

Financial accounting module 21: Contractual service margin homework assignment

(The attached PDF file has better formatting.)

An insurer writes a two-year policy on December 31, 20X0, and expects to

- ! receive on December 31, 20X0, premium of 350
- ! incur and pay two claims
  - " one on December 31, 20X1, for 150
  - " one on December 31, 20X2, for 200

The discount rate for this insurance contract is 5% *per annum*. For simplicity, the acquisition cash flows and the risk adjustment for non-financial risk are zero and the coverage units are the same in both years.

- A. What are the fulfilment cash flows at initial recognition?
- B. What is the contractual service margin at initial recognition?
- C. What are the fulfilment cash flows at December 31, 20X0, after the premium is received?

On December 31, 20X1:

the insurer re-estimates the December 31, 20X2, claim from 200 to 180  
the discount rate changes from 5% to 7% *per annum*

- D. What are the fulfilment cash flows at December 31, 20X1?
- E. What is the contractual service margin at December 31, 20X1, after the allocation to profit or loss?

The discussion forum reading on contractual service margins has a fully worked out illustration at the end that shows how to complete the homework assignment and how to answer the final exam problems on this topic. Onerous contracts complicate this subject, so ignore the sections on onerous contracts on your first reading. Onerous contracts are not tested on the final exam and are not used in the homework assignments.