

# Presentation and Disclosure

## **Basic Issue 18      How Should Information about Insurance Contracts be Presented in the Financial Statements?**

758. This section addresses the following Sub-issues:

- (a) should IASC specify reporting formats for the balance sheet, income statement and cash flow statement of an insurer;
- (b) should an insurer make the current/non-current distinction in its balance sheet;
- (c) should IAS 7, Cash Flow Statements, be amended for insurers; and
- (d) should policyholder interests be shown separately from stockholder interests on the face of the balance sheet, income statement and cash flow statement?

### **Sub-Issue 18A      Should IASC Specify Reporting Formats for the Balance Sheet, Income Statement and Cash Flow Statement of an Insurer?**

759. IAS 1, Presentation of Financial Statements, deals with the structure of financial statements including minimum requirements for the content of the balance sheet and income statement. Those requirements are intended to be sufficiently flexible that they can be applied by all enterprises, including banks and insurance enterprises. IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, sets out additional requirements for banks and similar financial institutions. IAS 1 also includes an appendix containing illustrative formats. The adoption of the formats is not compulsory.
760. Some argue that a more detailed standard format is needed for the balance sheet, income statement and cash flow statement of an insurer in order to achieve consistency and comparability between the financial statements of insurance enterprises world-wide. Such an approach has been adopted by European Union (and its member states) and the United States which prescribe the formats for the income statement and balance sheet. Some argue that standard formats allow ratios to be calculated and compared on a consistent basis between different entities. However, others argue that a single format may not be appropriate in the regulatory environments in place in all countries. The adoption of a prescribed format may require changes in legislation in certain jurisdictions in order to permit the use of the proposed IAS.
761. Appendix 2 of IAS 7 provides an illustrative format of a cash flow statement for a financial institution. Some believe that it would be useful to add a further appendix to IAS 7 setting out an illustrative format for an insurer.

*Tentative Steering Committee View*

762. *The Steering Committee believes that an International Accounting Standard on insurance may need to require the presentation of certain insurance specific items on the face of the balance sheet, income statement and cash flow statement, in addition to those required by IAS 1 and IAS 7. The Steering Committee also recommends that illustrative formats for the balance sheet, income statement, cash flow statement and note disclosures should be provided as an appendix to the Standard. Illustrations A77-A82 in the accompanying booklet are illustrative balance sheet, income statement and cash flow statement formats for insurers.*

**Sub-issue 18B            Should an Insurer Make the Current/Non-current Distinction in its Balance Sheet?**

763. Paragraph 53 of IAS 1 requires every enterprise to consider, based on the nature of its operations, whether a distinction needs to be made between current and non-current assets and liabilities. In summary, current assets and liabilities are those that are expected to be realised, sold, consumed or settled either in the normal course of the enterprise's operating cycle or within twelve months of the balance sheet date. Where the classification between current and non-current assets is not made, assets and liabilities should be presented broadly in order of their liquidity.
764. Most insurers believe that the current/non-current distinction has little meaning for an insurer and would be arbitrary and difficult to apply. One difficulty is that the operating cycle for an insurer could be regarded as starting when an insurance contract first comes into being and ending when the final payment is made; on this view, most insurers (even those engaged in life insurance or long-tail general insurance) would classify virtually all assets and liabilities as current.
765. Another difficulty would arise if the current/non-current distinction were based primarily on a cut-off date of twelve months. On this basis, many insurers would classify a substantial part of their liabilities as non-current.
766. Similar difficulties exist for the classification of an insurer's financial assets. The fact that management often intends to hold the investments for a long time to match the associated insurance liabilities may suggest that an insurer should classify them as non-current assets. However, some enterprises trade investments on a regular basis either to realign the portfolio or take profits on accrued gains. In addition, the readily realisable nature of most investments held by insurance companies suggests that they should be categorised as current assets.

*Tentative Steering Committee View*

767. *In the Steering Committee's view, it is not useful for an insurer's balance sheet to present current assets and liabilities separately from non-current assets and liabilities.*

768. IAS 7 requires all enterprises to present a cash flow statement. Appendix 2 of IAS 7 provides an illustrative format of a cash flow statement for a financial institution. Some argue that cash flow information does not provide useful information about an insurer, on the grounds that the liquidity position does not necessarily indicate whether an insurance company is solvent. In addition, insurance enterprises generally hold a substantial amount of marketable investments and therefore liquidity is not a concern. Also, some believe that information about an insurer's cash flows in the past is of limited value in predicting the amounts and timing of its future cash flows. One argument for this position is that cash inflows of premiums do not immediately increase an insurer's liquidity because they create an insurance liability at the same time and, in many jurisdictions, will also create a need for capital to meet solvency requirements.
769. Others believe that cash flow information about an insurer is at least as important as cash flow information about other enterprises – and may be even more important than in other industries because of the unusual length of the operating cycle in insurance. They point to the following statements in paragraphs 4 and 5 of IAS 7.
4. A cash flow statement, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an enterprise, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the enterprise to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different enterprises. It also enhances the comparability of the reporting of operating performance by different enterprises because it eliminates the effects of using different accounting treatments for the same transactions and events.

5. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.
770. Cash and cash equivalents are defined by IAS 7 to include demand deposits and other short term highly liquid investments. Some regard this definition as appropriate for insurers. Others may regard this definition as being too narrow for insurers, which tend to hold a significant portfolio of securities which are readily marketable. Therefore, some argue that it may be preferable to redefine cash and cash equivalents for insurers to include net portfolio investments. Financial Reporting Standard No 1 in the UK adopts a slightly different approach – it requires insurers to present cash flows relating to portfolio investments as a separate category on the face of the cash flow statement.

771. Under IAS 7, the cash flow statement should differentiate between investing and operating activities. Some believe that this format is also appropriate for an insurer because the returns from investments and the results of operations, while linked to some extent, are not driven entirely by the same economic factors. Others believe that this differentiation is of limited value for an insurer, and is perhaps even misleading, since the majority of investing activities form an integral part of the operating activities.
772. IAS 7 states that the amount of cash flows arising from operating activities is a key indicator of the enterprise's cash generating capability. Consideration therefore needs to be given whether investment income and realised gains should be regarded as part of the operating activities for this purpose. IAS 7 provides guidance where an enterprise holds securities and loans for dealing or trading purposes. Cash flows from these transactions are regarded as operating activities. Some may argue that only investment income (including interest) should be classified as part of operating activities; they argue that purchases and sales of investment securities should be shown separately. Sub-issue 19A discusses how income and expense from insurance contracts should be presented in the income statement – for example, as operating items or as financing items. It may be that criteria developed for classification in the cash flow statement should be consistent with criteria developed for the income statement.
773. Some believe that IASC should require specific additional cash flow disclosures about insurance contracts, for example:
- (a) cash flows for reinsurance; and
  - (b) separate disclosures of cash flows from general insurance contracts and life insurance contracts.

*Tentative Steering Committee View*

774. *The Steering Committee recommends that all insurers should present a cash flow statement under IAS 7. An illustrative cash flow statement could be provided in the Standard in order to promote consistency. The Steering Committee has not yet discussed whether investment income and cash flows from purchase and sale of investments should be included in operating cash flows.*
775. *The Steering Committee will consider whether there is a need for specific cash flow disclosures about insurance contracts. The Steering Committee notes that traditional income statement formats for insurers often include information about cash flows. If this information is no longer presented separately in the income statement, there may be a need for specific disclosures.*
776. *The Steering Committee invites respondents to indicate whether the presentation and disclosure requirements in IAS 7 need any amendment in order to provide informative information to users of financial statements.*

**Sub-issue 18D                      Should Policyholder Interests be shown Separately from Stockholder Interests on the Face of the Balance Sheet, Income Statement and Cash Flow Statement?**

777. Basic Issue 13 expresses the Steering Committee's tentative view that the insurer, comprising both policyholder and stockholder interests, is a single reporting entity for which financial statements should be prepared. Some take the view that assets and liabilities that are held in separate funds on behalf of policyholders (and perhaps related income, expense and cash flows) should be presented separately on the face of the balance sheet (and perhaps income statement and cash flow statement). Others agree that separate disclosure of policyholder interests is important, but consider that disclosure in the notes is sufficient.
778. Some believe that it is important to disclose the investment return earned on investments in policyholders' funds separately from the investment return earned on investments in stockholders' funds. They argue that investment return is an integral part of the overall return from insurance activity and that this relationship should be highlighted in the income statement. If this view is taken, it will be necessary to specify whether the return on policyholders' funds includes only the return on those assets backing the insurance liabilities directly, or also the return on stockholders' equity tied up in the insurance operation. Others believe that any distinction between the investment return on policyholders' funds and on stockholders' funds is likely to be arbitrary, unhelpful and potentially misleading.
779. Illustrations A77 and A80 show ways of presenting investment return. Sub-issue 19E discusses a related question - should an insurer include all, part or none of its investment return in operating returns?
780. Some argue that cash flows relating to policyholder funds should not be included in the cash flow statement, on the grounds that they do not provide any meaningful information to stockholders and may obscure the financial position relating to the stockholders. In the UK, policyholder cash flows are excluded from the cash flow statement but in the US they are included.
781. Others argue that the treatment in the cash flow statement should mirror the treatment in the balance sheet and income statement; if the balance sheet and income statement include "policyholder" assets and liabilities and related income and expense, the cash flow statement should include the related cash flows.
782. In the case of unit-linked policies, policyholders' benefits are directly linked to the performance of the underlying assets. As such assets are held solely for the benefit of policyholders, some believe that an insurer should present these assets, and the related liabilities separately on the face of the balance sheet. Others agree that separate disclosure of these items is important, but consider that disclosure in the notes to the financial statements is sufficient.

*Tentative Steering Committee View*

783. *The Steering Committee believes that policyholder assets and liabilities and related income, expense and cash flows should be disclosed separately in the notes to the financial statements where practicable (practicability may vary by jurisdiction); separate presentation on the face of the balance sheet, income statement and cash flow statement should be permitted but not required. Separate disclosure in the notes may be needed where there is uncertainty about how assets of specific funds will be allocated between policyholders and stockholders, as is the case with some assets of some UK insurers. Separate disclosure may also be needed of cash flows between policyholders' funds and stockholders' funds.*
784. *Where insurance enterprises hold assets on behalf of policyholders and the benefits payable to the policyholders are directly linked to those assets, the Steering Committee recommends that these assets and liabilities and related income, expense and cash flows should be presented separately on the face of the balance sheet, income statement and cash flow statement.*

**Basic Issue 19      How Should Income and Expense from Insurance Contracts be Presented?**

785. This section addresses the following Sub-issues:
- (a) how should an enterprise present income and expense arising from insurance contracts;
  - (b) should an insurer present premium revenue and expense on the face of the income statement;
  - (c) should an insurer present unwinding of the discount on insurance liabilities as operating expense or as finance expense;
  - (d) how should an insurer report the effect of experience adjustments and changes in assumptions;
  - (e) should an insurer include all, part or none of its investment return in operating returns;
  - (f) should income and expense be presented in the income statement separately for life insurance contracts and for general insurance contracts; and
  - (g) should taxes and levies be included in premium income?
786. Some performance reporting questions are discussed in other sections:
- (a) should IASC specify a reporting format for the income statement of an insurer (Sub-issue 18A);

- (b) should policyholder interests be shown separately from stockholder interests on the face of the income statement (Sub-issue 18D); and
- (c) should IASC require disclosure of the difference between the actual (risk-adjusted) amounts recognised and the expected values of the related cash flows, and of the movements in that difference during the period (Sub-issue 20B)? If required, such disclosure might be given by on the face of the income statement or in the notes.

**Sub-issue 19A            How should an Enterprise Present Income and Expense arising from Insurance Contracts?**

787. The Framework states that the objective of financial statements is “to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.” In relation to financial performance, the Framework states the following:

17. Information about the performance of an enterprise, in particular its profitability, is required in order to assess potential changes in the economic resources that it is likely to control in the future. Information about variability of performance is important in this respect. Information about performance is useful in predicting the capacity of the enterprise to generate cash flows from its existing resource base. It is also useful in forming judgements about the effectiveness with which the enterprise might employ additional resources.

788. The Framework states that the elements of financial statements that are directly related to financial performance are income and expenses, defined as follows:

- (a) income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants; and
- (b) expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

789. Information about financial performance is provided primarily in an income statement (sometimes known by other names, such as profit and loss account). However, some items that meet the above definition of income or expenses are sometimes reported either directly in equity or in a second performance statement. Under IAS 1, Presentation of Financial Statements, an enterprise should present, as a separate component of its financial statements, a statement showing:

- (a) the net profit or loss for the period;
- (b) each item of income and expense, gain or loss which, as required by other Standards, is recognised directly in equity, and the total of these items; and

- (c) the cumulative effect of changes in accounting policy and the correction of fundamental errors dealt with under the Benchmark treatments in IAS 8.
790. There is currently an active international debate on ways of reporting financial performance. To allow some experimentation while this debate is resolved, IAS 1 permits an enterprise to present this separate component in a number of ways. One presentation presents only the three items listed in the previous paragraph. Another presentation is a columnar format which reconciles between the opening and closing balances of each element within stockholders' equity and thus also includes capital transactions with owners and distributions to owners, opening and closing balances, transfers from one element to another and other movements.
791. Many performance reporting topics arise from the work of the Joint Working Group (JWG) on financial instruments (see Basic Issue 2). It is likely that the JWG will need to produce recommendations for resolving some of these topics before the JWG can develop proposals for an integrated and comprehensive standard on financial instruments. Those recommendations are likely to impact on IASC's insurance project.
792. The debate on performance reporting is also proceeding in another forum. The G4+1 group of standard setters has recently published a Position Paper, Reporting Financial Performance: Proposals for Change. This proposes a single performance statement presenting three main categories of income and expenses:
- (a) operating (or trading) activities;
  - (b) financing and other treasury activities; and
  - (c) other gains and losses.
793. IAS 1 already requires enterprises to present the results of operating activities and finance costs as two separate items on the face of the income statement. However, the details of that distinction could differ from the recommendations in the G4+1 paper. Some items that might be candidates for inclusion in the G4+1's category of "other gains and losses" may already be included in income statements today; others are today recognised directly in equity.
794. The G4+1 paper proposes that standard setters should specify in accounting standards those gains and losses that could be reported as other gains and losses and some (or all) of the contents of financing and other treasury activities. The default category would be operating (or trading) activities. In other words, if an item were not permitted to be included in other gains or losses or financing and other treasury activities, then it would have to be included in operating (or trading) activities.
795. The G4+1 proposes that those items actively managed to add value to the entity should be shown in operating or financing activities, while the economic impact of changes affecting peripheral aspects of an activity should be shown in other gains and losses. The G4+1 paper identifies the characteristics typical of operating (or trading)

activities and other gains and losses (see Table 17). Items that predominantly have the characteristics listed on the left would tend to be reported as part of operating activities. Those whose characteristics were predominantly those listed on the right would be reported as other gains and losses.

<b>Characteristics more typical of operating items</b>	<b>Characteristics more typical of other gains and losses</b>
Operating activities	Non-operating activities
Recurring	Non-recurring
Non-holding items	Holding items
Internal events (such as value adding activities)	External events (such as price changes)

**Table 17 – Operating (or Trading) Activities and Other Gains and Losses**

796. The G4+1 paper identifies only three items that are candidates for inclusion in the other gains and losses. Two of these are recognised directly in equity under current International Accounting Standards. These are the revaluation of certain assets (under the allowed alternative treatment in IAS 16, Property, Plant and Equipment, IAS 25, Accounting for Investments, and IAS 38, Intangible Assets) and foreign currency translation adjustments relating to a net investment in a foreign operation (under IAS 21). The third item is actuarial gains and losses relating to pensions (under IAS 19, Employee Benefits, these are currently recognised in the income statement, although enterprises are permitted to delay their recognition in part, through the corridor approach described in Sub-issue 6G).
797. Some argue that the category of other gains and losses should be regarded as a “holding tank”, in the sense that all items recognised initially in that category should ultimately be “recycled” (that is, transferred) into one of the other two categories. The G4+1 believes that there is no conceptual justification for recycling and that consequently it should be prohibited. The G4+1 recognises, however, that standard setters may permit or require recycling in certain situations, in the short term, where this represents an improvement upon existing practice. Under IAS 21, foreign currency translation adjustments are recycled on disposal of the foreign operation. IAS 16 and IAS 38 prohibit recycling of revaluation surplus on disposal of the related asset.
798. The G4+1 paper does not address the contents of the “financing and treasury” component in depth, because they are likely to be influenced by the result of the work by the JWG. The financing activities component is likely to include some items that reflect characteristics similar to those of “operating” items, and others that possess characteristics closer to items included in “other gains and losses”. Interest expense is a possible candidate for inclusion in financing activities; other possibilities include gains and losses on derivatives and other financial instruments.

799. For certain entities, particularly financial institutions, the “financing and other treasury activities” component will consist of items that are actively traded as part of the core operations of the entity. In such cases the G4+1 paper suggests that the “financing and other treasury activities” component should become a segment of “operating (trading) activities”.
800. Some argue that the distinction between operating activities and financing activities is not particularly meaningful for insurers, as their core operations are financial and that any such distinction will be arbitrary. Others believe that there is no reason to treat financial institutions, such as insurers, differently from other enterprises.
801. The debate on performance reporting raises questions about the best way to report changes in the liabilities (and assets, if any) recognised for insurance contracts. These changes arise from a number of factors:
- (a) any gain recognised on the sale of new business (see Sub-issues 7C, 8D and 11F);
  - (b) premiums;
  - (c) claims;
  - (d) the increase in insurance liabilities because of the passage of time (an effect similar to interest, sometimes called “unwinding of discount”);
  - (e) experience adjustments – differences between actual events and previous assumptions about those events;
  - (f) changes in assumptions about future events;
  - (g) changes in the discount rate;
  - (h) changes in the amount of any adjustment made to reflect risk and uncertainty (see Sub-issue 6F); and
  - (i) where a fair value model or an embedded value model is used, other changes in fair values or embedded values.
802. Items (a) to (c) would probably be included in operating activities. Today, item (d) is usually included in operating activities, although some argue that it might belong more naturally in financing and treasury activities. The classification of items (e) to (i) will depend largely on the performance reporting model that emerges from the current international debate. Similar comments apply to changes in the carrying amount of investments, which may be linked to some extent with changes in the carrying amount of insurance liabilities. Illustrations A77 and A80 show ways of presenting the income statement of an insurer.

*Tentative Steering Committee View*

803. *The Steering Committee plans to review the progress made by the Joint Working Group on Financial Instruments and by the G4+1 before developing specific proposals for presenting income and expense arising from insurance contracts.*

**Sub-issue 19B            Should an Insurer Present Premium Revenue and Claims Expense on the Face of the Income Statement?**

804. The Steering Committee has taken the view in this Issues Paper that the liabilities and assets that arise from insurance contracts should be measured on a basis that reflects the present value of future cash flows, including claims and benefit payments, expenses as appropriate and (for life insurance) future premiums from in-force contracts.<sup>18</sup> This causes a difficulty in reporting the components of financial performance, for the reason explained in the following paragraph.
805. If the carrying amount of an asset or liability already includes the present value of claims and benefits payments and some expenses and future premiums from inforce contracts, the normal accounting in most other industries would be not to recognise those cash flows as income and expense when they occur. This would suggest that claims incurred and expenses should not be reported as an expense and that premium receipts (at least for life insurance) should not be reported as income. Changes in estimates of the cash flows would be recognised as income or expense.
806. Insurers today do report premiums as income and claims as expenses and it seems likely that financial statement users would still want this information. One way to report this information would be to disclose it in the notes to the financial statements. An alternative would be to continue to present this information on the face of the income statement. However, the movements in reported assets and liabilities will not then reconcile unless a “recycling” adjustment is included in the income statement to remove the cash flows that were already effectively recognised at a previous date as part of a discounting calculation. The “recycling” adjustment will have no separate economic meaning, but is simply needed to make the income statement reconcile to the balance sheet.
807. If premiums and claims are reported on the face of the income statement, there are two methods of doing this. The first method presents cash receipts and payments on the face of the income statement and shows movements on related assets and liabilities (from, for example, unearned premiums and claims payable) as separate line items on the face of the income statement. The second method shows a single item for premium revenue and a single item for claims expense.
808. Supporters of the first method argue that it provides a clearer insight into cash flows and balance sheet movements. Proponents of the second method argue that it is

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<sup>18</sup> This Issues Paper proposes one exception to the principle that liabilities and assets that arise from insurance contracts should be measured on a basis that reflects the present value of future cash flows; as explained in Sub-issue 8D, the Steering Committee proposes that the liability recognised under a life insurance contract should not be less than the amount that would result from applying a retrospective (policyholder-deposit) approach.

more consistent with the form of accruals accounting that is commonly adopted in almost every other area of financial reporting; they also note that the cash flow statement reports information on cash flows.

809. Where contracts do not qualify as insurance contracts because there is no insurance risk, the issuer of the contract will report the receipts from the counterparty as a deposit receipt, rather than as income. Similarly, where an investment component is unbundled (Sub-issue 1E), deposit accounting will be used for the investment component and the insurer will report as premium revenue only that part of the receipt that relates to the insurance component.

*Tentative Steering Committee View*

810. *The Steering Committee believes that premiums and claims should be presented as a single item for premium revenue and a single item for claims expense, not as cash receipts and payments alongside movements on related asset and liabilities.*

**Sub-issue 19C                      Should an Insurer Present Unwinding of the Discount as Operating Expense or as Finance Expense?**

811. Where assets or liabilities are measured at present value, their present value will change with the passage of time as the discount “unwinds”. Some argue that the “unwinding” of the discount should always be presented as finance income or expense because:
- (a) economically, this component of the change in fair value is similar to interest. It is driven by the balance of the asset or liability and the discount rate. Financial statements are more understandable if this component is distinguished from components that are driven by other factors; and
  - (b) this treatment is already common practice for items such as zero-coupon bonds, deep-discount bonds and in other applications of the effective interest method. There is no conceptual justification for restricting such practices to cases where the initial measurement of an asset or liability reflects the initial cash payment or receipt. Conceptually, this treatment is equally valid for assets or liabilities that are measured initially on the basis of an explicit present value computation.
812. Those who oppose this treatment argue that:
- (a) the segregation of the “unwinding” requires arbitrary and potentially misleading allocations that users may not find helpful;
  - (b) the cost of distinguishing the separate components may outweigh the benefits to users; and
  - (c) it is not common practice today to report this interest element as finance income or expense.

813. Illustrations A77 and A80 present ways of presenting the unwinding. IASC has addressed this issue previously:

- (a) IAS 19, Employee Benefits, states explicitly that it does not specify whether an income statement should present interest cost and the expected return on plan assets in the same line item as current service cost. However, it requires an enterprise to disclose the line items in which they are included; and
- (b) IAS 37, Provisions, Contingent Liabilities and Contingent Assets, states that, “[w]here discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as an interest expense.”

*Tentative Steering Committee View*

814. *In the Steering Committee’s view, the “unwinding” of the discount should be classified in the same way as interest income and interest expense.*

**Sub-issue 19D            How Should an Insurer Present the Effect of Experience Adjustments and Changes in Assumptions?**

815. Some argue that the effects of experience adjustments and changes in assumptions (including changes in the discount rate) should be recognised not in the income statement but in a second performance statement or directly in equity (or, if the G4+1 proposals are accepted, in the income statement but within the category of “other gains and losses”). This raises a number of questions that IASC has not resolved, including:

- (a) whether financial performance includes those items that are recognised directly in equity;
- (b) the conceptual basis for determining whether items are recognised in the income statement or directly in equity;
- (c) whether net cumulative losses from experience adjustments and changes in assumptions should be recognised in the income statement, rather than directly in equity; and
- (d) whether certain items reported initially in equity should subsequently be reported in the income statement (“recycling”).

816. Others would argue that the effects of experience adjustments and changes in assumptions should be recognised in the income statement. Some who take this line argue that these items should be included in the category of “other gains and losses” that is proposed in the G4+1 Position Paper discussed in Sub-issue 19A. Others suggest that it would be more appropriate to include them in operating activities or finance and treasury activities.

817. In two recent Exposure Drafts (E64, Investment Property, and E65, Agriculture), IASC proposes that when assets are measured at fair value, changes in their fair value should be included in the income statement.

*Tentative Steering Committee View*

818. *At this stage, the Steering Committee has not formed a view on this issue. The Steering Committee will monitor progress by the Joint Working Group on Financial Instruments and in IASC's projects on Agriculture and Investment Property.*

**Sub-issue 19E                      Should an Insurer Include All, Part or None of its Investment Return in Operating Activities?**

819. As already discussed above, IAS 1 requires that the income statement should disclose separately results from operating activities and financing costs. There is no specific guidance in IAS 1 on the treatment of interest income and investment gains and losses. However, IAS 30 requires banks and similar financial institutions to give additional disclosures beyond those required by IAS 1.
820. IAS 30 requires disclosure in the income statement or the notes to the financial statements of interest income and gains and losses arising from dealing securities, investment securities and foreign currencies. A similar approach could be adopted for insurers, but the question arises whether results from operating activities should include:
- (a) no investment income (including interest) or gains or losses;
  - (b) investment income but excluding gains and losses;
  - (c) investment income and realised gains and losses; or
  - (d) all investment return including realised and unrealised gains and losses.
821. Some believe that investment activities are an integral part of the operations of an insurance enterprise. However, some argue that only investment income and/or realised gains and losses should be included within operating profit. Others would argue that the total investment return should form part of the operating result as it reflects management performance in managing the affairs of the company as a whole. Some believe that the distinction between realised and unrealised gains and losses is artificial as management is able to realise the appropriate amount of gains to report their target profit number. Others believe that the inclusion of unrealised gains and losses in the income statement is not prudent and introduces a considerable amount of volatility in the reported earnings.
822. IAS 7, Cash Flow Statements, addresses a similar issue – it states that a financial institution usually classifies interest paid and interest and dividends received as operating cash flows in the cash flow statement. IAS 7 cites “cash receipts and cash payments of an insurance enterprise for premiums and claims, annuities and other policy benefits” as an example of cash flows from operating activities.

823. Some argue that an insurer should classify part of its investment return as operating income and part as financial income. For example, in its Statement of Recommended Practice (SORP), Accounting for Insurance Business, the Association of British Insurers recommends that operating results should include investment return at the longer term rate of return; the rest of the investment return is shown outside operating results.
824. Those who support this approach argue that pricing of insurance contracts is linked to expected longer term investment returns. They suggest that insurers can give a clear picture of this link by including this portion of the investment return in operating results and by separating it from shorter term fluctuations around the expected longer term averages. Those who oppose this approach argue that any such allocation is arbitrary and of questionable relevance and reliability.
825. Illustrations A77 and A80 show ways of presenting investment return. Sub-issue 18D discusses a related question - should an insurer present the investment return earned on investments in policyholders' funds separately from the investment return earned on investments in stockholders' funds?

*Tentative Steering Committee View*

826. *The Steering Committee believes that the results of operating activities should include the total investment return ( dividend and interest income, as well as gains and losses both realised and - to the extent recognised - unrealised) as it reflects the total performance of the management in managing the underwriting and investment activities of the enterprise.*
827. *The Joint Working Group on Financial Instruments will be considering various issues about the reporting of changes in the carrying amount of financial instruments. The Steering Committee will monitor the progress of that work.*

**Sub-issue 19F                      Should Income and Expense be Presented in the Income Statement Separately for Life Insurance Contracts and for General Insurance Contracts?**

828. Insurers sometimes split their income statement into separate components, showing the results of the life business, the non-life business and a non-insurance section. This method of presentation is adopted in the European Union, where the results of underwriting activity are included within two sections described as "technical accounts" (for life and non-life activities), whilst the results of other activities are included in a "non-technical account". The non-technical account shows the results of activities such as the return on stockholders' investments, or expenses and charges not attributable to underwriting. However, investment return on stockholder funds in so far as they must be retained within the company to maintain solvency or meet other regulatory requirements could be considered as part of the insurance activities of the company and allocated to the respective technical accounts.

829. Those who support this split presentation argue that the characteristics of general insurance and life insurance differ significantly and users of financial statements often attribute more value to the relatively certain cash flows arising out of life insurance and investment business than they do to the more variable cash flows arising out of non-life business. Therefore, splitting the two businesses on the face of the income statement provides users with helpful information.
830. An alternative view is that the detailed analysis of revenue accounts need not be given on the face of the income statement, provided that adequate segmental analysis is disclosed in the notes to the financial statements. To include life, non-life and stockholders' results as separate sections on the face of the income statement may hinder the interpretation of the financial statements. Thus, the income statement is presented in some countries as a single primary statement reflecting all of the operations. This approach has been adopted in both the US and Australia.

*Tentative Steering Committee View*

831. *The Steering Committee believes that the most appropriate presentation format for the income statement is a single statement combining general and life insurance with further analysis provided as segmental information in the notes to the financial statements. The Steering Committee recognises that this approach may require amendment to legislation in certain jurisdictions.*

**Sub-Issue 19G      Should Taxes and Levies be Included in Premium Income?**832. In many jurisdictions, there are taxes and levies associated with insurance premiums. Paragraph 8 of IAS 18, Revenue, comments that:

Revenue includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. Amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes are not economic benefits which flow to the enterprise and do not result in increases in equity. Therefore, they are excluded from revenue.

833. The same principle seems appropriate for taxes collected with insurance premiums on behalf of taxing authorities. Such taxes may be a flat amount per policy or be a percentage based on the amount insured or the amount of the premium. The same applies to levies collected with insurance premiums on behalf of third parties to help pay for services related to the insured assets, such as fire service levies on house insurance policies and policyholder guarantee funds.
834. For some levies, the insurer is not simply acting as a collector on behalf of government or another third party. For example, each insurer selling motor vehicle insurance policies may be levied by government for the repair of roads based on their respective share of the motor vehicle insurance market. In such cases, government will typically determine the costs that need to be covered and then inform the insurers of the amount they will need to pay once each year. The insurers are responsible for factoring into their premiums an amount to pay for the levy. Insurers may identify a portion of the premium paid by policyholders as relating to the levy, even though it represents only the insurer's estimate of the amount needed to be received from each

policyholder to cover the government levy. In such cases, the insurer is not simply collecting amounts on behalf of government. The premiums should be recognised as the gross amounts, which includes the allowance for any levies. Accordingly, the levy imposed on the insurer by government is an expense of the insurer. That is, the levy is a cost of being in the motor vehicle insurance business and the premiums, including any amount separately identified as relating to the levy, are premium revenues of the insurer.

*Tentative Steering Committee View*

835. *The Steering Committee recommends that insurers follow IAS 18, Revenue, in determining which amounts are included in premium income. The Steering Committee further recommends that insurers disclose which taxes and levies have been included or excluded from the amount presented as premium income.*

## **Basic Issue 20      What Disclosures Should be Required about Insurance Contracts?**

836. This section addresses the following Sub-issues:

- (a) should the disclosures about financial instruments in IAS 32 and IAS 39 be extended to cover insurance contracts;
- (b) should IAS 37's disclosure requirements about provisions to cover insurance contracts;
- (c) should an insurer disclose details of claims development;
- (d) should disclosures of solvency be made in the financial statements;
- (e) does IAS 14 give sufficient guidance on segmental reporting by insurers;
- (f) should disclosures be required about key performance indicators; and
- (g) should disclosures be given about sensitivity?

837. The following extracts from IAS 1, Presentation of Financial Statements, give a reminder of the purpose of general purpose financial statements and provide a basic framework for disclosures.

5. Financial statements are a structured financial representation of the financial position of and the transactions undertaken by an enterprise. The objective of general purpose financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an enterprise's:

- (a) assets;
- (b) liabilities;
- (c) equity;
- (d) income and expenses, including gains and losses; and
- (e) cash flows.

This information, along with other information in the notes to financial statements, assists users in predicting the enterprise's future cash flows and in particular the timing and certainty of the generation of cash and cash equivalents.

93. Notes to the financial statements include narrative descriptions or more detailed analyses of amounts shown on the face of the balance sheet, income statement, cash flow statement and statement of changes in equity, as well as additional information such as contingent liabilities and commitments. They include information required and encouraged to be disclosed by International Accounting Standards, and other disclosures necessary to achieve a fair presentation.

838. It should be noted that more detailed disclosure will be needed in the notes to the financial statement if less detail is presented on the face of the balance sheet, income statement and cash flow statement.

## Materiality

839. The following extracts from IAS 1 give a reminder of the role of materiality.

**29. Each material item should be presented separately in the financial statements. Immaterial amounts should be aggregated with amounts of a similar nature or function and need not be presented separately.**

30. Financial statements result from processing large quantities of transactions which are structured by being aggregated into groups according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data which form line items either on the face of the financial statements or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of the financial statements may nevertheless be sufficiently material that it should be presented separately in the notes.

31. In this context, information is material if its non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item judged in the particular

circumstances of its omission. In deciding whether an item or an aggregate of items is material, the nature and the size of the item are evaluated together. Depending on the circumstances, either the nature or the size of the item could be the determining factor. For example, individual assets with the same nature and function are aggregated even if the individual amounts are large. However, large items which differ in nature or function are presented separately.

32. Materiality provides that the specific disclosure requirements of International Accounting Standards need not be met if the resulting information is not material.

### Disclosure in a Financial Review by Management

840. Some argue that some of the disclosures discussed below would be useful disclosures in a financial review by management (such as a Management Discussion and Analysis or a Directors' Report), but should not be included in the financial statements. *The Steering Committee invites respondents to indicate whether any of the items below should be addressed in this way.*

#### **Sub-issue 20A      Should the Disclosures about Financial Instruments in IAS 32 and IAS 39 be Extended to Cover Insurance Contracts?**

841. The Steering Committee concluded tentatively in Sub-issues 1B and 11A that an insurance contract is a type of financial instrument. IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement, require certain disclosures about financial instruments. Although insurance contracts are scoped out of IAS 32 and IAS 39, the disclosures required by those Standards may be appropriate for insurance contracts as well.
842. The disclosures required by IAS 32 are:

#### ***Disclosure of Risk Management Policies***

**43A. An enterprise should describe its financial risk management objectives and policies, including its policy for each major type of forecasted transaction for which hedge accounting is used. (note: this paragraph 43A was inserted in IAS 32 by IAS 39.)**

**47. For each class of financial asset, financial liability and equity instrument, both recognised and unrecognised, an enterprise should disclose:**

- (a) information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and
- (b) the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.

- 56. For each class of financial asset and financial liability, both recognised and unrecognised, an enterprise should disclose information about its exposure to interest rate risk, including:**
- (a) contractual repricing or maturity dates, whichever dates are earlier; and**
  - (b) effective interest rates, when applicable.**
- 66. For each class of financial asset, both recognised and unrecognised, an enterprise should disclose information about its exposure to credit risk, including:**
- (a) the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and**
  - (b) significant concentrations of credit risk.**
- 77. For each class of financial asset and financial liability, both recognised and unrecognised, an enterprise should disclose information about fair value. When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability, that fact should be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.**
- 88. When an enterprise carries one or more financial assets at an amount in excess of their fair value, the enterprise should disclose:**
- (a) the carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and**
  - (b) the reasons for not reducing the carrying amount, including the nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.**
- 91. When an enterprise has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:**
- (a) a description of the anticipated transactions, including the period of time until they are expected to occur;**
  - (b) a description of the hedging instruments; and**
  - (c) the amount of any deferred or unrecognised gain or loss and the expected timing of recognition as income or expense.**

94. Additional disclosures are encouraged when they are likely to enhance financial statement users' understanding of financial instruments. It may be desirable to disclose such information as:

- (a) the total amount of the change in the fair value of financial assets and financial liabilities that has been recognised as income or expense for the period;
- (b) the total amount of deferred or unrecognised gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and
- (c) the average aggregate carrying amount during the year of recognised financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognised financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the balance sheet date are unrepresentative of amounts on hand during the year.

843. The disclosures required by IAS 39 are:

**167. The following should be included in the disclosures of the enterprise's accounting policies as part of the disclosure required by IAS 32 paragraph 47(b):**

- (a) the methods and significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value, separately for significant classes of financial assets (paragraph 46 of IAS 32 provides guidance for determining classes of financial assets);**
- (b) whether gains and losses arising from changes in the fair value of those financial assets and financial liabilities that are measured at fair value subsequent to initial recognition, other than those held for trading, are included in net profit or loss for the period or are recognised directly in equity until the financial asset is disposed of or the liability is extinguished; and**
- (c) for each of the four categories of financial assets defined in paragraph 10, whether 'regular way' purchases of financial assets are accounted for at trade date or settlement date (see paragraph 30).**

168. In applying paragraph 167(a), disclosure would include prepayment rates, rates of estimated credit losses, and interest or discount rates.

**169. Financial statements should include all of the following additional disclosures relating to hedging:**

- (a) describe the enterprise's financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction (see paragraph 142(a));**

For example, in the case of hedges of risks relating to future sales, that description indicates the nature of the risks being hedged, approximately how many months or years of expected future sales have been hedged, and the approximate percentage of sales in those future months or years;

- (b) disclose the following separately for designated fair value hedges, cash flow hedges, and hedges of a net investment in a foreign entity:**

- (i) a description of the hedge;**
- (ii) a description of the financial instruments designated as hedging instruments for the hedge and their fair values at the balance sheet date;**
- (iii) the nature of the risks being hedged; and**
- (iv) for hedges of forecasted transactions, the periods in which the forecasted transactions are expected to occur, when they are expected to enter into the determination of net profit or loss, and a description of any forecasted transaction for which hedge accounting had previously been used but that is no longer expected to occur; and**

- (c) if a gain or loss on derivative and non-derivative financial assets and liabilities designated as hedging instruments in cash flow hedges has been recognised directly in equity, through the statement of changes in equity, disclose:**

- (i) the amount that was so recognised in equity during the current period;**
- (ii) the amount that was removed from equity and reported in net profit or loss for the period; and**
- (iii) the amount that was removed from equity and added to the initial measurement of the acquisition cost or other carrying amount of the asset or liability in a hedged forecasted transaction during the current period (see paragraph 160).**

**170. Financial statements should include all of the following additional disclosures relating to financial instruments:**

- (a) if a gain or loss from remeasuring available-for-sale financial assets to fair value (other than assets relating to hedges) has been**

recognised directly in equity, through the statement of changes in equity, disclose:

- (i) the amount that was so recognised in equity during the current period; and
  - (ii) the amount that was removed from equity and reported in net profit or loss for the period;
- (b) if the presumption that fair value can be reliably measured for all financial assets that are available for sale or held for trading has been overcome (see paragraph 70) and the enterprise is, therefore, measuring any such financial assets at amortised cost, disclose that fact together with a description of the financial assets, their carrying amount, an explanation of why fair value cannot be reliably measured, and, if possible, the range of estimates within which fair value is highly likely to lie. Further, if financial assets whose fair value previously could not be measured reliably are sold, that fact, the carrying amount of such financial assets at the time of sale, and the amount of gain or loss recognised should be disclosed;
- (c) disclose significant items of income, expense, and gains and losses resulting from financial assets and financial liabilities, whether included in net profit or loss or as a separate component of equity. For this purpose:
  - (i) total interest income and total interest expense (both on a historical cost basis) should be disclosed separately;
  - (ii) with respect to available-for-sale financial assets that are adjusted to fair value after initial acquisition, total gains and losses from derecognition of such financial assets included in net profit or loss for the period should be reported separately from total gains and losses from fair value adjustments of recognised assets and liabilities included in net profit or loss for the period (a similar split of 'realised' versus 'unrealised' gains and losses with respect to financial assets and liabilities held for trading is not required);
  - (iii) the enterprise should disclose the amount of interest income that has been accrued on impaired loans pursuant to paragraph 116 and that has not yet been received in cash;
- (d) if the enterprise has entered into a securitisation or repurchase agreement, disclose, separately for such transactions occurring in the current financial reporting period and for remaining retained

**interests from transactions occurring in prior financial reporting periods:**

- (i) the nature and extent of such transactions, including a description of any collateral and quantitative information about the key assumptions used in calculating the fair values of new and retained interests;**
- (ii) whether the financial assets have been derecognised;**
- (e) if the enterprise has reclassified a financial asset as one required to be reported at amortised cost rather than at fair value (see paragraph 92), disclose the reason for that reclassification; and**
- (f) disclose the nature and amount of any impairment loss or reversal of an impairment loss recognised for a financial asset, separately for each significant class of financial asset (paragraph 46 of IAS 32 provides guidance for determining classes of financial assets).**

844. Given the Steering Committee's tentative view that insurance contracts are financial instruments, there is a presumption that the disclosures required by IAS 32 and IAS 39 will be appropriate for insurance contracts, except where there is a specific justification for a difference.
845. Some argue that the disclosures required by IAS 32 and IAS 39 could, if applied to insurance contracts, be voluminous and place a significant burden on the preparers of financial statements. In addition there may be practical difficulties in obtaining information, for example, in calculating fair values of liabilities. An alternative approach would be to modify the disclosures required by IAS 32 so that a succinct summary is provided of the key types of business written and the risks and exposures arising. Some of the issues arising from the above disclosure requirements are as follows:
- (a) disclosures required by IAS 32, paragraph 47, could be provided in a summarised form of key terms and conditions by product grouping in order to avoid lengthy disclosures of different types of insurance contracts offered;
  - (b) calculation of interest rate risk may be complex for certain life insurance products; and
  - (c) it may be difficult to estimate the fair value of insurance liabilities (See Basic Issue 11 for further discussion).
846. Others argue that the disclosures required by IAS 32 and IAS 39 are necessary because they give users insight into the amount and timing of future cash flows that will flow from financial instruments and about the risks associated with those cash flows. They observe that paragraph 45 of IAS 32 provides some guidance to ensure that financial statements do not contain an excessive amount of detail and provide summarised information for homogeneous products.

*Tentative Steering Committee View*

847. *The Steering Committee believes that most of the disclosures required by IAS 32 are also likely to be relevant for insurance contracts. The Steering Committee intends to give some additional guidance to clarify how these requirements should be applied to insurance contracts in an informative and concise way. The Steering Committee notes that the Canadian Institute of Chartered Accountants (CICA) has issued guidance (Accounting Guideline AcG-4, Actuarial Liabilities of Life Insurance Enterprises) on how life insurers should make disclosures required by section 3860 of the CICA Handbook. Section 3860 and IAS 32 were developed together as part of a joint project and are virtually identical. Unlike IAS 32, section 3860 does not have a scope exclusion for insurance contracts.*
848. *Most of the disclosures required by IAS 39 arise from specific details of the recognition and measurement requirements of IAS 39. Similar requirements may or may not be needed for insurance contracts: this will depend on the recognition and measurement requirements adopted for insurance contracts.*

**Sub-Issue 20B      Should IASC extend IAS 37's Disclosure Requirements about Provisions to Cover Insurance Contracts?**

849. IAS 37, Provisions, Contingent Liabilities and Contingent Assets, requires the following disclosures.

**84.      For each class of provision, an enterprise should disclose:**

- (a)      the carrying amount at the beginning and end of the period;**
- (b)      additional provisions made in the period, including increases to existing provisions;**
- (c)      amounts used (i.e. incurred and charged against the provision) during the period;**
- (d)      unused amounts reversed during the period; and**
- (e)      the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.**

**Comparative information is not required.**

**85.      An enterprise should disclose the following for each class of provision:**

- (a)      a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;**

- (b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 48; and
  - (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.
- 86. Unless the possibility of any outflow in settlement is remote, an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:**
- (a) an estimate of its financial effect, measured under paragraphs 36-52;
  - (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
  - (c) the possibility of any reimbursement.
- 87.** In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements of paragraphs 85(a) and (b) and 86(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to warranties of different products, but it would not be appropriate to treat as a single class amounts relating to normal warranties and amounts that are subject to legal proceedings.
- 88.** Where a provision and a contingent liability arise from the same set of circumstances, an enterprise makes the disclosures required by paragraphs 84-86 in a way that shows the link between the provision and the contingent liability.
- 89. Where an inflow of economic benefits is probable, an enterprise should disclose a brief description of the nature of the contingent assets at the balance sheet date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36-52.**
- 90.** It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of income arising.
- 91. Where any of the information required by paragraphs 86 and 89 is not disclosed because it is not practicable to do so, that fact should be stated.**

**92. In extremely rare cases, disclosure of some or all of the information required by paragraphs 84-89 can be expected to prejudice seriously the position of the enterprise in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an enterprise need not disclose the information, but should disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

850. Insurance contracts are excluded from the scope of IAS 37. However, some argue that these disclosure requirements should be applied equally to insurance contracts. It may be appropriate to provide guidance on such disclosures for insurance contracts, perhaps with illustrative examples. For example, uncertainties arising from insurance contracts may be specific (for example relating to an outcome of litigation) or generic (for example the difficulty in estimating long tail liability provisions).

851. One reason for extending the IAS 37 disclosures to cover insurance contracts is that these disclosures address uncertainty, which is the essence of an insurance contract. Another useful precedent for such disclosures might be Statement of Position SOP 94-5 issued by the AICPA (American Institute of Certified Public Accountants), which requires a statement of risks and uncertainties relating to the nature of operations, use of estimates in the preparation of financial statements, certain significant estimates and current vulnerability due to certain concentrations. Some agree that some of this information would be useful, but argue that it should be presented outside the financial statements in a financial review by management.

852. The Steering Committee concluded in Sub-issue 6F that the measurement of insurance liabilities should reflect the risk that would be reflected in the price of an arm's length transaction between knowledgeable, willing parties. Some argue that IAS 37 should require disclosure about the extent of such risk adjustments. One precedent for such disclosures is found in Accounting Guideline AcG-4, Actuarial Liabilities of Life Insurance Enterprises – Disclosure, issued by the Canadian Institute of Chartered Accountants. Paragraph 22 of AcG-4 states:

**22. Actuarial liabilities include a provision for adverse deviations that is based on the extent of uncertainty inherent in the estimation process. This provision will emerge as profit in future years to the extent that it is not offset by adverse experience. Consideration should be given to disclosing the total amount provided for adverse deviation, together with an explanation of the nature of the risks allowed for by that provision, the company's overall approach to providing for possible adverse experience in future years and the level of conservatism incorporated into both the assumptions for expected experience and the associated margins for adverse deviation.**

853. Some argue that IAS 37's disclosures about reimbursements should be extended to require similar information about reinsurance.

### *Tentative Steering Committee View*

854. *The Steering Committee believes that the disclosures in IAS 37 should be extended to cover insurance contracts. The Steering Committee intends to give further guidance on the application of these disclosures to insurance contracts, including illustrative examples.*
855. *The Steering Committee believes that disclosures about the extent of risk adjustments may be useful. One possibility might be to require disclosure of the difference between the actual (risk-adjusted) amounts recognised and the expected values of the related cash flows, and of the movements in that difference during the period. The Steering Committee plans to develop further thoughts in this area. Illustrations A77-A81 show ways of presenting disclosures about the effect of risk adjustments.*

### **Sub-Issue 20C      Should an Insurer Disclose Details of Claims Development?**

856. Although IAS 37 requires disclosures about movements in provisions and about the uncertainties relating to the amount and timing of cash flows required to settle provisions, some believe that it would be useful to require more detailed disclosure about claims development. Such information is disclosed by insurers in certain countries. Most notably, US companies are required to disclose ten years claims development tables; this disclosure is made outside the financial statements in the Management's Discussion & Analysis. This typically highlights the out-turn of provision established at the end of each year. The SEC requires a 10 year claims development table for inclusion in the Form 10-K filing. In the European Union, there is a requirement to disclose, where material, any under or over prior year claims provisions by category.
857. Claims development details may assist the user of the financial statements of a general insurer to assess the potential risks facing the insurer and its historical track record of making adequate provisions for outstanding claims. In the case of an insurer with significant long tail exposures (such as asbestosis and latent diseases claims), users of financial statements will be interested in information that helps them to assess the amounts, timing and certainty of future cash flows resulting from those exposures. Claims development information will allow the user to assess whether past provisions have been optimistic or conservative and so aids the user in determining the reasonableness of the provisions in the balance sheet. The disclosure of the effect of any movement in prior year provisions on the current year's profit may also be helpful to users to analyse the trends in the recent performance without the distortions of the movements in prior years.
858. Another view is that limited disclosure of claims development information in summary form may not provide the user with sufficient information to assess the amounts, timing and certainty of future cash flows.
859. Claims development details will not necessarily be a useful disclosure for all insurance entities. For example, claims development information is unlikely to provide useful information to users of a life insurer's financial statements because claims tend to arise at steady rate. Instead, disclosure of experience variations and

changes in assumptions arising during the year will provide information about their effect on the profit for the current year.

860. If claims development disclosures are required, their exact format will depend on the recognition and measurement requirements for insurance liabilities because such disclosures would probably need to reconcile to amounts reported in the balance sheet. For example, if insurance liabilities are measured on a basis that reflects the insurer's own credit risk, it may be necessary, for greater clarity, to provide claims development disclosures in a format that excludes the effect of changes in the insurer's own credit risk. Similarly, it will be necessary to consider whether any required claims development disclosures should be presented in terms of cash flows or in discounted (present value) terms.

*Tentative Steering Committee View*

861. *The Steering Committee believes that claims development disclosures would be useful for general insurance activities. The Steering Committee has not yet developed detailed proposals, as these are likely to depend on recognition and measurement requirements.*

**Sub-issue 20D            Should Disclosures of Solvency be Made in the Financial Statements?**

862. Solvency of an insurer is critical to its ability to operate successfully. The nature of insurance business is such that claims may be payable long after receipt of the premium. Consequently, the financial soundness of an insurer is of considerable importance to users of financial statements. Regulators, policyholders, rating agencies and analysts are particularly interested in the solvency margin maintained by an insurer in order to gain comfort on its future claims paying ability.
863. In most countries, insurers do not generally give disclosures in their financial statements about their solvency margins for regulatory purposes. However, some insurers do refer in a financial review by management to their solvency margins and how they have changed during the year. Often the disclosures of solvency margins are based on a crude calculation of the ratio of net premium to equity. If disclosures of solvency margins are considered desirable, an appropriate international measure may need to be developed or it may be recommended that disclosures should be based on local regulatory rules.
864. Solvency requirements are often set, at least partly, for individual insurers within a group. It may be meaningless for consolidated financial statements to disclose the aggregate solvency requirements that are set on different bases for each insurer within a group. In addition, many groups are likely to contain non-insurance subsidiaries and this may distort a calculation based on the consolidated financial statements.

*Tentative Steering Committee View*

865. *The Steering Committee recognises that, for a large group (or financial conglomerate), disclosure of regulatory solvency margins may turn out to be either*

*very voluminous, or aggregated at such a high level that it is not meaningful. In the Steering Committee's view, an insurer should disclose how much of its equity is not available for distribution to stockholders, distinguishing amounts that are not distributable because of legal or other regulatory requirements from amounts that the insurer's management considers are not distributable for commercial reasons. The Steering Committee believes that an insurer should also disclose information about restrictions on its assets. The Steering Committee would welcome views on the best way to provide solvency information for a group in a concise and meaningful way.*

**Sub-Issue 20E      Does IAS 14 give Sufficient Guidance on Segment Reporting by Insurers?**

866. Given the wide variety in the types of insurance that can be written by a single insurance enterprise or group and hence the nature of risks that an insurer may be exposed to, segmental analysis of results is often a key disclosure in the financial statements. The need for segment reporting arises both in consolidated financial statements and also in the individual financial statements of an enterprise that has more than one business or geographical segment.
867. IAS 14, Segment Reporting, is mandatory only for enterprises whose equity and debt securities are publicly traded. Financial statements of insurers are widely used by many users and it may therefore be necessary to extend the requirements of IAS 14 to cover all insurers.
868. IAS 14 states that the objective of presenting information by segments is:
- to provide users of financial statements with information on the relative size, profit contribution, and growth trend of the different industries and different geographical areas in which a diversified enterprise operates to enable them to make more informed judgements about the enterprise as a whole.
869. Under IAS 14, the identification of segments reflects differences in the risks and rewards of an enterprise's products and services. Therefore, IAS 14 takes the position that the segments identified in a organisational and management structure and internal financial reporting system will normally provide an appropriate segmentation for this purpose. However, some feel that this may not be the case for some insurers.
870. IAS 14 requires management to decide between business type and geographical spread as the primary method of segmentation of the business. For the primary basis of segmentation, IAS 14 requires an enterprise to disclose for each segment its revenue, result, assets, liabilities, capital expenditure and depreciation expense and other non-cash expenses. For the secondary basis of segmentation, the required disclosures are revenue, assets and capital expenditure. The basis of inter-segment pricing should be disclosed for both the primary and secondary bases.
871. For many insurers, the primary basis of segmentation is likely to be by type of business as there is a natural split between life and non-life business. Moreover within these categories there are further natural splits, between life insurance, investment and pensions business within long term insurance and property, casualty,

marine etc for general business. For life insurance some may propose segmentation between investment products and risk products.

872. It might therefore be possible to lay down standard classes of business for the segmentation of insurance companies' results in order to promote comparability of different classes of business between companies. For example, in the European Union, segment information is required for direct non-life business by specified classes such as motor, property, marine etc. This type of segment information would allow greater comparability, but there may be problems defining standard classes internationally, given the diversity of products sold in different countries.
873. Some argue that some of the disclosures required under IAS 14 may not be material to users of an insurer's financial statements. For example, some argue that details of capital additions and depreciation by segment may not influence the economic decisions of users of an insurer's financial statements. It may also be difficult to allocate insurance assets between classes of business where several different classes are backed by the assets of a single fund. Some believe that certain disclosure requirements of IAS 14 should be refined so that only information relevant to the users of insurance company financial statements is provided.
874. Under IAS 14, where a segment's operations are primarily of a financial nature, segment revenue and segment expense include interest income and expense (including interest on advances or loans to or from other segments), dividend income, and gains and losses on sales of investments. Some believe that additional guidance may be needed on the allocation of such items in the segment reports of insurers.

*Tentative Steering Committee View*

875. *The Steering Committee recommends that segmental analysis following IAS 14 should be provided by all insurance enterprises, and not merely by those that have issued publicly traded equity or debt securities.*
876. *The Steering Committee intends to develop guidance on the identification of reportable segments by class of business. The Steering Committee believes that the organisational and management structure and internal financial reporting system of some insurers may not indicate the insurers' predominant source of risks and returns for the purpose of their segment reporting.*
877. *The Steering Committee will consider whether there is a need for insurers to provide any additional segment disclosures beyond those required by IAS 14.*

**Sub-issue 20F      Should Disclosures be Required About Key Performance Indicators?**

878. Some believe that it is important for insurers to disclose information about key performance indicators. One example of a performance indicator that may need disclosure is the levels of new business, particularly for life insurance where new contracts will have a significant effect on an insurer's cash flows for many years. Other candidates for disclosure include the sum insured in life insurance.

879. Others note that IASC does not require such disclosures for other industries. They believe that other disclosures either should be voluntary or should be encouraged as part of a financial review by management outside the financial statements.
880. A majority of the Steering Committee concluded in Sub-issue 7H that catastrophe and equalisation provisions do not meet the definition of a liability articulated in IAS 37 and the Framework. Some believe that there is a need for specific disclosures about low-frequency, high-severity risks - perhaps by segregating a separate component of equity.

*Tentative Steering Committee View*

881. *The Steering Committee believes that insurers should disclose key performance indicators, including the level of new business and the sum assured in life business. The Steering Committee welcomes comments on the sort of key performance indicators that would give users relevant and reliable information at a reasonable cost.*
882. *The Steering Committee will investigate whether there is a need for specific disclosures about low-frequency, high-severity risks - perhaps by segregating a separate component of equity.*

**Sub-issue 20G                      Should Disclosures be Required About Sensitivity?**

883. The accounting measures that are included in financial statements are traditionally single numbers. Some believe that disclosures of single numbers are incomplete because they do not capture the full range of possible outcomes. Those who hold this view argue that an insurer should disclose the sensitivity of key figures, such as its net profit or loss for the period and equity, to changes in key assumptions. For example, an insurer might report the sensitivity of its net profit or loss for the period and equity to a one percentage point increase or decrease in claims ratios, interest rates, expenses and inflation. It would often be necessary to report the effect of an increase as well as a decrease, as such effects are often non-linear.
884. Some financial institutions have been developing sensitivity measures known as **value at risk**. Value at risk may be defined as the maximum loss that an enterprise expects over a given period at a given confidence level. For example, a general insurer may determine, on the basis of past statistical experience, that it is 99% confident (the confidence level) that its claims on all existing insurance contracts will not exceed the most likely amount by more than X million.
885. Some disclosure requirements in IAS 32 (for example, those on interest rate risk) already address certain aspects of sensitivity to certain risk factors, but these disclosures may need to be extended for insurance contracts.
886. Asset-liability management is an important issue for insurers and for insurance supervisors. Some argue that insurers should disclose their policies for asset-liability management and the degree of **mismatch risk** arising because assets and liabilities do

not respond equally to economic events, such as changes in interest rates. To an extent, the asset-liability management policies are already covered by disclosures in IAS 32. However, some believe that further disclosure is needed of the degree of mismatching.

*Tentative Steering Committee View*

887. *The Steering Committee believes that sensitivity disclosures, possibly including value at risk measures, would be useful to users of financial statements. The Steering Committee plans to develop further thoughts in these areas.*

**Sub-issue 20H            Should any Other Disclosures be Required About Insurance Contracts?**

888. *The Steering Committee invites commentators to indicate whether any other disclosures should be required about insurance contracts.*