FA Module 24: IFRS 17: reconciliation exhibits

(The attached PDF file has better formatting.)

Presentation – IFRS 17 reconciliation exhibits

IFRS 17 presents results differently from the way previously done by insurers. IFRS 17 is a principles-based standard, so the instructions explain the method but do not prescribe specific exhibits. The exercises here use the exhibits in the IFRS 17 *Illustrative Examples*.

The “reconciliation of the insurance contract liability,” also called “the source of changes in the fulfilment cash flows,” has four columns:

! present value of future cash flows
! risk adjustment for non-financial risk
! contractual service margin
! insurance contract liability

The exhibit here has seven rows:

! Opening balance
! Changes related to future service
! Cash inflows
! Insurance finance expenses
! Changes related to current service
! Cash outflows
! Closing balance

The columns in this table are specified by paragraph 101:

> *an entity shall disclose reconciliations from the opening to the closing balances separately for each of:*
>
> *(a) the estimates of the present value of the future cash flows*
> *(b) the risk adjustment for non-financial risk*
> *(c) the contractual service margin.*

[The right-most column in the table below is the sum of the three columns listed above.]

The reconciliations are from the top row (opening balance) to the bottom row (closing balance). The rows of this table are specified in paragraphs 100, 104, 105, and 106:

Paragraph 100: “An entity shall disclose reconciliations from the opening to the closing balances …”

Paragraph 104: “An entity shall separately disclose in the reconciliations … each of the following amounts related to insurance services:

(a) changes that relate to future service …
(b) changes that relate to current service …”

Paragraph 105: “an entity shall also disclose separately each of the following amounts …

(a) cash flows in the period, including:
    (i) premiums received …
    (iii) incurred claims paid and other insurance service expenses paid …
(b) the effect of changes in the risk of non-performance by the issuer of reinsurance contracts held

(c) insurance finance income or expenses …"

[The examples here do not show reinsurance contracts held or the risk of non-performance.]

Paragraph 106: "an entity shall disclose an analysis of the insurance revenue … comprising:
(a) the amounts relating to the changes in the liability for remaining coverage … disclosing:
  (i) the insurance service expenses …
  (ii) the change in the risk adjustment for non-financial risk …
  (iii) the amount of the contractual service margin recognised in profit or loss …
(b) the allocation of the portion of the premiums related to the recovery of insurance acquisition cash flows."

[The allocation of insurance acquisition cash flows is illustrated in a separate exercise.]

IFRS 17 *Basis for Conclusions* paragraph BC351 explains that insurers must "disclose a reconciliation … separately for insurance contracts issued and reinsurance contracts held."

The level of detail is not prescribed by IFRS 17. Paragraph 95 says that

> *an entity shall aggregate or disaggregate information so that useful information is not obscured either by the inclusion of a large amount of insignificant detail or by the aggregation of items that have different characteristics.*

The guidance above suggests separate exhibits by insurance portfolio and by group within portfolio. Insurers with many groups might aggregate groups so readers of financial statements can better judge performance.

Illustration: An insurer writes whole life insurance and term life insurance, with groups by region and by year of issue within each line. The insurer should form the IFRS 17 exhibits by group within portfolio, and also aggregate the groups in each portfolio into summary exhibits for readers of financial statements. Many exhibit entries use parameters specific to the group, such as discount rates for computing the insurance finance expense on the contractual service margin and the allocation of the contractual service margin to profit or loss. The exhibits must be formed by group; they are not the sum of transactions over all insurance contracts. The level of detail shown in the financial statements may be less than the detail used to form the exhibits.

The source of changes in the fulfilment cash flows

	Present Value of Future Cash Flows	*Risk Adjustment For Non-financial Risk*	*Contractual Service Margin*	*Insurance Contract Liability*
Opening Balance				
Changes for Future Service				
Cash Inflows				
Insurance Finance Expenses				
Changes for Current Service				
Cash Outflows				
Closing Balance				

Reconciliation of the statement of financial position with the statement of profit or loss

IFRS 17 affects three entries on the statement of financial position:

- the cash asset = premium collected – claims paid – directly attributable acquisition expenses paid
- an insurance asset or liability is set up:
  - an insurance contract liability for primary insurance contracts issued
  - a reinsurance contract asset for reinsurance contracts held
- equity = the cash asset minus the insurance contract liability or plus the reinsurance contract asset

If the insurer pays directly attributable acquisition cash flows before premiums are received, it may have an insurance contract asset. If a ceding insurer does not pay the reinsurance premium until after the initial recognition of the reinsurance contract held, it may have a reinsurance contract liability. The four entries:

- insurance contract liability
- reinsurance contract liability
- insurance contract asset
- reinsurance contract asset

are shown separately on the statement of financial position.

The exhibit shows the changes in balance sheet entries for cash, insurance contract liability, and equity from a group of insurance contracts. The entries (especially cash and equity) comprise other items as well.

IFRS 17 shows the statement of financial position in single-column format:

- asset are negative figures.
- liabilities are positive figures.
- equity is a positive figure.

The common GAAP balance sheet uses a double-column format, with assets on the left as positive entries and liabilities + equity on the right (also as positive entries). The format here is not required by IFRS.

- The statement of financial position shows valuation dates: 12/31/20X1, 12/31/20X2, and so forth.
- The statement of profit or loss shows years (20X1, 20X2, …) and a total.

Each group of contracts has different years and valuation dates. Insurers may show separate reconciliations by group of insurance contracts and aggregate summaries by portfolio showing the reconciliation of the profit or loss for the year with the statement of financial position at the beginning and end of the year.

Statement of financial position	*12/31/20X1*	*12/31/20X2*	*12/31/20X3*
Cash			
Insurance contract liability			
Equity			

IFRS 17 shows three entries for non-onerous contracts on the statement of profit and loss:

- changes for current service, stemming from
  - differences between actual and expected claims or expenses
  - release of the risk adjustment for non-financial risk
  - allocation of the contractual service margin to year of service
- insurance finance expenses, stemming from
  - the effect of the time value of money on the present values of future cash flows

" the interest accreted on the contractual service margin

! profit of loss = the changes for current service – the insurance finance expenses

Statement of profit and loss	*20X1*	*20X2*	*20X3*	*Total*
Changes for current service				
Insurance finance expenses				
Profit				

The reconciliation by type of insurance contract liability

IFRS 17 paragraph 100 requires insurers to disclose reconciliations from the opening to the closing balances for each of:

(a) the net liabilities (or assets) for the remaining coverage component, excluding any loss component.
(b) any loss component,
(c) the liabilities for incurred claims.

IFRS 17 *Effects Analysis* calls this exhibit the "progression of the insurance contract liabilities for remaining coverage and for incurred claims."

IFRS 17 *Illustrative Examples* refers to this exhibit as "the reconciliation required by paragraph 100 between the amounts recognised in the statement of financial position and the statement of profit or loss," since the exhibit shows the insurance revenue and insurance service expenses that form the insurance result on the IFRS 17 statement of profit or loss. The insurance finance income or expense is combined with the investment income on the contract cash flows to form the finance result.

The exhibit shows columns for

- the liability for remaining coverage, excluding the loss component
- the loss component of the liability for remaining coverage
- the liability for incurred claims
- the insurance contract liability

and rows for

- Opening balance
- Cash inflows
- Insurance revenue
- Insurance service expenses
- Investment component
- Insurance finance expenses
- Cash outflows
- Closing balance

If the contract is not onerous, the loss component is zero and the first two columns may be combined.

Progression of the insurance contract liabilities for remaining coverage and for incurred claims (20X1)

	Liability for remaining coverage excluding loss component	*Liability for remaining coverage: loss component*	*Liability for incurred claims*	*Insurance Contract Liability*
Opening balance				0.00
Cash inflows				0.00
Insurance revenue				0.00
Insurance service expenses				0.00
Insurance finance expenses				0.00
Cash outflows				0.00
Closing balance	0.00	0.00	0.00	0.00

IFRS 17 distinguishes two types of investment components:

- components that are separated from the host insurance contract and reported under IFRS 9
- components that reported with the host insurance contract with disclosure of the investment part

The investment components here are the second type in the list above.

Progression of the insurance contract liabilities for remaining coverage and for incurred claims

	Liability for remaining coverage excluding loss component	*Liability for remaining coverage: loss component*	*Liability for incurred claims*	*Insurance Contract Liability*
Opening balance				
Cash inflows				
Insurance revenue				
Insurance service expenses				
Insurance finance expenses				
Cash outflows				
Closing balance				

Insurance revenue is *determined* as

the change in the insurance contract liability for remaining coverage excluding the loss component
– cash flows for the net premium (gross premium minus acquisition cash flows)
– amortized and allocated acquisition expenses recognized in the year
– insurance finance income or expenses

We analyze insurance revenue in each year as the sum of

! The accumulated premium compensating the expected claims, benefits, and other expenses.
! The release of the risk adjustment for non-financial risk.
! The allocated insurance acquisition cash flows.
! The allocation of the contractual service margin to profit or loss.