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Project	Transition Resource Group for IFRS 17 *Insurance Contracts*		
Paper topic	Premium experience adjustments related to current or past service		
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Introduction

1. We have received three submissions about how differences between expected premiums and actual premiums (ie premium experience adjustments) which relate to current or past service should be accounted for. Should those differences:
   (a) adjust the contractual service margin; or
   (b) be recognised in the statement of profit or loss immediately as part of either:
      (i) insurance revenue; or
      (ii) insurance service expenses.
2. The objective of the paper is to provide background and an accounting analysis to support discussion at the Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG).

Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) implementation question; and

   (c) review of accounting requirements.

4. Appendix A to this paper provides examples of accounting for premium experience adjustments related to current or past service.

Background information

Experience adjustments

5. Appendix A of IFRS 17 defines an experience adjustment as:

   > A difference between:
   >
   > (a) for premium receipts (and any related cash flows such as insurance acquisition cash flows and insurance premium taxes)—the estimate at the beginning of the period of the amounts expected in the period and the actual cash flows in the period; or
   >
   > (b) for insurance service expenses (excluding insurance acquisition expenses)—the estimate at the beginning of the period of the amounts expected to be incurred in the period and the actual amounts incurred in the period.

6. Paragraph B96 of IFRS 17 states that, among other changes in the fulfilment cash flows, the following changes relate to future service and therefore adjust the contractual service margin:

   > […] (a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c); […]

7. Paragraph B97 of IFRS 17 states that, among other changes in the fulfilment cash flows, the following changes do not relate to future service and therefore do not adjust the contractual service margin:

> […] (c) experience adjustments, except those described in paragraph B96(a).

8. Paragraph BC233 of the Basis for Conclusions on IFRS 17 explains:

> The Board defined experience adjustments as (a) differences between the premium receipts (and related cash flows) that were expected to happen in the period and the actual cash flows or (b) differences between incurred claims and expenses that were expected to happen in the period and the actual amounts incurred. The Board decided that for the liability for remaining coverage, in general, it was reasonable to assume that experience adjustments relate to current or past service. In contrast, changes in estimates of future cash flows in general can be assumed to relate to future service. The Board noted that experience adjustments relating to premiums received for future coverage relate to future service and are an exception to this general rule.

Insurance revenue

9. Paragraph 83 of IFRS 17 states:

> An entity shall present in profit or loss insurance revenue arising from the groups of insurance contracts issued. Insurance revenue shall depict the provision of coverage and other services arising from the group of insurance contracts at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. Paragraphs B120–B127 specify how an entity measures insurance revenue.

10. Paragraphs B120–B127 of IFRS 17 state:[1]

> B120 The total insurance revenue for a group of insurance contracts is the consideration for the contracts, ie the amount of premiums paid to the entity:
>
> (a) adjusted for a financing effect; and
>
> (b) excluding any investment components.
>
> B121 Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:
>
> (a) amounts related to the provision of services, comprising:
>
> (i) insurance service expenses, excluding any amounts allocated to the loss component of the liability for remaining coverage;
>
> (ii) the risk adjustment for non-financial risk, excluding any amounts allocated to the loss component of the liability for remaining coverage; and
>
> (iii) the contractual service margin.
>
> (b) amounts related to insurance acquisition cash flows.
>
> B122 Insurance revenue for a period relating to the amounts described in paragraph B121(a) is determined as set out in paragraphs B123–B124.
>
> […]

[1] At the June 2018 International Accounting Standards Board (Board) meeting the Board tentatively decided to propose minor amendments to paragraphs 104, B121 and B124 of IFRS 17 to remove requirements that could result in double-counting of the risk adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analyses.

B123 Applying IFRS 15, when an entity provides services, it derecognises the performance obligation for those services and recognises revenue. Consistently, applying IFRS 17, when an entity provides services in a period, it reduces the liability for remaining coverage for the services provided and recognises insurance revenue. The reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes in the liability that do not relate to services expected to be covered by the consideration received by the entity. Those changes are:

(a) changes that do not relate to services provided in the period, for example:

  (i) changes resulting from cash inflows from premiums received;

  […]

B124 Consequently, insurance revenue for the period can also be analysed as the total of the changes in the liability for remaining coverage in the period that relates to services for which the entity expects to receive consideration. Those changes are:

(a) insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period), excluding:

  (i) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(a);

  (ii) repayments of investment components;

  (iii) amounts that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes) (see paragraph B65(i)); and

  (iv) insurance acquisition expenses (see paragraph B125).

(b) the change in the risk adjustment for non-financial risk, excluding:

  (i) changes included in insurance finance income or expenses applying paragraph 87;

  (ii) changes that adjust the contractual service margin because they relate to future service applying paragraphs 44(c) and 45(c); and

(iii) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(b).

(c) the amount of the contractual service margin recognised in profit or loss in the period, applying paragraphs 44(e) and 45(e).

B125 […]

B126 When an entity applies the premium allocation approach in paragraphs 55–58, insurance revenue for the period is the amount of expected premium receipts (excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk, if applicable, applying paragraph 56) allocated to the period. The entity shall allocate the expected premium receipts to each period of coverage:

(a) on the basis of the passage of time; but

(b) if the expected pattern of release of risk during the coverage period differs significantly from the passage of time, then on the basis of the expected timing of incurred insurance service expenses.

B127 An entity shall change the basis of allocation between paragraphs B126(a) and B126(b) as necessary if facts and circumstances change.

Implementation question

11. The submissions ask how differences between expected premiums and actual premiums (ie premium experience adjustments[2]) which relate to current or past service should be accounted for. Should those differences:

    (a) adjust the contractual service margin; or

[2] This paper does not discuss differences between expected and actual premiums that occur because premiums are contingent on claims. Those differences are claims experience adjustments which are discussed in Agenda Paper 3 *Commissions and reinstatement premiums in reinsurance contracts issued* of the September 2018 TRG meeting.

(b) be recognised in the statement of profit or loss immediately as part of either:

(i) insurance revenue; or

(ii) insurance service expenses.

12. One submission describes two examples of premium experience adjustments related to current or past service in which coverage in a prior period was based on an estimated risk exposure and is adjusted in the current period based on actual risk exposure. In these examples, the premium experience adjustment relating to the difference between expected and actual coverage in the prior period is received or refunded in the current period. The two examples are:

(a) workers' compensation—in which a premium rate is applied to estimated headcount and salaries and the total premium is then adjusted at a later date based on actual headcount and salaries; and

(b) reinsurance—in which coverage in a prior period was based on estimated risk exposure determined based on the expected amount of underlying insurance contracts covered and is adjusted in the current period based on actual risk exposure determined by the actual amount of underlying insurance contracts covered.

13. One submission asks how to determine whether premium experience adjustments relate to current and past service or future service.

14. One submission also asks whether the principles for accounting for premium experience adjustments related to current or past service are similar applying the general model and the premium allocation approach (PAA). The submission considers two opposing views. The first is that similar principles apply because the PAA is a simplification of the general model, and the treatment of premium experience adjustments relating to current or past service should be consistently applied. The second is that an entity can select an appropriate approach for premium experience adjustments applying the PAA and follow it consistently

because IFRS 17 does not provide any specific requirements on how to account for premium experience adjustments applying the PAA.

Review of accounting requirements

General model

15. The submissions consider whether premium experience adjustments related to current or past service adjust the contractual service margin. Paragraph B96(a) of IFRS 17 states that experience adjustments arising from premiums received in the period that relate to future service adjust the contractual service margin. Applying paragraph B97(c) of IFRS 17 all other experience adjustments do not relate to future service and therefore do not adjust the contractual service margin. Accordingly, premium experience adjustments that relate to current or past service are recognised immediately in the statement of profit or loss.

16. Paragraphs BC232–BC233 of the Basis for Conclusions on IFRS 17 explain that it is reasonable to assume that for the liability for remaining coverage, in general, experience adjustments relate to current or past service. Those paragraphs also explain that experience adjustments related to premiums received for future coverage are an exception to this general rule and relate to future service.

17. An example in which a premium experience adjustment relates to future service is when the actual premium received in the current period for coverage in a future period differs from the expected premium because lapses differ from those expected.

18. Experience adjustments that relate to current or past service are recognised immediately in the statement of profit or loss. Examples of premium experience adjustments that relate to current or past service are those that relate to services that have already been provided, such as the examples described in paragraph 12 of this paper. The submissions ask whether premium experience adjustments are recognised as part of:

(a) insurance revenue; or

(b) insurance service expenses.

19. Paragraphs B120–B127 of IFRS 17 specify how an entity measures insurance revenue. Paragraph B120 of IFRS 17 states that total insurance revenue for a group of insurance contracts is the amount of premiums paid to the entity (adjusted for a financing effect and excluding any investment components). Paragraph B123 of IFRS 17 requires that when an entity provides services in a period, it reduces the liability for remaining coverage for the services provided and recognises insurance revenue. Paragraph B123 of IFRS 17 specifies which changes in the liability for remaining coverage give rise to insurance revenue.

20. Applying the requirements in paragraphs B120 and B123 of IFRS 17, the staff observe that premium experience adjustments related to current or past service should be recognised in the statement of profit or loss immediately as part of insurance revenue because total insurance revenue is the total amount of premiums paid to the entity.

21. Appendix A to this paper includes examples (Example A and Example B) to demonstrate the mechanics of applying paragraph B123 of IFRS 17 to a group of insurance contracts with a premium experience adjustment related to current or past service. Applying paragraph B123(a)(i) of IFRS 17, the reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes that result from cash inflows of premiums received. Examples A and B demonstrate that applying paragraph B123(a)(i) of IFRS 17 to a group of insurance contracts with a premium experience adjustment results in total insurance revenue being equal to the total premium received.

22. The staff note that the analysis of insurance revenue in paragraph B124 of IFRS 17 does not specifically identify premium experience adjustments relating to current or past service. However, because the purpose of paragraph B124 of IFRS 17 is to demonstrate an alternative analysis of insurance revenue as determined by paragraph B123 of IFRS 17, applying the requirements in IFRS 17 should result

in premium experience adjustments relating to current and past service being included in insurance revenue.

Premium allocation approach

23. One submission asks whether the principles for accounting for premium experience adjustments related to current or past service are similar applying the general model and the PAA. Paragraphs B126–B127 of IFRS 17 specify the requirements for measuring insurance revenue applying the PAA.

24. The staff observe that the mechanics for recognising insurance revenue applying the PAA are different to the mechanics for recognising insurance revenue applying the general model. Applying paragraph B126(a) of IFRS 17, an entity allocates the expected premium receipts to each coverage period on the basis of the passage of time. Since premium experience adjustments are part of the expected premium receipts, they are allocated on the basis of passage of time as well. If the expected pattern of release of risk differs significantly from the passage of time, the expected premium receipts are allocated to each period of coverage on the basis of the expected timing of incurred insurance service expenses, applying paragraph B126(b) of IFRS 17. Since premium experience adjustments are part of the expected premium receipts they are allocated to each period of coverage on the basis of the expected timing of incurred insurance service expenses as well.

25. Appendix A to this paper includes an example (Example C) of contracts with a premium experience adjustment related to current service accounted for applying the PAA.

TRG Discussion

Question to TRG members
What are your views on the implementation question presented above?

Appendix A—Examples of accounting for premium experience adjustments related to current or past service

A1. This appendix includes three examples:

(a) Example A—General model: premium experience adjustment that relates to current service;

(b) Example B—General model: premium experience adjustment that relates to past service; and

(c) Example C—PAA: premium experience adjustment that relates to current service.

A2. For simplicity, the following assumptions are made in the examples:

(a) discount rates are 0%; and

(b) all claims occur as expected and are paid immediately.

Example A—General model: premium experience adjustment that relates to current service

A3. An entity issues an insurance contract for workers' compensation coverage for a period of one year, 1 January 2021–31 December 2021. The premium is based on the number of employees covered by the contract over the duration of the coverage period. On 1 January 2021, the policyholder pays a premium of 2,500 based on an expected headcount of 100.

A4. At initial recognition, the entity determines that the insurance contract is a group of insurance contracts applying the level of aggregation requirements in IFRS 17. The entity measures the group of insurance contracts as follows:

Fulfilment cash flows – expected cash outflows (CF)	1,800
Fulfilment cash flows – risk adjustment for non-financial risk (RA)	200
Contractual service margin (CSM) (2,500 – (1,800 + 200))	500

Insurance contract liability at 1 January 2021	**2,500**

A5. Journal entries:

Dr	Cash	2,500
Cr	Insurance contract liability – liability for remaining coverage	2,500

A6. At 31 December 2021 this example assumes that, for simplicity, all claim events have occurred as expected and 1,800 has been paid. However, at that date the actual headcount for 2021 is determined to be 120 compared to the expected headcount of 100. The policyholder immediately pays the extra premium of 500 (2,500 x 20/100).

A7. The entity measures the insurance contract liability at 31 December 2021 as follows:

	CF	**RA**	**CSM**	**Total**
1 January 2021	1,800	200	500	2,500
Cash outflows	(1,800)	0	0	(1,800)
Changes related to current service	(500)	(200)	(500)	(1,200)
Cash inflows	500	0	0	500
31 December 2021	**0**	**0**	**0**	**0**

A8. The movement in the period can also be reconciled as follows, showing the split between the liability for remaining coverage (LRC) and liability for incurred claims (LIC):

	LRC	LIC	Total
1 January 2021	2,500	0	2,500
Insurance revenue	(3,000)[3]	0	(3,000)
Insurance service expenses	0	1,800	1,800
Cash outflows	0	(1,800)	(1,800)
Cash inflows	500	0	500
31 December 2021	**0**	**0**	**0**

A9. Journal entries:

Claims incurred		
Dr	Insurance service expenses	1,800
Cr	Insurance contract liability – liability for incurred claims	1,800

[3] The total reduction in the liability for remaining coverage is 2,500. Applying paragraph B123(a)(i) of IFRS 17, the reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes that result from cash inflows of premiums received. Therefore, the entity must exclude from the change of 2,500 the increase of 500 from the receipt of premiums. This means that the reduction in the liability for remaining coverage that gives rise to insurance revenue is 3,000 (2,500 – (-500) = 3,000).

Payment of claims incurred		
Dr	Insurance contract liability – liability for incurred claims	1,800
Cr	Cash	1,800

Changes in the liability for remaining coverage because of cash inflows from premiums received (excluded from insurance revenue applying paragraph B123(a)(i) of IFRS 17)		
Dr	Cash	500
Cr	Insurance contract liability – liability for remaining coverage	500

Other changes in the liability for remaining coverage (ie excluding change because of cash inflows from premiums received)		
Dr	Insurance contract liability – liability for remaining coverage	3,000
Cr	Insurance revenue	3,000

Example B—General model: premium experience adjustment that relates to past service

A10. The facts set out in paragraphs A3–A4 of this paper also apply for Example B.

A11. Again, for simplicity, at 31 December 2021 it is assumed that all claim events have occurred as expected and 1,800 has been paid. However, in this example the actual headcount for the year has not yet been determined at 31 December 2021 and will be determined at a later date. As at 31 December 2021, the entity has not changed its expectation of the headcount. Any payment/repayment of premiums will occur at a later date when the actual headcount is determined.

A12. The entity measures the insurance contract liability at 31 December 2021 as follows:

	CF	**RA**	**CSM**	**Total**
1 January 2021	1,800	200	500	2,500
Cash outflows	(1,800)	0	0	(1,800)
Changes related to current service	0	(200)	(500)	(700)
31 December 2021	**0**	**0**	**0**	**0**

A13. The movement in the period can also be reconciled as follows, showing the split between the liability for remaining coverage (LRC) and liability for incurred claims (LIC):

	LRC	**LIC**	**Total**
1 January 2021	2,500	0	2,500
Insurance revenue	(2,500)	0	(2,500)
Insurance service expenses	0	1,800	1,800
Cash outflows	0	(1,800)	(1,800)
31 December 2021	**0**	**0**	**0**

A14. Journal entries:

Claims incurred		
Dr	Insurance service expenses	1,800
Cr	Insurance contract liability – liability for incurred claims	1,800

Payment of claims incurred		
Dr	Insurance contract liability – liability for incurred claims	1,800
Cr	Cash	1,800

Insurance revenue		
Dr	Insurance contract liability – liability for remaining coverage	2,500
Cr	Insurance revenue	2,500

A15. During 2022, the actual headcount for 2021 is determined to be 120 compared to the expected headcount of 100. The policyholder immediately pays the extra premium of 500 (2,500 x 20/100).

A16. At 31 December 2022, the entity measures the change in the insurance contract liability as follows:

	CF	RA	CSM	Total
1 January 2022	0	0	0	0
Changes related to past service	(500)	0	0	(500)
Cash inflow	500	0	0	500
31 December 2022	**0**	**0**	**0**	**0**

A17. The movement in the period can also be reconciled as follows, showing the split between the liability for remaining coverage (LRC) and liability for incurred claims (LIC):

	LRC	LIC	Total
1 January 2022	0	0	0
Insurance revenue	(500)[4]	0	(500)
Cash inflows	500	0	500
31 December 2022	**0**	**0**	**0**

[4] The total reduction in the liability for remaining coverage is 0. Applying paragraph B123(a)(i) of IFRS 17, the reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes that result from cash inflows of premiums received. Therefore, the entity must exclude from the change of 0 the increase of 500 from the receipt of premiums. This means that the reduction in the liability for remaining coverage that gives rise to insurance revenue is 500 (0 – (-500) = 500).

A18. Journal entries:

Changes in the liability for remaining coverage because of cash inflows from premiums received (excluded from insurance revenue applying paragraph B123(a)(i) of IFRS 17)		
Dr	Cash	500
Cr	Insurance contract liability – liability for remaining coverage	500

Other changes in the liability for remaining coverage (ie excluding change because of cash inflows from premiums received)		
Dr	Insurance contract liability – liability for remaining coverage	500
Cr	Insurance revenue	500

Example C—PAA: premium experience adjustment that relates to current service

A19. The facts for Example C are the same as for Example A, however in this example the entity chooses to apply the PAA.

A20. At initial recognition the entity determines that the insurance contract is a group of insurance contracts applying the level of aggregation requirements in IFRS 17. The entity measures the group of insurance contracts as follows:

Premiums received at initial recognition	2,500
Insurance contract liability at 1 January 2021	**2,500**

A21. Journal entries:

Dr	Cash	2,500
Cr	Insurance contract liability – liability for remaining coverage	2,500

A22. The entity measures the insurance contract liability at 31 December 2021 as follows:

1 January 2021	2,500
Premiums received in the period	500
Insurance revenue	(3,000)
31 December 2021	**0**

A23. The movement in the period can also be reconciled as follows, showing the split between the liability for remaining coverage (LRC) and liability for incurred claims (LIC):

	LRC	**LIC**	**Total**
1 January 2021	2,500	0	2,500
Insurance revenue	(3,000)[5]	0	(3,000)
Insurance service expenses	0	1,800	1,800
Cash outflows	0	(1,800)	(1,800)

[5] Applying paragraph B126 of IFRS 17, total premium receipts for the contract of 3,000 are allocated to each coverage period based on the passage of time.

Cash inflows	500	0	500
31 December 2021	**0**	**0**	**0**

A24. Journal entries:

Claims incurred		
Dr	Insurance service expenses	1,800
Cr	Cash	1,800

Premiums received in the period		
Dr	Cash	500
Cr	Insurance contract liability – liability for remaining coverage	500

Insurance revenue		
Dr	Insurance contract liability – liability for remaining coverage	3,000
Cr	Insurance revenue	3,000