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| Project | <b>Insurance Contracts</b>                       |
| Topic   | <b>Presentation of the performance statement</b> |

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### Purpose of this paper

1. This paper discusses presentation of performance statement (the statement of comprehensive income), with as its key issue when (if ever) should an insurer recognise premium receipts as revenue and when (if ever) should an insurer recognise them as deposit receipts.
2. This paper describes different models we identified for presenting the performance statement. To illustrate these models, the appendix to this paper include some presentation examples based on examples in the discussion paper *Preliminary Views on Insurance Contracts*, published in 2007.
3. At this stage, staff does not ask the boards to make a choice between the presentation approaches or to seek any other Board decisions; this will be part of future Board meetings.
4. We have requested input from Working Group members and field testing participants on this topic and will consider that input in developing this topic further.

### Structure of the paper

5. The rest of this paper is divided into the following sections:
  - (a) Background (paragraphs 7-9)
  - (b) Presentation models (paragraphs 10-15)

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This paper has been prepared by the technical staff of the FAF and the IASCF for discussion at a public meeting of the FASB or the IASB.

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- (c) Key issues (paragraphs 16-30)
  - (d) Selecting a presentation model (paragraphs 31-36)
  - (e) Unbundling of deposit premiums (paragraphs 37-41)
  - (f) Appendix
6. It is beyond the purpose of this paper to discuss the following topics, which we will ask the boards to discuss in November:
- (a) whether an insurer should recognise some or all changes in insurance liabilities in other comprehensive income rather than in profit or loss.
  - (b) how an insurer might disaggregate changes in insurance liabilities in the performance statement, including presentation of subsequent remeasurements.  
We will discuss this in more detail once the boards have selected the basic structure of the performance statement.
  - (c) whether recognition of revenue should be limited to the period during which protection is provided or whether revenue should also be recognised during the claims handling period.
  - (d) whether an insurer should unbundle insurance contracts for recognition and measurement. [Agenda paper 4A discusses that topic.]

## **Background**

7. The premium for an insurance contract could be viewed as comprising payments for elements such as:
- (a) The expected present value of payments to the small proportion of policyholders who incur insured losses.
  - (b) The expected present value of other expenses.
  - (c) A margin for services provided under the contract (including the service of bearing risk).

- (d) If applicable, the expected present value of repayments to the same policyholders who paid the premiums (examples: annuities, endowments, some finite reinsurance contracts, some group insurance contracts). In substance, some view this component as a deposit component that is not closely related to the underlying insurance exposure. Significant deposit components are found in many longer term insurance contracts, particularly, but not exclusively, in life insurance.
8. The discussion paper *Preliminary Views on Insurance Contracts* discussed whether premiums should be treated as revenue, as deposits, or as a mixture of revenue and deposits, but did not put forward specific proposals on this topic. Most respondents viewed all premiums as revenue, especially for non-life contracts.
9. However, some saw merit in a presentation that treats some or all premiums as deposit receipts, particularly for life contracts. Others proposed retaining a revenue presentation in the performance statement (premiums shown as revenue, claims shown as an expense), supplementing this with a margin analysis in the notes, especially for life contracts. (We discuss later in this paper what we mean by a margin analysis). In this context, some saw life contracts as closer to financial instruments and non-life contracts as closer to service contracts.

### Presentation models

10. We identified the following models for the performance statement, in particular with respect to the treatment of premiums.
- (a) Premiums received are recognised immediately as revenue (written premium), and at the same time a corresponding increase in the liability is recognised as an expense. (**traditional life model**)
- (b) Premiums received are recognised as a liability (unearned premium) and are then transferred to revenue as they are deemed to be earned. (**traditional non-life model**)

- (c) The elements of premiums that reflect expected repayments to the same policyholder are recognised as a deposit receipt. Amounts charged (explicitly or implicitly) to a policyholder for the provision of protection against risk (and, if applicable, other services) are recognised as revenue when the insurer performs under the contract. If those charges are made in advance, they would be treated initially as unearned premium (**fee approach**).
- (d) Premiums received are recognised as a deposit receipt. Subsequently, as the insurer is released from risk (and, if applicable, provides other services), the related portion of the margin amounts is no longer needed and is recognised as revenue in the income statement. (**margin approach**).
11. The **traditional non-life model** and the **traditional life model** are applied under many existing accounting models and practice is accustomed to these approaches. Particularly for the traditional non-life model (unearned premium), many respondents to the DP noted that it is well-understood and works well in practice. However, under those approaches all premiums are recognised as revenue over the life of the contract. Some believe that this might not be the best answer in all cases.
12. The **fee model** reports as revenue only the part of the premium that the policyholder pays for services under the contract, not the deposit receipt that relates to expected future repayments to the same policyholders. It recognises the part of the premium for services (including risk protection) as revenue based on performance under the contract (ie when the insurer provides the services). This model is therefore comparable with the performance statement presentation for investment management by fund managers. (It is worth remembering that many life insurers provide a wide range of contracts, from pure insurance to pure fund management and many intermediate products that combine insurance and investment management).
13. In contrast to all the other approaches, the **margin model** treats all premiums as deposits and all claims and benefits as repayments to the policyholder. The margin model reports in the income statement the release of the margin during the reporting period. [It is beyond the purpose of this paper to discuss whether the margin will be

treated as one single composite margin or whether it will be segregated into two or more components. In this paper, we therefore refer to the overall margin.] All premiums received and benefit and claims payments are considered deposit payments from, and repayments to, the policyholder.

14. We emphasise that, under the same liability measurement, these different approaches would have the same net effect on profit or loss, although the individual line items in the performance statement could differ significantly.
15. The appendix to this paper illustrates these models by using examples similar to those included in the discussion paper.

## Key issues

16. The key issues with respect to presentation of the performance statement are:
  - (a) when should revenue be reported?
  - (b) which part of the premiums is to be reported as revenue throughout the life of the contract?

### ***When is revenue recognised?***

17. If some or all premiums are reported as revenue, one also has to decide when premiums should be reported as revenue. We identified two approaches:
  - (a) at receipt, with amounts that relate to future periods added to insurance liabilities (written premiums);
  - (b) as 'earned' through performance under the contract (earned premiums).
18. The first approach is simple because it reports revenue based on receipt (written basis). However, this approach is, in staff's view, inconsistent with existing practices for recognising revenue for contracts other than insurance contracts and with the boards' proposed model in the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*. The revenue recognition model

would require the insurer to recognise a slice of the premium as revenue as it fulfils each slice of the performance obligation over the life of the contract (ie as an asset is transferred to the customer).

19. For an approach based on revenue earned, any written premium amount related to future periods will be booked as a payment received in advance for future services and treated as unearned premium. When deemed to be earned as a result from subsequent performance under the contract, it will be reported as revenue. This is consistent with an unearned premium approach<sup>1</sup> and the model proposed in the revenue recognition discussion paper.

***Which part of the premium is revenue?***

20. If the performance model recognises revenue, one also has to decide whether all or some premiums will be reported as revenue over the life of the contract. We explore two issues in particular:

- (a) deposit components;
- (b) margin reporting.

*Deposit components*

21. Because the policyholder generally has to pay the premiums in advance, most insurance contracts have implicit or explicit deposit components. Many current accounting models recognise the total premiums including the deposit component as revenue.
22. However, recognising all premiums as revenue could result in a distorted, perhaps even misleading, presentation, particularly when a deposit component is relatively significant and includes prepayments that are not closely related to the underlying insurance exposure (in other words part of the premium relates to expected future

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<sup>1</sup> In its July 2009 meeting, the IASB decided to require (rather than permit) the use of an unearned premium approach for pre-claims liabilities of short-duration insurance contracts. The FASB will discuss this topic at a future meeting.

repayments to the same policyholders who paid the premiums). The following highly simplified example illustrates this.

### Background

Insurer A enters into one thousand five-year traditional endowment insurance contract on January 1, 2010. (A traditional endowment pays a death benefit if the policyholder dies during the contract term and a maturity benefit if the policyholder is still alive when the contract matures.) For simplicity, we ignore time value of money and expenses. We also ignore subsequent changes in circumstances. The annual premium is CU100 and is received at the beginning of each year. The benefit paid at maturity is CU400, if the policyholder is still alive then. If the policyholder dies before the end of the contract, a death benefit of CU500 is paid. For simplicity, we presume that the policyholder cannot surrender the contract and that there are no lapses.

At inception, the expected mortality rate is 2% for year one, 4% for year 2, 6% for year 3, 8% for year 4 and 10% for year 5.

We can analyse the contract as made up of two components:

- The deposit component is an annual deposit of CU80, bearing interest at 5% and building up to a repayment of CU400 at maturity.
- The insurance component has an annual premium of CU20 (CU100 – CU80). It pays a death benefit equal to CU500, including the accumulated balance of the deposit component.

(The numbers presented below are in CU1,000, rounding differences may exist)

### Application of the presentation models

Based on the traditional life model, the performance statement would be presented as follows:

|   | 2010 | 2011 | 2012 | 2013 | 2014  | Total |
|---|------|------|------|------|-------|-------|
| <b>Premiums received (written premiums)</b> |      |      |      |      |       |       |
| Revenue                                     | 100  | 98   | 94   | 88   | 81    | 462   |
| Changes in liability                        | (86) | (71) | (57) | (45) | 259   | -     |
| Benefits paid                               | (10) | (20) | (28) | (35) | (334) | (427) |
| Profit                                      | 4    | 7    | 8    | 8    | 7     | 35    |

Below we present the three different performance statements that all report the whole premium as revenue over the life of the contract on an 'earned' basis, but each presentation uses a different driver for depicting performance under the contract (and, hence, for depicting revenue). (It is beyond the scope of this paper to determine what the driver should be.)

#### (1) Passage of time

|                      |      |      |      |      |       |       |
|----------------------|------|------|------|------|-------|-------|
| Revenue              | 92   | 92   | 92   | 92   | 92    | 462   |
| Changes in liability | (78) | (66) | (56) | (49) | 248   | -     |
| Benefits paid        | (10) | (20) | (28) | (35) | (334) | (427) |
| Profit               | 4    | 7    | 8    | 8    | 7     | 35    |

**(2) Expected claims and benefits payments**

|                      |      |      |      |      |       |       |
|----------------------|------|------|------|------|-------|-------|
| Revenue              | 11   | 21   | 31   | 38   | 361   | 462   |
| Changes in liability | 3    | 5    | 6    | 6    | (21)  | -     |
| Benefits paid        | (10) | (20) | (28) | (35) | (334) | (427) |
| Profit               | 4    | 7    | 8    | 8    | 7     | 35    |

**(3) Release from risk(\*)**

|                      |      |      |      |      |       |       |
|----------------------|------|------|------|------|-------|-------|
| Revenue              | 63   | 101  | 114  | 105  | 80    | 462   |
| Changes in liability | (49) | (74) | (77) | (61) | 261   | -     |
| Benefits paid        | (10) | (20) | (28) | (35) | (334) | (427) |
| Profit               | 4    | 7    | 8    | 8    | 7     | 35    |

Note that the profit patterns are identical for all the presentations, but the pattern of individual line items, including revenue, varies significantly.

(\*) Release from risk is a function of both the expected mortality rates and the amount at risk, updated continuously throughout the life of the contract. The amount at risk is the death benefit paid out to a policyholder (CU500) less any deposit amounts already accumulated for that policyholder.

For comparison, we present a fee approach that treats the part of the premium expected to be repaid to the same policyholders as a deposit, presuming that all the necessary information is readily available.

|                       |     |      |      |      |     |      |
|-----------------------|-----|------|------|------|-----|------|
| Revenue               | 13  | 20   | 23   | 21   | 16  | 92   |
| Mortality claims paid | (8) | (13) | (14) | (13) | (9) | (58) |
| Profit                | 4   | 7    | 8    | 8    | 7   | 35   |

In the margin model, revenue represents the (implicit) charge to the policyholder for risk protection, reported on the basis of release from risk. The mortality claims paid are the death benefits paid out to a policyholder (CU500) less any deposit amounts already accumulated for that policyholder (which are treated as a repayment to the policyholder and therefore do not impact profit or loss).

23. The example shows in our view that when a deposit component is relatively large and includes elements that are not closely related to the underlying insurance exposure, reporting all premiums as revenue would probably not result in a meaningful outcome. Such a deposit payment, either implicit or explicit, is not linked to a service the insurer provides to the policyholder under the contract. Some might even argue that this approach is inconsistent with the proposed revenue recognition model because it would report on the revenue line the part of the premium (if any) that is not for services provided under the contract.

24. As a result, both revenue and changes in insurance liabilities do not seem to produce a pattern that provides a useful depiction of performance. This analysis is



consistent with the comment by some respondents to the discussion paper that the existing income statement formats for life insurers are not meaningful.

25. The issue could be solved by treating part of the premium (the part that funds expected future repayments to the same policyholders) as a deposit receipt. In other words, the only part of the premium recognised as revenue would be the part that the policyholder pays for services under the contract. However, this model (the fee model) would require that, in all cases, deposit components of a premium that relates to expected future repayments to the same policyholders should be separated from the other parts of the premium.
26. We note that if the deposit component is relatively small and/or most of the premium is viewed as a prepayment for a service, the traditional non-life model (unearned premium) and a fee model result in a revenue line that would be similar, perhaps even identical.

*Margin reporting*

27. A margin approach would report as revenue only the part of the premium that is released as a margin over the life of a contract.
28. This model arguably is inconsistent with revenue recognition because it does not recognise the entire premium that covers services provided under the contract as revenue. The remaining part is treated as a repayment to the policyholder, including:
- (a) the part of the premium that covers the expected (mean) insurance losses. In aggregate, one could perhaps argue that these are repayments to the policyholders collectively, and so are akin to a deposit. But if we focus on individual policyholders, the amount each policyholder pays is different from the amount received by that particular policyholder. From that perspective, the amounts paid seem more like an expense incurred in generating revenue, rather than a repayment of a deposit.
  - (b) the part of the premium that is for expenses. The margin approach in effect treats the expected expenses as a repayment.

29. However, some note that the proposed measurement model for insurance contracts separates the margin explicitly as one of the building blocks. It would therefore be possible to show the profit emergence through the margin release directly rather than deriving a profit number each period from allocated customer consideration on one hand and incurred claims and expenses on the other hand. Arguably, it is simply another, more direct, way of deriving and presenting performance under the contract. Information about headline indicators and performance metrics could be part of disclosures.
30. Some have proposed, as a variation to a margin model or, perhaps, a mix of a margin model and a fee model, an approach that reports as revenue the margin plus some or all of the insurance losses (paragraph 28(a)) and expenses (paragraph 28(b)). Such a 'grossed-up' margin approach reports revenue that would be more akin to the premium paid for services under the contract than the revenue line under the basic margin approach. However, in some cases the measurement would be updated for changes in circumstances. The revenue reported over the life of the contract would in that case include the effect of subsequent changes (if any) and not necessarily equal the actual consideration the policyholder paid for services under the contract.

### **Selecting the presentation model**

31. The following five possibilities could be considered for selecting the presentation model(s):
- (a) Treat all premiums (including the portion that pays for the deposit component) for all insurance contracts as revenue. Use the traditional non-life model for those premiums (or perhaps the traditional life model, but, as argued below, that seems inconsistent with the approach adopted in the project on revenue recognition.)
  - (b) For presentation in the income statement, unbundle all (or specified) insurance contracts into an insurance component, as in (a) and a deposit component. The result is a fee approach. The boards could consider requiring (or permitting)

that presentation even if they do not permit or require it for recognition and measurement.

- (c) Treat all premiums for all insurance contracts as deposits, and all claims and expenses as repayments of deposits. Use the margin model for the margin.
- (d) For insurance contracts that meet specified criteria (perhaps life insurance contracts, or long duration contracts), treat all premiums for all contracts as deposits, as in (c). For all other insurance contracts, treat all premiums (or perhaps all earned premiums, rather than written premiums) as revenue, as in (a).
- (e) Permit insurers to choose for each class of insurance contracts between a revenue presentation, as in (a), and a deposit presentation, as in (c) perhaps subject to some constraints.

32. The first option, treat all premiums as revenue, is unlikely to be appropriate:

- (a) An approach that recognises written premiums as revenue on receipt (traditional life model) is in our view inconsistent with the proposed revenue recognition model.
- (b) An approach that recognises earned premiums as revenue (traditional non-life model) arguably results in useful information only when the deposit component is relatively small and it is reasonable to view most of the premium as a prepayment for a service. One could even argue that this approach is inconsistent with revenue recognition if the premium includes deposit elements that are not closely related to the underlying insurance exposure. Also, that approach would be complex for some types of contract, such as single-premium annuities: many existing models treat the single premium as revenue at inception, with a corresponding expense caused by the change in the liability; in contrast, an earned premium would require the insurer to recognise part of the premium as revenue in each year of the annuitant's remaining life.

33. Unbundling all or specified contracts into an insurance component and a deposit component (option (b)) avoids the disadvantages of a single on-off switch that creates a radical difference in the presentation of income and expense. That approach (a fee approach) would also be comparable with the performance statement presentation for investment management by fund managers. However, unbundling could be arbitrary and costly to perform. To minimise these disadvantages, unbundling could be targeted at contracts for which the benefits are most likely to exceed the costs (paragraphs 37-41 discusses unbundling a deposit receipt further).
34. Presenting all premiums for all insurance contracts as deposit receipts (option (c)) would avoid the disadvantages of using an on-off switch to distinguish different types of contract. It would also avoid the costs of unbundling and avoid the need to determine how much of the original premium is earned. However, a margin approach would report only the released margin as revenue and would therefore be inconsistent with proposed revenue recognition model. It would also result in a significant change from current practice and users would need disclosures to help them derive headline indicators and performance metrics. Furthermore, if an insurer used an unearned premium model for only part of its business<sup>2</sup>, the insurer would show two income statement presentations; one for the unearned premium model and one for the margin model. A variation based on 'grossed-up' margins (see paragraph 30) would mitigate these issues, but could report revenue that differs somewhat from the actual customer consideration.
35. If different models are used for different classes of insurance contract (option (d)), the Board would need to define when each model is used. The definitions could target those contracts that are most likely to contain significant deposit components. However, we have so far identified no reason to draw boundaries between different classes of insurance contracts other than application of a simplified model for pre-

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<sup>2</sup> The IASB decided tentatively to require an unearned premium approach for pre-claims liabilities of short-duration insurance contracts. The FASB will discuss this topic at a future meeting. As a result of requiring the unearned premium approach for pre-claims liabilities of short-duration insurance contracts, the IASB would have to require, or at least permit, the unearned premium approach for those contracts.

claims liabilities of short-duration contracts (the unearned premium model). The boundaries might be arbitrary and difficult to define.

36. Permitting insurers to choose between a revenue presentation and a deposit presentation (option (e)) may allow them to select the most appropriate presentation in each case, but could undermine comparability.

### Unbundling of deposit premiums

37. In paragraph 31 we discussed what options the boards have when selecting a presentation model for the performance statement. Some of those options use a fee model, either as the selected approach in some or all cases or as part of the presentation models the insurer can choose from.

38. This means that, even if unbundling is not applied for recognition and measurement, treating the deposit component of a premium as a deposit receipt rather than revenue may have to be considered for presentation purposes. [Agenda paper 4A discusses unbundling for recognition and measurement.]

39. Some existing models already use an unbundled model in the performance statement, for example in *Financial Services – Insurance Topic* (944) of the FASB Accounting Standards Codification, first introduced to US GAAP by FAS 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, which applies to universal life contracts<sup>3</sup> as well as to participating and nonguaranteed-premium contracts that include features specified under that standard.

40. However, some have argued that an unbundled model is difficult to apply, particularly for contracts that do not have explicitly unbundled charges (they are

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<sup>3</sup> Universal life contracts could be described as a type of permanent life insurance that allows the policyholder, after its initial payment, to pay premiums at any time, in virtually any amount, subject to a specified minimum and maximum. Universal life contracts explicitly unbundle the charges (fees) for mortality and other expenses from other contract elements. A universal life contract also permits the policyholder to reduce or increase the death benefit more easily than under a traditional whole life policy.

usually explicitly unbundled in universal life contracts). For these contracts, splitting all premiums into a revenue component and a deposit component may be arbitrary and costly to perform. Furthermore, some would argue that if separating a contract into its separate components is not required for recognition and measurement, it would not be logical to require unbundling of the deposit element of a premium for the purpose of presenting revenue. They would argue that in that case it is likely that separating the premium into a deposit element and a fee element would also be arbitrary.

41. To minimise these potential difficulties, unbundling could be targeted at contracts for which the benefits are most likely to exceed the costs. However, one would need to decide how to draw the line between those two approaches. Some respondents to the discussion paper therefore argued that the insurer should have the ability to decide which approach to apply; however, this may impair comparability.

**Question for the boards**

Have you identified any other presentation models that the boards should consider?

Do you need more information to select a presentation model?

Do you have any other comments?

## Appendix: Examples of Presentation Models

The following fact pattern is designed to illustrate the four presentations discussed in paragraph 10 of this agenda paper. To focus on the style of presentation rather than recognition and measurement, the examples are simple and all use the same fact pattern, as follows:

- Premium CU1,000, paid 1 January and covering insured events between 1 January and 31 December.
- Expected claims (including claims handling costs) CU700. CU350 is paid on 30 June and CU350 on 31 December.
- Acquisition costs CU100, incurred on 1 January. The examples in this paper recognise acquisition costs as an expense when incurred. In addition, the measurement of the insurance liability does not include the part of the premium that recovers the acquisition costs. [This treatment is in line with the tentative decision by the IASB to recognize as revenue at inception the part of the premium that covers acquisition costs. The FASB decided tentatively not to recognise any revenue at inception. Under the FASB proposal, numbers in the examples would change somewhat, but the structure of the presentation models would be the same].
- Other expenses associated with the administration of the contracts CU80, incurred evenly through the period.
- Expected investment return 8 per cent and risk free rate used to discount the liability cash flows 5 per cent.
- The insurer estimates that there is no material profit or loss at inception (1 January). On 30 June, the insurer estimates that the appropriate margin is CU69, which results in a liability measurement of CU450 (coincidentally equal to a conventional unearned premium of CU500 less conventional deferred acquisition costs of CU50).
- No differences between actual outcomes and previous estimates.

- This illustration focuses on presenting premiums for a contract that does not include an explicit deposit component.



**Example 1 Non-life insurance presentation**

| <b>Income statement</b>                    | <i>Inception<br/>1 Jan</i> | <i>2 Jan<br/>to 30 Jun</i> | <i>1 July<br/>to 31 Dec</i> |
|--|----------------------------|----------------------------|-----------------------------|
| Premiums written                           | 1,000                      |                            |                             |
| Change in unearned premium                 | (900)                      | 450                        | 450                         |
| Premiums earned                            | 100                        | 450                        | 450                         |
| Investment income                          |                            | 36                         | 22                          |
| Claims                                     |                            | 350                        | 350                         |
| Expenses                                   |                            | 40                         | 40                          |
| Acquisition costs                          | 100                        | -                          | -                           |
| Total expenses                             | 0                          | 390                        | 390                         |
| Profit                                     | 0                          | 96                         | 82                          |
| <b>Balance sheet</b>                       | <i>1 Jan</i>               | <i>30 Jun</i>              | <i>31 Dec</i>               |
| Cash                                       | 900                        | 546                        | 178                         |
| Insurance liabilities                      | (900)                      | (450)                      | -                           |
| Equity                                     | 0                          | 96                         | 178                         |
| Claims ratio                               | 0%                         | 78%                        | 78%                         |
| Expense ratio (without acquisition costs)  | 0%                         | 9%                         | 9%                          |
| Combined ratio (without acquisition costs) | 0%                         | 87%                        | 87%                         |
| Expense ratio (with acquisition costs)     | 100%                       | 9%                         | 9%                          |
| Combined ratio (with acquisition costs)    | 100%                       | 87%                        | 87%                         |

**Comment:**

1. In many existing accounting models, the acquisition costs are deferred and amortised over the life of the contract. This example recognises acquisition costs as an expense when incurred and, in addition, recognises revenue at inception to cover the incremental acquisition costs.
2. Respondents consider ratios based on earned premium and claims and expenses to be important performance indicators for non-life contracts. Therefore, this example illustrates those ratios.

**Example 2 Life insurance presentation****Income statement**

|                               | <i>Inception<br/>1 Jan</i> | <i>2 Jan<br/>to 30 Jun</i> | <i>1 July<br/>to 31 Dec</i> |
|-------------------------------|----------------------------|----------------------------|-----------------------------|
| Premium revenue               | 1,000                      |                            |                             |
| Investment income             |                            | 36                         | 22                          |
| Total income                  | 1,000                      | 36                         | 22                          |
| Claims                        |                            | 350                        | 350                         |
| Change in insurance liability | 900                        | (450)                      | (450)                       |
| Expenses                      |                            | 40                         | 40                          |
| Acquisition costs             | 100                        |                            |                             |
| Total expenses                | 1,000                      | (60)                       | (60)                        |
| Profit                        | 0                          | 96                         | 82                          |

**Balance sheet**

|                       | <i>1 Jan</i> | <i>30 Jun</i> | <i>31 Dec</i> |
|-----------------------|--------------|---------------|---------------|
| Cash                  | 900          | 546           | 178           |
| Insurance liabilities | (900)        | (450)         |               |
| Equity                | 0            | 96            | 178           |

Comment:

1. In many existing accounting models, the acquisition costs are deferred and amortised over the life of the contract. This example recognises acquisition costs as an expense when incurred and, in addition, recognises revenue at inception to cover the incremental acquisition costs.

**Example 3 Fee presentation**

|                                 | <i>Inception<br/>1 Jan</i> | <i>2 Jan<br/>to 30 Jun</i> | <i>1 July<br/>to 31 Dec</i> |
|---------------------------------|----------------------------|----------------------------|-----------------------------|
| Charges to policyholder account | -                          | 473                        | 461                         |
| Policyholder benefits           | -                          | (350)                      | (350)                       |
| Expenses                        | -                          | (40)                       | (40)                        |
| Insurance margin                |                            | 83                         | 71                          |
| Gross gain at inception         | 100                        |                            |                             |
| Acquisition costs               | (100)                      |                            |                             |
| Net gain at inception           | 0                          | 0                          | 0                           |
| Investment income               |                            | 36                         | 22                          |
| Interest on insurance liability |                            | (23)                       | (11)                        |
| Net interest and investment     | 0                          | 13                         | 11                          |
| Profit                          | 0                          | 96                         | 82                          |
| <b>Balance sheet</b>            |                            |                            |                             |
|                                 | <i>1 Jan</i>               | <i>30 Jun</i>              | <i>31 Dec</i>               |
| Cash                            | 900                        | 546                        | 178                         |
| Insurance liabilities           | (900)                      | (450)                      | -                           |
| Equity                          | 0                          | 96                         | 178                         |

## Comments:

1. This format presents all premiums as deposits (except the part needed to pay for acquisition costs), and presents as revenue the explicit or implicit charges made to policyholder accounts.
2. In US GAAP, a somewhat similar presentation is used for universal life contracts. This format is possible for these contracts because the design of the contract unbundles the different contract elements. This approach may be more challenging if charges to policyholders are implicitly bundled into a premium, rather than identified explicitly.
3. In this illustration, there is no explicit policyholder account and, hence, no explicit charge. The amounts shown as policyholder charges are implicit and are computed as the expected value of policyholder benefits and expenses, plus the risk margin

(and, if applicable, service margin) released in the period. (The margin presentation in example 4 shows as revenue only the release of those margins.)

**Example 4 Margin presentation**

|   | <i>Inception<br/>1 Jan</i> | <i>2 Jan<br/>to 30 Jun</i> | <i>1 July<br/>to 31 Dec</i> |
|---|----------------------------|----------------------------|-----------------------------|
| Insurance margin (same as in example 3) |                            | 83                         | 71                          |
| Gross gain at inception                 | 100                        |                            |                             |
| Acquisition costs                       | (100)                      |                            |                             |
| Net gain at inception                   | 0                          | 0                          | 0                           |
| Investment income                       |                            | 36                         | 22                          |
| Interest on insurance liability         |                            | (23)                       | (11)                        |
| Net interest and investment             | 0                          | 14                         | 11                          |
| Profit                                  | 0                          | 96                         | 82                          |

**Balance sheet**

|                       | <i>1 Jan</i> | <i>30 Jun</i> | <i>31 Dec</i> |
|-----------------------|--------------|---------------|---------------|
| Cash                  | 900          | 546           | 178           |
| Insurance liabilities | (900)        | (450)         | -             |
| Equity                | 0            | 96            | 178           |

Comments:

1. This format is similar to the analysis of changes in embedded value provided by many larger life insurers in the UK, Continental Europe, Australia, New Zealand, Canada and South Africa, and to the 'sources of earnings analysis' provided by some Canadian life insurers.
2. This format treats all premiums as deposits, and all claims expense, claims handling expense and other contract-related expense as repayments of deposits.
3. Insurance margin' refers to the difference between the margin at the start of the period and the margin at the end of the period. Thus, it represents the following amounts:
  - (a) Applying the updated IAS 37 model tentatively adopted by the IASB, it is the sum of (i) the risk margin attributable to risk borne during the period (ii) the

margin attributable to other services, if any, provided during the services  
(iii) if applicable, remeasurement of the risk and service margins during the period (iv) release of the residual margin during the period, using a driver in a systematic way that best depicts the insurer's performance under the contract .

- (b) Applying the current fulfilment model tentatively adopted by the FASB, it is the release of the composite margin during the period, using a driver in a systematic way that best depicts the insurer's performance under the contract. Those drivers are likely to include risk borne during the period and other services, if any, provided during the period.