

## October 2014 update on IASB insurance accounting project

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The International Accounting Standards Board (IASB) continues to make tentative decisions in its insurance accounting project. However, the IASB has now indicated that its re-deliberations will extend into next year, 2015, which marks the 14th year for the IASB's project. Issues surrounding performance measurement and the treatment of participating contract features continue to be the most difficult issues.

### JULY AND SEPTEMBER MEETINGS

Since our last update in July, the IASB has had two meetings during which its members have discussed the insurance accounting project. Both meetings were split between education sessions and decision-making sessions.

#### Education sessions

At its July meeting, the IASB held an education session on the mechanics of using other comprehensive income (OCI) for contracts with participating features. At its September meeting, the IASB held an education session on the determination of the interest expense for contracts with participating features.

#### Decision-making sessions

At the July meeting, the IASB made decisions about:

- The rate used to accrete interest on and calculate the present value of cash flows that offset against the contractual service margin (CSM)
- Accounting policy issues regarding the presentation of the effect of changes in discount rates

At the September meeting, the IASB made decisions about certain aspects of the premium allocation approach.

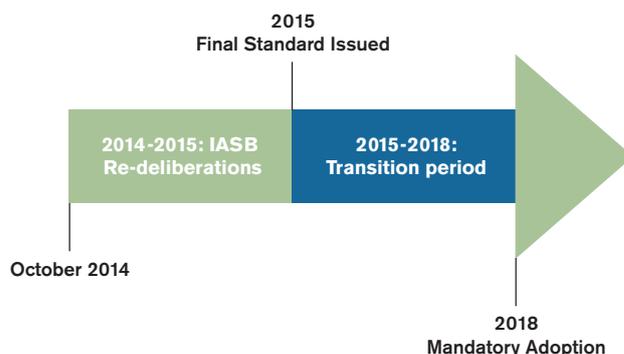
These decisions are covered in more detail in the pages that follow.

**This suggests that a final standard would be issued in late 2015. Given that the IASB has agreed to a three-year period between final standard and mandatory adoption, full implementation is likely no earlier than year-end 2018.**

### CURRENT PROJECT TIMELINE

The September project update summary posted by the IASB to its website indicates it plans to issue a final standard in 2015. The IASB's chairman, Hans Hoogervorst, has commented that he believes deliberations will continue into 2015 as well. This suggests that a final standard would be issued in late 2015. Given that the IASB has agreed to a three-year period between final standard and mandatory adoption, full implementation is likely no earlier than year-end 2018.

FIGURE 1: LATEST TIMELINE



### SUMMARY OF IASB DECISIONS IN 2014

The IASB has made many tentative decisions during its re-deliberations in 2014. The following paragraphs summarize all of the decisions made in 2014 grouped by topic. In parentheses after each item, we note the month of the meeting in which the decision was made.

#### Significant insurance risk

The IASB decided to clarify the guidance in paragraph B19 of the 2013 exposure draft (ED) relating to significant insurance risk. It clarified that significant insurance risk exists only when there is a possibility that an insurer will incur a loss on a present value basis. (May)

### Discount rates

The IASB confirmed the principle that the discount rates used to adjust the cash flows in an insurance contract for the time value of money should be consistent with observable current market prices for instruments with cash flows whose characteristics are consistent with those of the insurance contract and that an entity should use judgment to:

- Ensure that appropriate adjustments are made to observable inputs to accommodate any differences between observed transactions and the insurance contracts being measured.
- Develop any unobservable inputs using the best information available given the circumstances. Unobservable inputs should not contradict any available and relevant market data. (June)

The IASB tentatively decided that the effects of changes in discount rates may be recognized in profit or loss or in OCI at the option of the reporting entity as long as the entity applies the same accounting policy to groups of similar portfolios, and applies International Accounting Standard (IAS) 8, "Accounting Policies, Changes in Accounting Estimates and Errors," when changing accounting policies. (March)

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**It also decided to add guidance explaining that in determining the contractual service margin or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts. This could have significant consequences for portfolios where a subgroup of contracts is known to be onerous.**

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If an entity chooses to recognize the effect of changes in discount rates in OCI then the interest expense recognized in profit and loss (P&L) must be determined using the discount rate applied at the date of inception and the difference between current and initial discount rates in OCI. (March)

An entity should disclose for all portfolios of contracts:

- The amount of interest accretion at current discount rates
- The effect of changes in discount rates in the period
- The difference between the present value of changes in expected cash flows that adjust the CSM in the reporting period measured at both the original inception discount rates and the current discount rates
- The interest accretion at the discount rate applied at initial recognition (when changes in discount rates are reported in OCI)
- The movement in OCI for the period (March)

### Customer service margin

The IASB confirmed the principle in the 2013 ED that an entity should recognize the remaining contractual service margin (CSM) in profit or loss over the coverage period in a systematic way that best reflects the remaining transfer of services that are provided under the contract. Regardless of the principle, the IASB further specified that for contracts with no participating features, the service represented by the CSM is insurance coverage that is provided on the basis of the passage of time and reflected the expected number of contracts in force. (May)

The IASB confirmed the proposals in the 2013 ED that the CSM should be unlocked for changes in estimates related to future coverages and other future services subject to the condition that the CSM should not be negative. The CSM will also be unlocked for changes in the risk adjustment related to future coverage or future services. Changes in the risk adjustment that relate to coverage and other services provided in the current and prior periods are recognized immediately in profit or loss. Favorable changes in estimates that arise after losses were previously recognized in profit or loss must first be reversed before a positive margin can be reestablished. (March)

The IASB confirmed the proposal in the 2013 ED that, for contracts without participating features, an entity should use the locked-in rate at inception of the contract for accreting interest and for determining the change in the present value of expected cash flows that offsets the CSM. (July)

### Level of aggregation

The IASB clarified its intent with regards to measurement. It stated that the objective is to measure an individual insurance contract but that in applying the standard an entity could aggregate insurance contracts provided it meets that objective. To make this clear, the IASB decided to amend the definition of a portfolio of insurance contracts to be "insurance contracts that provide coverage for similar risks and are managed together in a single pool." It also decided to add guidance explaining that in determining the contractual service margin or loss at initial recognition, an entity should not aggregate onerous contracts with profit-making contracts. This could have significant consequences for portfolios where a subgroup of contracts is known to be onerous. This also applies when using the premium allocation approach (PAA). The IASB stated its intention to provide examples on how an entity could aggregate contracts while still satisfying the objective at subsequent measurements. (June)

### Reinsurance

The IASB tentatively decided that, after inception, an entity should recognize in profit or loss any changes in estimates of fulfillment cash flows for a reinsurance contract that an entity holds when those changes arise as a result of changes in estimates of fulfillment cash flows for an underlying direct contract that are also immediately recognized in profit or loss. (June)

### Premium allocation approach

The IASB has clarified that when recognizing revenue under the PAA it should be based on the passage of time. However, if the expected pattern of release of risk differs significantly from the passage of time, then revenue should be recognized on the basis of the expected timing of incurred benefits/claims. (September)

The IASB tentatively decided that, when an entity that applies the PAA to contracts where the associated claim liability is discounted and chooses to present the effect of changes in discount rates in OCI, then the interest expense recognized in profit and loss should be determined using the discount rate that is locked in at the date the liability for incurred claims is recognized. This would also apply to any onerous contract liability recognized for contracts to which the PAA is applied. (September)

### Accounting policy

The IASB decided it needed to clarify that applying its accounting policies should be consistent in application with similar contracts, considering the portfolio in which the contracts is included, the assets that the entity holds, and how those assets are accounted for. (June)

The IASB tentatively decided that an entity should apply the requirements in IAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors," to changes in accounting policy relating to the presentation of the effect of changes in discount rates. (July)

### Fixed-fee service contracts

The IASB tentatively decided that entities should be permitted but not required to apply the revenue recognition standard to the fixed-fee service contracts that meet the criteria in paragraph 7(3) of the 2013 ED. (May)

### Business combinations/portfolio transfers

The IASB clarified paragraphs 43 to 45 of the 2013 ED by stating that contracts acquired in a business combination or portfolio transfer should be accounted for as if they had been issued by the entity at the date of the portfolio transfer or business combination. (May)

### Insurance contract revenue

The IASB confirmed the position taken in the 2013 ED that an entity should present insurance contract revenue and expense in the statement of comprehensive income and should disclose the following:

- A reconciliation of the opening and closing balances of the component of the insurance contract assets or liability.
- A reconciliation from the premiums received in the period to the insurance contract revenue in the period.
- The inputs used when determining the insurance contract revenue that is recognized in the period.
- The effect of the insurance contracts that are initially recognized in the period on the amounts recognized in the statement of financial position. (April)

The IASB decided to prohibit an entity from presenting premium information in the statement of comprehensive income if that information is not consistent with commonly understood notions of revenue. This reconfirms that the investment components of a premium must be excluded from the statement of comprehensive income. (April)

### SUMMARY OF 2014 IASB EDUCATION SESSIONS

Simultaneous with its decision-making sessions, the IASB has held several education sessions on the following topics:

- Proposals to recognize the effect of changes in the discount rate in OCI. (March)
- Insurance contract revenue. (April)
- Contracts with participating features. In particular, the IASB discussed that adaptations might be needed to apply the previous decisions for contracts with no participating features to contracts with such features. (May)
- Identifying underlying items in contracts with participating features. In particular the IASB explored how it might limit the application of any alternative adaptations that might be made to the general model for insurance contracts when those adaptations would rely on the identification of the underlying items. (June)
- The mechanics of OCI for contracts with participating features. (July)
- The determination of interest expense for contracts with participating features including what would be presented in profit and loss versus OCI. (September)

### CONCLUSION

There have been many tentative decisions made by the IASB that materially alter the proposals contained in the 2013 ED. While some key issues have yet to be decided, including the important topic of measuring participation features, the IASB continues to discuss insurance contracts at each meeting. Deliberations will continue into 2015, but it is still possible that a final standard will be issued in late 2015 with mandatory adoption by year-end 2018.

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