presented in the statement of profit or loss and other comprehensive income. Accordingly, the IASB proposes to require entities to disclose the premiums written during the period, disaggregated into the effect of those contracts on the fulfilment cash flows and on the contractual service margin. The premiums written is the amount of all expected premiums, including investment components, relating to contracts written in the period. Such disclosure would:

(a) provide useful information about the volume of sales that would supplement the insurance contract revenue presented in the statement of profit or loss and other comprehensive income; and

(b) allow users of financial statements to compare the volume of business written in prior years with the volume of contracts written in the current year.

BC89 In addition, the IASB proposes that entities should reconcile the insurance contract revenue to the premium receipts each period. The amount of the premium receipts would already be available to entities because they are required to reconcile contract balances. The IASB believes that there would generally be immaterial differences between the amount of the premium receipts and the premium due, which is the amount of the invoiced or receivable premium that is unconditionally due to the entity. The premium due is a familiar measure used in some jurisdictions. Paragraphs BC105–BC107 explain why the IASB does not propose to use premiums due as the measure of insurance contract revenue.

Consequences

Excluding investment components from insurance contract revenue and incurred claims (paragraph 58)

BC90 One consequence of presenting any measure of gross performance on the statement of profit or loss and other comprehensive income is the need to consider whether to eliminate any investment components from that measure. An investment component is an amount that the insurance contract requires the entity

to repay to the policyholder even if an insured event does not occur. Such obligations, if not included within an insurance contract, would be measured and presented in accordance with IFRS 9. The IASB believes that when an investment component is interrelated with the insurance components in an insurance contract, it is appropriate to measure the investment component and the insurance component in accordance with the proposals in this Exposure Draft. However, the IASB believes that it would not faithfully represent the similarities between financial instruments within the scope of IFRS 9 and investment components embedded in insurance contracts within the scope of this Exposure Draft if an entity were to present the receipts and repayments of such investment components as insurance contract revenue and incurred claims. To do so would be equivalent to a bank recognising a deposit as revenue. Accordingly, the IASB's proposals would exclude such investment components from insurance contract revenue and incurred claims.

BC91 Some are concerned that it would be too complex to separate interrelated cash flows and exclude some of them from insurance contract revenue and incurred expenses. The IASB considered whether complexity would be reduced if it chose a different approach to determining which cash flows should be excluded from insurance contract revenue and incurred expenses, such as by defining the investment component as the amount that the contract requires to be repaid when no insured event occurs. Using that definition, an entity would need to identify cash flows relating to an investment component only if it made a payment in the absence of an insured event. For example, if the entity pays the higher of an account balance and a fixed amount in the event of a policyholder's death, the whole of the payment that results from the policyholder's death would be regarded as relating to the insurance component rather than to the investment component. However, the IASB believes that defining an investment component in this way does not faithfully portray that the amount accumulated in the account balance through deposits by the policyholder is paid to the policyholder in all circumstances, including in the event of the policyholder's death. In the IASB's view, the insurance benefit is the additional amount that the entity would be required to pay if an insured event occurs, in other words, the difference between the account balance and the fixed amount both before and after the time of the insured event.

Insurance contract revenue recognised on the basis of expected claims and benefits

BC92 The IASB proposes that an entity should measure the satisfaction of its obligations in each period using the change in the measurement of the liability for the remaining coverage during each period. A consequence of this decision is that insurance contract revenue would be recognised partly on the basis of the expected cash outflows, which include the expected claims and benefits. Some expressed a view that the service provided by an insurance contract was inadequately represented by the change in the measurement of an entity's obligation to pay a claim when the insured event occurs. However, the amount reported as the liability for the remaining coverage represents the value of the obligation to provide coverage and other services. As a result, the IASB concluded that the reduction in the liability for the remaining coverage is a reasonable representation of the value of the performance obligation to provide coverage and services that was satisfied in the period.

Acquisition costs (paragraphs B89(a) and B90(d))

BC93 In many cases, the cash outflows associated with acquisition costs occur at the beginning of the contract coverage period before any coverage or other service has been provided. Because the services provided by a contract would be measured on the basis of expected cash outflows, the approach for determining insurance contract revenue might result in the entity recognising insurance contract revenue when those costs are incurred, often before the entity has provided any coverage or services under the contract.

BC94 The IASB noted that this outcome was consistent with the proposals in the 2010 Exposure Draft, which proposed that an entity would recognise acquisition costs as expenses when incurred and, at the same time, recognise the amount of premium equal to those costs. That proposal was consistent with the view that the premium that the policyholder pays for the contract has a component relating to the coverage that the entity provides and a component relating to the acquisition costs that the entity recovers. Furthermore, recognising acquisition costs as expenses and recognising the related amounts of premium when incurred would ensure that the measurement of identical insurance contract liabilities would be identical, regardless of the amount of expense incurred to acquire those liabilities.

BC95 However, because the proposals in the 2010 Exposure Draft proposed a net presentation of the margin from insurance contracts rather than a presentation of revenue and expenses, the issue that an entity would recognise insurance contract revenue before any services were provided did not arise. The 2011 Exposure Draft *Revenue from Contracts with Customers* proposed to prohibit the recognition of revenue before an

entity has satisfied any performance obligations. To be consistent with those proposals, and to avoid recognising insurance contract revenue before any coverage has been provided, this Exposure Draft proposes that entities should, for presentation purposes, present the insurance contract revenue and expenses associated with such costs over the coverage period in line with the pattern of services provided under the contract, rather than when the costs are incurred. Because this allocation approach applies only to the premium charged to cover such costs, and affects only the amount of insurance contract revenue and expenses that is grossed up from the margin, there is no recognition of an asset representing the acquisition of the insurance contract. In addition, no separate impairment test is needed to test the recoverability of such an asset (see paragraphs BCA45–BCA57 for a discussion of the treatment of cash flows relating to acquisition costs).

Recognition of incurred claims (paragraph 57)

BC96 The IASB believes that reporting claims and expenses when they are actually incurred is consistent with the reporting of expenses for other types of contracts and would provide useful information to users of financial statements. This would only be the case when insurance contract revenue is measured using the liability for the remaining coverage as a measure of progress towards satisfying an obligation.

BC97 When insurance contract revenue is measured in any other way, the incurred claims must be reconciled to the amount of expense that is presented in the period. This is because both insurance contract revenue and incurred claims and benefits are measures of changes in the insurance contract liability relating to coverage in the period. Thus, measuring insurance contract revenue as proposed in this Exposure Draft would mean that the uncertainty that is inherent in the measurement of insurance contracts, discussed in paragraph BC4, is reflected in the timing of insurance contract revenue, rather than in the amount of expense presented in the period. In contrast, measuring insurance contract revenue in any other way would mean that the uncertainty that is inherent in the measurement of insurance contracts would be reflected in the amount of expense presented in the period. Furthermore, any other measure of insurance contract revenue would include changes in the insurance contract liability relating to coverage in both the current and the future periods.

Premium-allocation approach

BC98 The proposed method of measuring insurance contract revenue should be measured on a basis that would be consistent with the proposals in the 2011 Exposure Draft *Revenue from Contracts with Customers* and that would allocate the premiums paid for services in a way that reflects the transfer of services provided under the contract. The simpler premium-allocation approach, also allocates customer consideration in a way that reflects the transfer of services provided under the contract. As a result, the insurance contract revenue presented for contracts accounted for using the main proposals in this Exposure Draft could be meaningfully combined with the insurance contract revenue for contracts accounted for using the premium-allocation approach. This is consistent with the IASB's view that the premium-allocation approach is a simplification to the general requirements of the proposed Standard. It is also consistent with the proposal to permit, rather than to require, the use of the premium-allocation approach for eligible contracts (see paragraphs BCA116–BCA124).

Complexity

BC99 In the IASB's view, the main disadvantage of requiring entities to present insurance contract revenue is likely to be the costs. In particular, when contracts are onerous, the measurement of insurance contract revenue requires entities to disaggregate the most recent estimates of expected cash flows, separating the original estimates from any later changes recognised in profit or loss. It also requires entities to track the unwinding of any losses on initial recognition of insurance contracts—these losses unwind as the claims are incurred. This requirement to track developments on onerous contracts separately could significantly increase the costs of applying the proposed Standard. That would not be required by the other approaches discussed in paragraphs BC101–BC116, which the IASB rejected for reasons noted there. The IASB notes that entities do not generally issue contracts that have losses on initial recognition, so the practical impact of this requirement is not expected to be widespread.

BC100 In addition, as described in paragraphs BC90–BC91, entities must identify investment components and exclude them from insurance contract revenue and from incurred claims presented in the statement of profit or loss and other comprehensive income. Some are concerned about the operational challenges of doing this. However, the IASB believes that these potential costs are outweighed by the following benefits of these proposals:

(a) many users of financial statements believe that reporting investment components as revenue would overstate revenue and could distort performance measures such as combined ratios. Accordingly, the IASB believes that there are significant benefits in distinguishing revenue from investment components (see paragraphs BCA204–BCA206).

(b) measuring insurance contract revenue at an amount that depicts the consideration transferred in exchange for providing coverage and other services in the period would increase consistency between the measurement and presentation of insurance contract revenue and the revenue from other types of contracts with customers within the scope of the 2011 Exposure Draft *Revenue from Contracts with Customers*. This would reduce the complexity of financial statements overall.

Other approaches considered but rejected

BC101 Many of the comment letters on the 2010 Exposure Draft criticised the summarised-margin approach proposed in that document because it did not provide a gross measure of performance in profit or loss.

BC102 Because the comments received generally supported the method for measurement of the net profit for the period, the IASB focused on how best to gross up the measurement to show a gross performance measure (insurance contract revenue) and information about the related cost (claims and benefits). This means that, regardless of the gross performance measure considered, the net profit for the period would be measured using the measurement model as proposed in this Exposure Draft. In other words, the amount of claims and expenses presented in each period would be allocated to the revenue to ensure that the same net profit or loss for the period is reported.

Premium approaches

BC103 The IASB considered two approaches for presentation that are used in current practice:

(a) a written-premium presentation, which allocates the total expected insurance contract revenue to the period in which the contracts are initially recognised (written). At the same time, an expense is presented for the total expected claims and expenses relating to those contracts.

(b) a premiums-due presentation, which allocates the total expected insurance contract revenue to the periods in which the premiums become unconditionally due to the entity. At the same time, the entity recognises an allocation of the total expected expense on the basis of the amount of the premium recognised compared with the expected total revenue.

BC104 Some note that a written-premium presentation provides information about new business during the period, including the expected present value of the amounts to be received and the obligations assumed. However, the IASB rejected this approach because the premiums, claims and expenses presented in the statement of profit or loss and other comprehensive income are not measured by applying commonly understood notions of revenue and expenses. In particular, the revenue is recognised before the entity has performed a service and the claims and expenses are recognised before they have been incurred.

BC105 Many entities that issue long-duration insurance contracts currently apply a premiums-due presentation in the statement of profit or loss and other comprehensive income. Some argue that a premiums-due approach is useful because:

(a) the purpose of a gross performance measure is to measure growth and provide a denominator for claims and expenses ratios. A measure based on premiums due is objective, sufficient for that purpose and is simpler to provide than insurance contract revenue.

(b) it provides information about the additional premiums for insurance coverage and other services to which the entity has an unconditional right.

BC106 However, the IASB rejected this approach because:

(a) the gross performance measure presented using a premiums-due approach is not consistent with commonly understood concepts of revenue. As a result, it is likely to mislead non-specialist users of financial statements.

(b) although the premiums-due presentation would be an objective gross performance measure, insurance contracts give rise to inherently uncertain amounts. In a premiums-due presentation, the uncertainty would be reflected in the claims and benefits presented. The IASB believes that reporting claims and expenses when incurred would provide useful information to users of financial statements, as discussed in paragraph BC96.

(c) when an entity uses the premiums-due presentation and also presents claims and benefits on an incurred basis, it must reconcile those amounts to remove the effects of changes in the insurance contract liability relating to coverage in a future period from the premiums due.

(d) a revenue measure generally does not provide information about unconditional rights to payments. Instead, the revenue measure provides information on when the entity provides goods or services to customers. In a premiums-due approach:

(i) the revenue would typically be recognised before the entity has performed the corresponding service, with corresponding claims and expenses being recognised before they have been incurred; and

(ii) the amounts presented as insurance contract revenue and claims, benefits and expenses vary depending on when a contract requires payment of the premium. For example, if a premium is due at the start of the contract, then all revenue and expenses are presented in the period that the contract is issued. If the premium is instead due annually, the revenue and expenses are presented at that point in each year. Thus, revenue and expenses may not indicate when the entity performs the service.

BC107 Although the IASB notes that some of the information provided by a premiums-due approach may be useful, it concluded that, if a gross performance measure is to be presented in profit or loss, it must be measured in a way that is consistent with commonly understood notions of revenue and expense. However, because the IASB concluded that other measures of gross performance could be useful, it proposes to require supplementary disclosure of other measures of gross performance (see paragraphs BC86–BC89).

Presenting insurance contract revenue for some contract types

BC108 The 2010 Exposure Draft proposed that an entity would be prohibited from presenting in the statement of profit or loss and other comprehensive income revenue and claims and other related expenses, except for contracts that were measured using the premium-allocation approach, for the following reasons:

(a) the premium-allocation approach is an allocated customer consideration approach similar to that proposed in the 2011 Exposure Draft *Revenue from Contracts with Customers*. When an entity applies the premium-allocation approach, the amount and timing of insurance contract revenue would be straightforward to measure, consistent with the recognition and measurement requirements of other types of revenue transactions and familiar to many users of financial statements.

(b) when considering contracts that are not eligible for the premium-allocation approach, insurance contract revenue is an unfamiliar concept, which has not been previously used by users of financial statements. Measuring insurance contract revenue could significantly increase operational costs because the information required to do so is not needed to apply the other proposals in the Exposure Draft.

BC109 However, requiring insurance contract revenue for some contracts and not for others may result in a reporting difference that does not faithfully represent the economic differences between similar contracts, when the entity could apply either approach to a qualifying contract. Accordingly, the IASB proposes that entities should present insurance contract revenue for all insurance contracts.

BC110 For similar reasons, the IASB rejected an approach that would permit an option for entities to present insurance contract revenue if they believe that the benefits of doing so do not exceed the costs.

Treating all premiums as deposits (summarised-margin presentation)

BC111 Much of the complexity in the IASB's proposals arises from the need to eliminate investment components from measures of revenue. Investment components may be more significant in some contracts than in others. For example, significant investment components exist in many longer-term life insurance contracts and in some large longer-term, or bespoke, non-life insurance or reinsurance contracts. Some argue that any attempt to distinguish between investment components that have not been separated and the premium charged for insurance and other services would be arbitrary and complex to apply (see paragraphs BC99–BC100).

BC112 In contrast, the summarised-margin presentation that was proposed in the 2010 Exposure Draft treats all payments that arise in an insurance contract as repayments of deposits. This is operationally less complex

than any presentation that provides a gross performance measure in the statement of profit or loss and other comprehensive income. This is because the summarised-margin presentation would not need to draw a line between investment components and premiums for services provided.

BC113 Another advantage of the summarised-margin approach is that it would link clearly to the measurement approach for the insurance liability in the statement of financial position, because it would separately report:

(a) income from the entity's performance under the contract as it is released from risk and as it provides other services;

(b) changes in circumstances that exceed the contractual service margin, together with any differences between estimates at the end of the previous reporting period and actual outcomes; and

(c) the interest expense on insurance liabilities, presented or disclosed in a way that highlights the relationship with changes in discount rates and with the investment return on the assets that back those liabilities.

BC114 Furthermore, the summarised-margin approach would not need an exception for the treatment of acquisition costs (see paragraphs BC93–BC95) to avoid a situation in which an entity recognises insurance contract revenue before the coverage has been provided.

BC115 Some contend that the lack of comparability between existing insurance presentations and revenue amounts reported by companies in other sectors is not a significant disadvantage to users of financial statements of entities that issue insurance contracts. In their view, users of financial statements do not compare the results of entities that issue insurance contracts with those of other entities. Instead, many users of financial statements that specialise in the insurance sector rely on the disaggregated information in the notes to the financial statements and expect to derive little value from the information reported in the statement of profit or loss and other comprehensive income because:

(a) the accounting models for life insurance contracts, unlike those for other transactions, typically measure the profit from insurance contracts directly through the release of the risk adjustment and the release of the contractual service margin. In contrast, the profit from other transactions is measured as the difference between revenue and expense.

(b) some believe that the most meaningful measure of gross performance and growth for insurance contracts is one that measures total premiums, which include both revenue and investment components. Such measures give information about the total increase in assets under management. However, those with this view accept that this measure is inconsistent with revenue and therefore accept that this information should not be presented in the statement of profit or loss and other comprehensive income. It would instead be reported in the notes to the financial statements and elsewhere.

BC116 Nonetheless, the summarised-margin approach would be a significant change from current practice, and was widely criticised in the comment letters on the 2010 Exposure Draft. The information that the IASB obtained in the response to its 2010 Exposure Draft was that, although many respondents thought that information about net margins was useful, they believed that this information was more suitable for the notes. In addition, the IASB noted that:

(a) insurance contracts combine service and investment elements. Entities recognise revenue when they satisfy their obligation to perform services under a contract. The summarised-margin approach would not present any amounts as revenue or expense in the statement of profit or loss and other comprehensive income. As a result, the summarised-margin approach would not faithfully represent the extent to which an entity provides services under an insurance contract.

(b) a summarised-margin approach, or a substitute for revenue that is unique to insurance contracts, reduces the comparability across the financial reporting for insurance contracts and the financial reporting for other contracts; and

(c) many of those who report, use and quote financial measures expect such financial measures to include a measure of gross performance. If the IASB does not require the presentation of an amount that is measured using principles that are applicable to revenue from contracts with customers, preparers and sell-side analysts might substitute other measures for them.