IFRS

STAFF PAPER

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Project	Transition Resource Group for IFRS 17 *Insurance Contracts*		
Paper topic	Insurance acquisition cash flows when using fair value transition		
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Introduction

1. We have received a submission about whether, when the fair value approach to transition is applied, insurance acquisition cash flows that occurred prior to the transition date are recognised as revenue and expense in the statement of financial performance for reporting periods subsequent to the transition date.

2. The objective of the paper is to provide background and an accounting analysis to support discussion at the Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG).

Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) implementation question; and

   (c) review of accounting requirements.

Background information

IFRS 17 requirements

4. Insurance acquisition cash flows paid before a group of insurance contracts is recognised are included in the determination of the contractual service margin. Applying paragraph 27 of IFRS 17, when the insurance acquisition cash flows of a group of insurance contracts are paid (or received) before the group of insurance contracts is recognised an entity recognises an asset or liability[1]. The entity derecognises that asset or liability when the group of insurance contracts to which the cash flows are allocated is recognised.

5. Insurance revenue recognised in a period includes amounts related to insurance acquisition cash flows (paragraph B121(b) of IFRS 17). Insurance revenue related to insurance acquisition cash flows is determined by allocating a portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time. The same amount is recognised as insurance service expenses (paragraph B125 of IFRS 17).

[1] Paragraph 59(a) of IFRS 17 states that an entity can choose to expense insurance acquisition cash flows when incurred if the coverage period of each contract in the group is no more than one year when applying the premium allocation approach.

Transition

6. Paragraph C5 of IFRS 17 states that if it is impracticable for an entity to apply IFRS 17 retrospectively for a group of insurance contracts, it shall apply either the modified retrospective approach or the fair value approach to transition.

7. Applying the fair value approach, paragraph C20 of IFRS 17 states that the contractual service margin or loss component at the transition date is determined as the difference between the fair value of the group of insurance contracts and the fulfilment cash flows measured at that date.

Implementation question

8. The submission raises the question of whether, when the fair value approach to transition is applied, insurance acquisition cash flows that occurred prior to the transition date are recognised as revenue and expense in the statement of financial performance applying paragraphs B121(b) and B125 of IFRS 17 for reporting periods subsequent to the transition date.

9. The submission includes two views:

   (a) View 1: Applying the fair value approach to determine the contractual service margin at the transition date implies that it is impracticable to determine the insurance acquisition cash flows that occurred prior to the transition date. Therefore, it is not necessary to identify and recognise these amounts.

   (b) View 2: It is necessary to estimate insurance acquisition cash flows related to existing contracts and to recognise the corresponding revenue and expense even if applying the fair value approach to determine the contractual service margin at the transition date.

10. The submission notes that applying the view set out above in 9.(b) would be burdensome and largely impracticable and so requests that if IFRS 17 does require

these past cash flows to be determined, that an amendment is made to the Standard to change that requirement.

Review of accounting requirements

11. The requirement in paragraphs B121(b) and B125 of IFRS 17 to include insurance acquisition cash flows in the presentation of revenue and expenses should be read in the context of the insurance acquisition cash flow requirements considered in the measurement of the insurance contracts. This is highlighted in paragraph BC177 of the Basis for Conclusions on IFRS 17:

> Consequently, the Board concluded that an entity should recognise insurance acquisition cash flows as an expense, and should recognise an amount of revenue equal to the portion of the premium that relates to recovering its insurance acquisition cash flows. IFRS 17 achieves this by requiring that the cash flows for a group of insurance contracts include the insurance acquisition cash outflows or inflows associated with the group of contracts (including amounts received or to be received by the entity to acquire new insurance contracts). This approach reduces the contractual service margin on initial recognition of the group of insurance contracts and has the advantage that the insurance acquisition cash flows are treated the same as other cash flows incurred in fulfilling contracts.

12. Accordingly, the amount of insurance acquisition cash flows included in the presentation of revenue and expenses over the duration of a group of insurance contracts is the same amount as the insurance acquisition cash flows included in the measurement of the contractual service margin. Applying IFRS 17 requirements, the amount of insurance acquisition cash flows included in the measurement of contractual service margin is the total of:

    (a) the amounts occurring before initial recognition which were previously recognised as an asset or liability (paragraph 38(b) of IFRS 17); and,

    (b) the amounts occurring at or after initial recognition which are also included in the fulfilment cash flows.

13. In contrast, applying the fair value approach on transition as set out in paragraph C20 of IFRS 17, the amount of insurance acquisition cash flows included in the measurement of contractual service margin will only be the amount occurring after initial recognition that is also included in the fulfilment cash flows. The entity is not required and is not permitted to include in the measurement of the contractual service margin any insurance acquisition cash flows occurring prior to the date of transition.

14. The submission asks whether an entity would need to identify the amount of insurance acquisition cash flows that have occurred in the past and which might be regarded as implicit in the fair value amount when presenting the insurance revenue and expenses. IFRS 17 does not require and does not permit an implicit identification of such insurance acquisition cash flows.

15. The staff observe that fair value reflects future cash flow expectations and does not reflect past cash flows, including insurance acquisition cash flows that occurred prior to the transition date. This provides the entity with a ‘fresh start’ approach to transition as intended by the Board.

16. The staff observe that since insurance acquisition cash flows that occurred prior to date of transition are not included in the measurement of the contractual service margin at the transition date, they are not included in presentation of insurance revenue and expenses.

TRG Discussion

Question to TRG members

What are your views on the implementation question presented above?