Premium Allocation Approach: example with comparison to existing accounting practice

IFRS17 Insurance Contracts
Introduction

This example illustrates the mechanics of the premium allocation approach (PAA) requirements in IFRS 17 *Insurance Contracts* for contracts with short coverage periods. It includes a comparison to the accounting commonly used applying existing practice for these contracts.

This example demonstrates that:

- the timing of premium receipts do not directly affect the revenue recognition pattern applying the PAA
- the PAA may result in similar measurement outcomes to existing practice

Requirements in IFRS 17 *Insurance Contracts* and guidance in the Basis for Conclusions on IFRS 17 *Insurance Contracts*
Paragraphs 53–59 of IFRS 17 Insurance Contracts
Paragraphs BC288–BC295 of the Basis for Conclusions on IFRS 17 *Insurance Contracts*

Transition Resource Group for IFRS 17
This example was included as an Appendix to Agenda Paper 6 discussed at the 2 May 2018 Transition Resource Group for IFRS 17 (TRG) meeting.
- *Agenda Paper 6: Implementation challenges outreach report*
- *Summary of the Transition Resource Group for IFRS 17 Insurance Contracts meeting held on 2 May 2018*
  Available at: https://www.ifrs.org/news-and-events/calendar/2018/may/ifrs-17-transition-resource-group/

Webcast explaining the premium allocation approach requirements
- *Simplified accounting for contracts with short coverage periods: part 1*
- *Simplified accounting for contracts with short coverage periods: part 2*
  Available at: go.ifrs.org/IFRS-17-implementation
3 scenarios in this example

Scenario 1 – Premium paid up front

Scenario 2 – Premium paid at the end of the coverage period

Scenario 3 – Premium paid on a monthly basis
Assumptions

• Insurance services are provided evenly over the coverage period
• No claims are incurred
• For IFRS 17 measurement, the insurance contract is accounted for as a group of insurance contracts
## Scenario 1 – Premium paid upfront

*Existing practice*

**Insurance line items on the statement of financial position and revenue reported**

<table>
<thead>
<tr>
<th>Reporting date</th>
<th>01.07.X1</th>
<th>30.09.X1</th>
<th>31.12.X1</th>
<th>31.03.X2</th>
<th>30.06.X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium receivable</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Unearned premium reserve (UPR)</td>
<td>(1200)</td>
<td>(900)</td>
<td>(600)</td>
<td>(300)</td>
<td>0</td>
</tr>
<tr>
<td>Deferred acquisition cost (DAC)</td>
<td>180</td>
<td>135</td>
<td>90</td>
<td>45</td>
<td>0</td>
</tr>
<tr>
<td><strong>Sum of insurance line items on the statement of financial position (overall liability position)</strong></td>
<td>(1020)</td>
<td>(765)</td>
<td>(510)</td>
<td>(255)</td>
<td>0</td>
</tr>
<tr>
<td>Revenue for each period (change in UPR)</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
</tr>
</tbody>
</table>
Expected premium receipts allocated to coverage periods (CU1200 / 4 periods = CU300)

Journal entries
At initial recognition – 01.07.X1
Receipt of premiums:
- Dr Cash 1200
- Cr Insurance contract liability 1200

Insurance acquisition cash flows:
- Dr Insurance contract liability 180
- Cr Cash 180

At each reporting date (30.09.X1, 31.12.X1, 31.03.X2 and 30.06.X2)
Amortisation of insurance acquisition cash flows:
- Dr Insurance service expenses 45
- Cr Insurance contract liability 45

Insurance revenue:
- Dr Insurance contract liability 300
- Cr Insurance revenue 300
### Scenario 2 – Premium paid at the end

*Existing practice*

Insurance line items on the statement of financial position and revenue reported

<table>
<thead>
<tr>
<th>Reporting date</th>
<th>01.07.X1</th>
<th>30.09.X1</th>
<th>31.12.X1</th>
<th>31.03.X2</th>
<th>30.06.X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium receivable</td>
<td>1200</td>
<td>1200</td>
<td>1200</td>
<td>1200</td>
<td>0</td>
</tr>
<tr>
<td>Unearned premium reserve (UPR)</td>
<td>(1200)</td>
<td>(900)</td>
<td>(600)</td>
<td>(300)</td>
<td>0</td>
</tr>
<tr>
<td>Deferred acquisition cost (DAC)</td>
<td>180</td>
<td>135</td>
<td>90</td>
<td>45</td>
<td>0</td>
</tr>
<tr>
<td><strong>Sum of insurance line items on the statement of financial position (overall asset position)</strong></td>
<td>180</td>
<td>435</td>
<td>690</td>
<td>945</td>
<td>0</td>
</tr>
<tr>
<td>Revenue for each period (change in UPR)</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
</tr>
</tbody>
</table>
Scenario 2 – Premium paid at the end

IFRS 17 PAA

Insurance contract asset / (liability) on the statement of financial position and revenue reported

<table>
<thead>
<tr>
<th>Reporting date</th>
<th>01.07.X1</th>
<th>30.09.X1</th>
<th>31.12.X1</th>
<th>31.03.X2</th>
<th>30.06.X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td>0</td>
<td>180</td>
<td>435</td>
<td>690</td>
<td>945</td>
</tr>
<tr>
<td>55(a)(i) Premium received on initial recognition</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>55(a)(ii) Insurance acquisition cash flows</td>
<td>180</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>55(b)(i) Premiums received in the period</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>(1200)</td>
<td></td>
</tr>
<tr>
<td>55(b)(iii) Amortisation of insurance acquisition cash flows</td>
<td>(45)</td>
<td>(45)</td>
<td>(45)</td>
<td>(45)</td>
<td></td>
</tr>
<tr>
<td>55(b)(v) Insurance revenue applying B126¹</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>Closing balance of insurance contract asset / (liability)</td>
<td>180</td>
<td>435</td>
<td>690</td>
<td>945</td>
<td>0</td>
</tr>
</tbody>
</table>

¹ Expected premium receipts allocated to coverage periods (CU1200 / 4 periods = CU300)

**Journal entries**

At initial recognition – 01.07.X1

Insurance acquisition cash flows:

Dr   Insurance contract asset 180
Cr   Cash 180

At each reporting date (30.09.X1, 31.12.X1, 31.03.X2 and 30.06.X2)

Amortisation of insurance acquisition cash flows:

Dr   Insurance service expenses 45
Cr   Insurance contract asset 45

Insurance revenue:

Dr   Insurance contract asset 300
Cr   Insurance revenue 300

At the end of the coverage period (30.6.X2)

Receipt of premium:

Dr   Cash 1200
Cr   Insurance contract asset 1200
**Scenario 3 – Premium paid monthly**  
*Existing practice*

**Insurance line items on the statement of financial position and revenue reported**

<table>
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<tr>
<th>Reporting date</th>
<th>01.07.X1</th>
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<td>0</td>
</tr>
<tr>
<td>Unearned premium reserve (UPR)</td>
<td>(1200)</td>
<td>(900)</td>
<td>(600)</td>
<td>(300)</td>
<td>0</td>
</tr>
<tr>
<td>Deferred acquisition cost (DAC)</td>
<td>180</td>
<td>135</td>
<td>90</td>
<td>45</td>
<td>0</td>
</tr>
<tr>
<td><strong>Sum of insurance line items on the statement of financial position (overall asset position)</strong></td>
<td>180</td>
<td>135</td>
<td>90</td>
<td>45</td>
<td>0</td>
</tr>
<tr>
<td>Revenue for each period (change in UPR)</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>300</td>
<td>0</td>
</tr>
</tbody>
</table>
Expected premium receipts allocated to coverage periods (CU1200 / 4 periods = CU300)

**Journal entries**

**At initial recognition – 01.07.X1**

Insurance acquisition cash flows:

- Dr Insurance contract asset 180
- Cr Cash 180

**At each reporting date (30.09.X1, 31.12.X1, 31.03.X2 and 30.06.X2)**

Receipt of premiums:

- Dr Cash 300
- Cr Insurance contract asset 300

Amortisation of insurance acquisition cash flows:

- Dr Insurance service expenses 45
- Cr Insurance contract asset 45

Insurance revenue:

- Dr Insurance contract asset 300
- Cr Insurance revenue 300