



Presentation and disclosures

Example presentation of the Statement of Comprehensive Income in compliance with the Exposure Draft on Insurance Contracts issued in July 2010

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Executive summary

The International Accounting Standards Board (IASB) issued an Exposure Draft (ED) on 30 July 2010 which, if adopted, will replace IFRS 4 *Insurance Contracts* (IFRS 4). The ED seeks to establish a single consistent recognition and measurement model, with complementary presentation and disclosure requirements aimed at enhancing transparency, for all insurance contracts issued by entities reporting under International Financial Reporting Standards.

This publication provides an overview of the presentation model and specific disclosures required by the ED. It highlights the main differences with the previous presentation requirements under IFRS 4, and considers some possible implementation issues. It does not attempt to highlight the differences between the current and the proposed measurement model. The analysis is based on a fictitious composite insurer (Insurance Group Ltd.) and seeks to illustrate how the current presentation of the Statement of Comprehensive Income under IFRS can be transformed into the presentation model that the ED proposes. The analysis also seeks to show how the presentation within the Statement of Comprehensive Income interacts with the reconciliation of insurance contract balances - a new disclosure requirement proposed in the ED.

The proposed presentation model under the ED (the summarised margin presentation) intends to present the drivers of underwriting performance as a means to provide insight into the accuracy and reliability of the estimated cash flows for the insurance contracts. The traditional financial performance indicators such as premium volume, insurance benefits and claims, may now be presented in the financial statement footnote, Reconciliation of Contract Balances.

Should this model be adopted in the new standard, users of financial reporting, including analysts and regulators who are more familiar with the concepts of premiums, claims and benefits, might need additional guidance to understand the key financial indicators, especially the underwriting performance. As stated in our comment letter to the IASB on the ED, we believe that a summarised margin presentation will not provide more useful information to all users of financial statements because it will not convey adequate information about an insurer's operations. Please see our comment letter, submitted to the IASB on 30 November 2010.

Background

The ED proposes that an insurer measures insurance liabilities using a model based on the 'present value of the fulfilment cash flows' plus a residual margin.

Building on the proposed measurement model, the presentation model seeks to reflect the key financial indicators of an insurance entity: underwriting margin, experience adjustments, changes in estimates and interest on insurance contract liabilities. This differs significantly from the presentation format currently applied by insurers. IFRS 4 and IAS 1 *Presentation of Financial Statements* are largely silent on the format of the Statement of Comprehensive Income for insurers. However, most insurers currently apply a revenue-based model in which premium volume and changes in insurance liabilities take centre stage.

The ED presentation model is based on the summarised margin approach. Premiums, claims and expenses (including acquisition costs) that relate to the fulfilment of insurance contracts are no longer shown on the face of the Statement of Comprehensive Income.

A modified model is proposed in the ED for short-duration contracts that meet certain criteria. The illustration below reflects the presentation requirements of this modified model as well.

Illustration

The illustration begins with a traditional Statement of Comprehensive Income of Insurance Group Ltd. It shows how the information could be disclosed in the new format contained in the ED. Assumptions made in preparing these disclosures are included in Appendix 1. The presentation requirements summarised from the ED are stated in Appendix 2.

Current presentation

The Statement of Comprehensive Income currently presented by Insurance Group Ltd. under existing IFRS is illustrated below:

Table 1: Statement of Comprehensive Income

	Life*	General*	Total
Gross premiums	6,728.8	2,335.3	9,064.1
Premiums ceded to reinsurers	-336.4	-196.2	-532.6
Net premiums	6,392.4	2,139.1	8,531.5
Dividend and interest income	1,657.5	157.2	1,814.7
Investment gains and losses	-709.8	122.9	-586.9
Investment gains and losses attributable to unit-linked policyholders	902.6	0.0	902.6
Total investment income	1,850.2	280.1	2,130.3
Total revenue	8,242.6	2,419.2	10,661.8
Gross benefits and claims paid	5,079.8	1,497.4	6,577.2
Claims ceded to reinsurers	-254.0	-75.9	-329.9
Movements in insurance liabilities due to change in the interest rate	-842.8	-9.3	-852.1
Changes in unit-linked liabilities	902.6	0.0	902.6
Other movements in insurance liabilities	1,486.2	42.0	1,528.1
Net benefits and claims	6,371.7	1,454.2	7,825.9
Acquisition costs	319.0	444.3	763.3
Other costs	768.3	256.1	1,024.4
Other expenses	1,087.3	700.4	1,787.7
Total benefits, claims and other expenses	7,459.0	2,154.6	9,613.6
Profit before tax	783.6	264.6	1,048.2
Income tax expense	199.8	67.5	267.3
Profit for the year	583.8	197.1	780.9

* Under IFRS, it is not required to present the statement of comprehensive income for life insurance contracts separately from the general insurance contracts

Proposed presentation

Illustration of the Statement of Comprehensive Income proposed by the ED:

Table 2: Statement of Comprehensive Income proposed under ED

ED reference	Footnote	Short-duration contracts	Long-duration contracts	Total
75(a)i	Premium revenue	2,335.3		2,335.3
77, 46	Premium ceded to reinsurers	-196.2		-196.2
75(a)ii	Claims incurred	-1,497.4		-1,497.4
77	Claims ceded to reinsurers	75.9		75.9
75(a)iii	Expenses incurred	-341.5		-341.5
75(a)iv	Amortisation incremental acquisition costs	-330.9		-330.9
75(a)	Underwriting margin short-duration contracts, net of reinsurance**	45.3		45.3
72(a)i	Release of risk adjustment claims liabilities, gross	144.4		144.4
77	Release of risk adjustment claims liabilities, reinsurance	-21.7		-21.7
	Total release of risk adjustment claims liabilities	122.8		122.8
72(a)i	Release of risk adjustment		169.5	169.5
72(a)ii	Release of residual margin		82.8	82.8
77(a)	Underwriting margin long-duration contracts		252.3	252.3
72(b)iii	New business losses (onerous contracts)		-56.6	-56.6
72(c)	Non-incremental acquisition costs	-113.4	-82.8	-196.3
72(d)i	Experience adjustments and change in discount rates	2	962.5	952.8
72(e)	Interest accretion	-60.4	-1,239.4	-1,299.8
78(a)	Movements in unit-linked liabilities		-902.6	-902.6
	Total other expenses	-183.6	-1,318.9	-1,502.5
IFRS 7	Investment income	1	947.6	1,227.7
78(b)	Investment income attributable to unit-linked policyholders		902.6	902.6
	Total investment income	280.1	1,850.2	2,130.3
	Profit before tax	264.6	783.6	1,048.2
	Income tax expense	67.5	199.8	267.3
	Profit for the year	197.1	583.8	780.9

* All general insurance contracts are assumed to meet the definition of short-duration contracts

** The ED allows the detailed breakdown of the underwriting margin for short-duration contract to be presented either on the face of the statement of comprehensive income or in the notes to the financial statements

Table 2 Footnote disclosures

Footnote 1 Investment income			
IFRS reference		Short-duration contracts	Long-duration contracts
IFRS 7	Dividend and interest income	157.2	1,657.5
IFRS 7	Investment gains and losses	122.9	-709.8
	Investment income	280.1	947.7
Footnote 2 Experience adjustments and change in discount rates			
ED reference		Short-duration contracts	Long-duration contracts
	Experience adjustments	-19.1	11.3
	Change in discount rate	9.3	951.2
72(d)ii	Experience adjustments and change in discount rates	-9.8	962.5

The following interpretations have been made of the ED:

- ▶ Even though the change in risk adjustment is not separately identified as part of the underwriting margin in accordance with paragraph 75(a), the release of the risk adjustment from claims liabilities for short-duration contracts is separately presented in this illustration as it is a component of the underwriting margin in accordance with paragraph 72(a).
- ▶ The effects of a change in discount rate related to long-duration contracts are shown separately from changes in estimates of cash flows in footnote disclosure 2. This is to support the requirement in paragraph 73 that changes in discount rates and interest on insurance liabilities should be disclosed in a manner that reflects their relationship with the investment return on the assets backing those liabilities. Such disclosure might also be elaborated further by the insurer to explain the earnings volatilities that arise due to market movements and mismatches between the investment returns and the required amounts due to interest accretion on the insurance liabilities. This disclosure can be presented as follows:

Table 3: Investment income, interest accretion on insurance liabilities and changes in discount rates

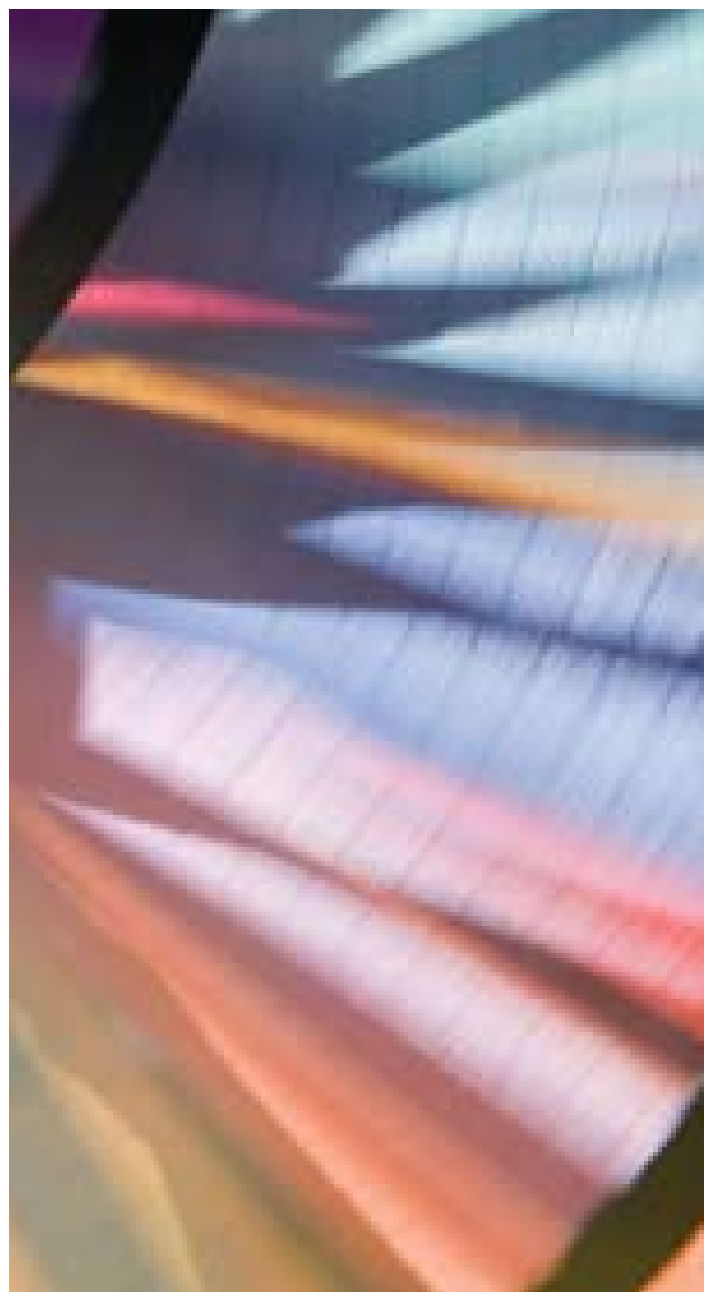
	Short-duration contracts	Long-duration contracts
Dividend and interest income	157.2	1,657.5
Investment gains and losses	122.9	-709.8
Investment income	280.1	947.7
Interest accretion	-60.4	-1,239.4
change in discount rates	9.3	951.2
Interest accretion and change in discount rates	-51.1	-288.2
Net return on investment*	229.0	659.5

*For non-linked business after interest accretion on insurance liabilities

From the illustration, it is evident that premiums, claims, claim handling costs and incremental acquisition costs included in the measurement of the insurance liability are not presented on the face of the Statement of Comprehensive Income for long-duration contracts; these are treated as deposit receipts or repayments. The financial statement reader must refer to the Reconciliation of Contract Balances' footnote for disclosure of these gross financial performance indicators.

In addition, for short-duration contracts there is a choice to present premium revenue, claims incurred and expenses incurred on the face of the Statement of Comprehensive Income. Therefore, property and casualty insurers may present the Statement of Comprehensive Income in a format close to their current practice. Composite insurers may opt for a presentation of underwriting margins with a disclosure of the volume indicators.

The illustration of the Statement of Comprehensive Income under the ED provides information about the actual cash flows compared to earlier assumptions and changes in these assumptions. Presentation of this format is consistent with current embedded value reporting, so it is not entirely new for some insurers and financial analysts.



The following schedule provides an illustration of Reconciliation of Contract Balances for long-duration contracts:

Table 4: Reconciliation of Contract Balances

		Total insurance liabilities* para 86(a)	Risk adjustment para 86(b)	Residual margin para 86(c)
87(a)	Carrying amount beginning of period	52,281.3	2,419.2	1,022.6
Changes in risk adjustment and residual margin				
87(b)	New contracts recognised	56.6	177.9	71.3
Cash flows period:				
87(c)	Premiums received	6,392.4		
87(d)i	Claims and benefits paid	-4,825.8		
87(d)iii	Incremental acquisition cost**	-236.2		
87(d)ii	Operating expenses incurred	-768.3		
	Total cash flows	562.0	-	-
Results:				
	Underwriting margins	-252.3	-169.5	-82.8
	Experience results	-50.1		
87(f)	Operating assumption changes	38.8		
	Change in discount rates	-951.2	-25.9	
	Interest accretion	1,239.4	51.7	43.6
	Movements in unit-linked liabilities	902.6		
		927.2	-143.7	-39.2
87(a)	Carrying amount end of period	53,827.1	2,453.4	1,054.8

* Risk adjustments and risk margin are components of the total insurance liabilities. Therefore, the sum of these two components does not equal to the total liabilities.

** The ED treats the incremental acquisition costs as fulfilment cash flows. Those acquisition costs are therefore included as a cash outflow (payment) in the reconciliation of contract balances from insurance contracts. A separate disclosure may be included that highlights the effect of the incremental acquisition costs on the residual margin.

Note: In this schedule, you see the value of new business and the addition to the residual margin that reflects the expected contributions of the new contracts recognised during the reporting year. The residual margin increase could become a monitored performance metric in the future.

The schedule below (Table 5) illustrates the roll-forward of short-duration contracts:

		Total insurance liabilities	Pre-claims liabilities 88(a)	Claims liabilities 88(c)	Risk adjustment in claims liabilities 86(b)	Total reinsurance assets	Pre-claims reinsurance assets	Claims reinsurance assets	Risk adjustment in claims reinsurance assets	Net position
87(a)	Carrying amount beginning period	3,301.7	635.2	2,666.4	233.9	359.5	14.9	344.6	41.3	2,942.1
Cash flow:										
87(c)	Premium received	2,325.8	2,325.8			198.8	198.8			2,127.0
87(d)i	Claims paid	-1,406.7		-1,406.7		-70.7		-70.7		-1,336.1
87(d)iii	Incremental acquisition costs paid	-348.9	-348.9			-19.4	-19.4			-329.5
87(d)ii	Expenses paid	-345.3		-345.3						-345.3
		224.9	1,976.9	-1,752.1		108.7	179.4	-70.7		116.2
Results:										
	Underwriting margin	-146.2	-1,985.0	1,838.9	119.7	-100.9	-176.8	75.9	6.1	-45.3
	Release risk adjustment	-144.4		-144.4	-144.4	-21.7		-21.7	-21.7	-122.8
	Experience results	8.7		8.7		-12.9		-12.9		21.7
87(f)	Changes in estimates	-3.4		-3.4	-0.3	-0.8		-0.8	-0.2	-2.6
	Change in discount rate	-10.3	-1.6	-8.7		-1.1	0.0	-1.0		-9.3
	Interest accretion	66.2	11.1	55.1	3.9	6.0	0.3	5.7	0.0	60.2
87(a)	Carrying amount end of period	3,297.1	636.6	2,660.5	212.8	336.8	17.8	319.0	25.5	2,960.3

The following comments should be considered:

- ▶ For those contracts for which uncertainty about the amount and timing of claims payments is not typically resolved fully within one year, an insurer must disclose the claims and expenses incurred during that period. In the illustration, this requirement is met by showing the experience results and changes in estimates on previous years' claims, as well as the release of the risk adjustment separately.

What should be considered in preparing the presentation?

- ▶ *Insurance contract classification*: In a scenario where the insurer writes long-duration life insurance contracts and reinsures a portion of the risks using a short-duration contract, the insurer is required to present these contracts under two separate models.
- ▶ *The (re)insurance liability*: Under the above-mentioned scenario, the insurance liability is required to be measured using the fulfilment model and presented in accordance with the summarised margin model. However, the reinsurance contracts is required to be accounted for following the short-duration model.

Findings

Whilst the Statement of Comprehensive Income reflects the IASB's measurement model, it results in quite different financial measures being highlighted. The attention is now drawn to the movements in insurance margins and expected cash flows. Under this model, experience results are presented separately from the impact of changes in the assumptions/estimates. Hence, the profitability of the underwriting process is separated from the results arising from the accounting estimation process as well as the reliability of the cash flow estimation process. If this presentation model will be reflected in the final standard, it will demand a strong investor relations effort to explain the new performance metrics.

The presentation model no longer gives information about premium volume and claim benefits for long-duration insurance contracts in the Statement of Comprehensive Income. This will be a major change for insurers, as the basis for established financial performance indicators, such as the Combined Operating Ratio, may be relegated to the notes to the financial statements, specifically, the Reconciliation of Contract Balances.

Due to the model, the presentation of expenses related to the insurance business, general expenses, non-incremental acquisition costs and incremental acquisition costs is scattered over the financial statements. Additional disclosures may be required to provide a complete picture of expenses.

Further enhancements and clarifications relating to the details of the presentation, as well as the choices between presentation and disclosure proposed in the ED, are necessary. This is certainly the case for composite insurers, bancassurers and situations where direct insurance contracts and the related risk-mitigating reinsurance contracts appear under different contract classification. For example, direct insurance contracts are classified as long-duration, whilst reinsurance contracts are classified as short-duration.

Concluding remarks

The combination of the proposed measurement model and the proposed changes to presentation represent a major change for insurers and the established financial measures. Some users will find this presentation enhances the relevance and decision usefulness of the financial statements in terms of presenting the underwriting performance drivers and the fulfilment value of insurance liabilities of an insurer. However, we believe that a summarised margin presentation will not provide more useful information to all users of financial statements because it will not convey adequate information about an insurer's operations.

As illustrated in the previous schedule, the proposed format of the Statement of Comprehensive Income focuses on the main drivers of the profitability of insurance contracts, whilst the footnote disclosure of the reconciliation of contract balances provides insight into the traditional financial performance indicators.

Should the proposed presentation model be adopted in the new standard, users of financial reporting, including analysts and regulators who are more familiar with the concepts of premiums, claims and benefits, might need additional guidance to understand the financial indicators. In addition, insurers are likely to require significant changes to existing systems and processes to produce all of the newly required disclosures.

Appendices

Appendix 1

Assumptions made in preparing the illustrative example:

General insurance contracts and related reinsurance contracts are of short duration, i.e., the coverage period of the insurance contract is one year or less. In addition, the contract does not contain embedded options or other derivatives that significantly affect the variability of cash flows after unbundling any embedded derivatives. No life insurance contracts and related reinsurance contracts are classified as short-duration contracts.

Comparative figures have not been provided for the income statement:

- ▶ The Statement of Comprehensive Income does not reflect all items, but is focused on insurance specific requirements as proposed in the ED. For example, general administration and overhead expenses are excluded from this illustration.
- ▶ Amounts presented in the traditional Statement of Comprehensive Income (table 1) are already determined in accordance with the measurement models under the ED. No changes are applied to the measurement basis.

The following items have not been addressed in the case study:

- ▶ Losses on reinsurance contracts acquired in a portfolio transfer (para 72(b)i).
- ▶ Gains on reinsurance contracts bought by a cedant (para 72(b)ii).

Appendix 2

Presentation requirements of the ED

Statement of Financial Position (para 69 – 71)

The ED requires presentation of each portfolio of insurance contracts as a single item within insurance contract assets or liabilities. An insurer is not permitted to offset reinsurance assets against insurance contract liabilities.

The ED requires assets and related liabilities associated with unit-linked contracts to be presented as single line items by the insurance entity that owns the assets and is contractually obligated to pay the liabilities.

Statement of Comprehensive Income (para 72 – 78)

An insurer is required to present, at a minimum, the following items:

- ▶ The change in risk adjustment
- ▶ The release of residual margin
- ▶ Differences between expected and actual cash flows
- ▶ Changes in estimates of cash flows and changes in discount rates
- ▶ Interest on insurance contract liabilities

Changes in discount rates and interest on insurance liabilities should be disclosed in a manner that reflects their relationship with the investment return on the assets backing those liabilities.

The margin presentation requires an insurer to treat all premiums in the same way as deposits and all claims and benefits in the same way as repayments to the policyholder. This means that

premiums, claims expenses, claims handling expenses, incremental acquisition costs and expenses included in the measurement of the insurance contract should not be presented in the Statement of Comprehensive Income.

The ED requires certain short-duration contracts applying the simplified measurement model to use a different presentation model. An insurer applying the simplified measurement model is expected to present, at a minimum, the following items (although the insurer has the choice to give this information either in the statement of comprehensive income or in the disclosures):

- ▶ Premium revenue
- ▶ Claims incurred
- ▶ Expenses incurred
- ▶ Incremental acquisition costs incurred

Income and expenses from unit-linked contracts should be presented as a single line item, and should not be combined with income and expense from the insurer's other insurance contract assets and liabilities.

Reconciliation of Contract Balances (para 85 – 89)

A reconciliation is required from the opening and the closing aggregate contract balances, in respect of each of the following as applicable:

- ▶ Insurance contract liabilities and, separately, insurance contract assets; as well as risk adjustments and residual margins included therein
- ▶ Reinsurance assets arising from reinsurance contracts held by the insurer as a cedant; as well as risk adjustments and residual margins included therein, and impairment losses on reinsurance assets

For each reconciliation the insurer should present, at a minimum, the following items as applicable:

- ▶ The carrying amounts at the beginning and end of the period
- ▶ New contracts recognised during the period
- ▶ Premiums received
- ▶ Payments, with separate disclosure of:
 - ▶ Claims and benefits
 - ▶ Expenses
 - ▶ Incremental acquisition costs
- ▶ Other cash paid and, separately, other cash received
- ▶ Income and expense, reconciled to the amounts disclosed in the Statement of Comprehensive Income
- ▶ Amounts relating to contracts acquired from, or transferred to, other insurers in portfolio transfers or business combinations
- ▶ Net exchange differences arising from the translation of foreign currency amounts into the presentation currency

For certain short-duration contracts applying the simplified measurement, an insurer should disclose the reconciliation separately for:

- ▶ Pre-claims liabilities
- ▶ Additional liabilities for onerous insurance contracts
- ▶ Claims liabilities

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