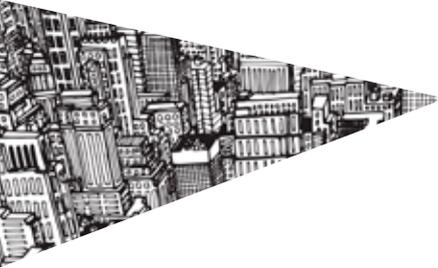


Insurance Accounting Alert

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IASB confirms the use of insurance contracts revenue

What you need to know

- ▶ The Board tentatively decided that an entity should present in its statement of comprehensive income insurance contracts revenue and incurred expenses for all insurance contracts.
- ▶ The Board tentatively decided to re-deliberate only seven 'non-targeted' areas of the 2013 ED.

Overview

During the April 2014 meeting, the International Accounting Standards Board (IASB, or Board) continued re-deliberations on its 2013 Exposure Draft *Insurance Contracts* (ED). The Board discussed the following items.

- ▶ Whether an entity should present insurance contracts revenue and incurred expenses for all insurance contracts
- ▶ Whether there are any topics raised in the comment letters to the 2013 ED, in addition to the five targeted topics, that the IASB should consider during its re-deliberations

Insurance contracts revenue

The inclusion of insurance contracts revenue in the statement of comprehensive income was one of the five targeted topics in the 2013 ED. The model proposed in the ED requires entities to report an insurance contracts revenue figure for all types of contracts, irrespective of whether they are measured under the building block approach or the simplified approach (premium allocation approach) that applies to contracts that meet certain criteria.

The staff reminded the Board that, under the existing accounting, the reported 'top-line' premium figure for non-life is fairly consistent with the proposals in the forthcoming revenue recognition standard but, for (long-term) life contracts, a variety of approaches exists that would not be consistent with the revenue recognition proposals. The staff highlighted that, under existing models for long-term contracts:

- ▶ The reported premiums often reflected the premiums due amount in the period rather than the part of the premium that would be earned during the period for the transfer of services to the policyholder
- ▶ The reported premiums figure generally includes an investment component, which would not be considered as revenue under the revenue recognition proposals



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The insurance contracts revenue figure proposed in the 2013 ED would represent an allocation of the total premium over the coverage period of the contract on the basis of the transfer of services (e.g., the provision of coverage to the policyholder) and would exclude the investment component applied to all types of insurance contracts. The staff noted the goal of introducing this notion of insurance contracts revenue is to achieve consistency with the revenue recognition proposals and to improve comparability between types of insurance contracts and with other industries.

Whether to require presentation of insurance contracts revenue

The comment letters to the 2013 ED agreed with including insurance contracts revenue for contracts accounted for under the premium allocation approach, but responses were mixed on the treatment for contracts accounted for under the building block approach. The staff commented that the respondents who disagreed with the ED proposal did not provide consistent feedback for alternative revenue amounts. Some respondents indicated that the Board should reconsider the summarised margin approach, but the staff continues to believe that entities that issue insurance contracts should present volume information on premiums and claims in their statement of comprehensive income in the same way that all other entities do. The staff concluded that the only viable approach to achieve this in a transparent and consistent manner is to report the volume information on the basis of insurance contracts revenue and incurred expenses.

Some of the board members noted many of the comment letters from preparers raised concerns about the complexity involved in determining insurance contracts revenue. The staff acknowledged there are costs involved in implementing this proposal. However, the staff believes the cost are

outweighed by the additional benefits achieved from increased transparency and comparability. The staff noted this evaluation aligns with the feedback from users that they would benefit from a consistent insurance contracts revenue figure. The staff also believes that entities will have sufficient time to implement the insurance contracts revenue proposal.

Most of the Board members agreed with the staff. In particular, many of the Board members noted that eliminating the investment component from insurance contracts revenue would be consistent with both the revenue recognition proposals and the accounting for financial instruments. One Board member noted that an incurred expense number in the statement of comprehensive income would provide useful information to users and the inclusion of an incurred expense figure would, by definition, require the inclusion of a revenue figure as proposed in the 2013 ED. When put to the vote, 15 Board members agreed and one disagreed with the staff recommendation.

Disclosures supporting insurance contracts revenue

To help users' understand insurance contracts revenue, the staff proposes to confirm the following disclosure included in the 2013 ED:

1. A reconciliation that separately reconciles the opening and closing balance of the components of the insurance contract asset or liability
2. A reconciliation from the premiums received in the period to the insurance contract revenue in the period
3. The inputs used when determining the insurance contract revenue that is recognised in the period
4. 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

The staff concluded that the disclosures will assist the users by providing a link between the existing premium volume measures and insurance contracts revenue and by explaining the drivers of the insurance contracts revenue amount recognised in the reporting period.

Fifteen Board members supported the staff recommendation; one Board member disagreed.

Prohibiting volume information that is not consistent with insurance contracts revenue

The staff believes it necessary to prohibit entities from including other volume information (e.g., premiums due or premiums written) within the statement of comprehensive income that is not consistent with the concepts in the Board's forthcoming standard on revenue recognition. Without such a prohibition, the staff believes entities could introduce, by reference to the provisions of IAS 1 *Presentation of Financial Statements*, additional line items representing volume measures other than insurance contracts revenue. The staff is concerned that users' attention would be drawn to these additional volume numbers and users might conclude that these other volume measures represent a commonly understood notion of revenue.

Thirteen Board members supported the staff recommendation. They agreed that the existing volume measures for long-term contracts generally do not represent commonly understood notions of revenue.

These board members also agreed that including alternative volume measures in the statement of comprehensive income in addition to insurance contracts revenue could be misleading.

How we see it

The Board believes insurance contracts revenue provides users with a useful depiction of performance of insurance contracts that is consistent with the overall concept of what constitutes revenue. The Board concluded that these benefits overrule preparers' concerns that insurance contracts revenue will be too complicated and costly to apply. Now that the Board has confirmed the desire to have an earned premium amount in the statement of comprehensive income, it should anticipate that further practical issues are likely to arise on how to determine the insurance contracts revenue amount, for example, how to disaggregate non-distinct investment components for presentation purposes.

Project plan for non-targeted topics

In the 2013 ED, the Board sought comments on the following five topics (also known as targeted topics):

- ▶ Unlocking of the CSM
- ▶ Participating contracts
- ▶ Insurance contracts revenue
- ▶ Interest expense in profit or loss, including the use of OCI
- ▶ Effective date and transition

The respondents to the 2013 ED did not strictly limit their comments to these five topics and also raised additional issues (i.e., non-targeted topics). The staff evaluated the additional issues and proposed that the Board further analyse only the following seven non-targeted topics during future meetings:

- ▶ Fixed-fee service contracts
- ▶ Significant insurance risk guidance
- ▶ Portfolio definition and unit of account
- ▶ Discount rate for long-term contracts and unobservable market data
- ▶ Asymmetrical treatment of reinsurance contracts
- ▶ Recognition of contracts acquired through the portfolio transfer or business combination
- ▶ Allocation pattern for the contractual service margin

Some Board members raised other non-targeted issues that, in their view, would benefit from further discussion, for example, the application of the confidence level disclosure for the risk adjustment, the presentation of ceding commissions, and the use of an approach that combines the contractual service margin with other comprehensive income. The staff outlined the reasons why re-deliberation on these topics is not necessary, in their view.

With 14 members voting in favour of the staff recommendation, the Board tentatively decided to re-deliberate the list of seven non-targeted proposed by the staff, but not to add any other non-targeted topics to this list. In addition, the Board instructed the staff to prepare the material for the identified seven non-targeted topics such that it would enable focused and efficient re-deliberations.

How we see it

Having tentatively decided to re-deliberate some of the non-targeted issues raised in the comment letters, the Board is acknowledging that there may be topics, in addition to the five targeted topics of the ED, that require some modification or further clarification. At the same time, the Board's decision to keep the list of items limited to those identified by staff highlights its desire to keep re-deliberations as restricted as possible.

What's next?

The Board's next meeting on the insurance contracts project is in May; the topics have not yet been announced. The IASB expects to complete its re-deliberations on its insurance contracts proposals in 2014, with the publication of a final standard in 2015.



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