IFRS 4 INSURANCE CONTRACTS

FACT SHEET

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This fact sheet is based on existing requirements as at 31 December 2015 and does not take into account recent standards and interpretations that have been issued but are not yet effective.

IMPORTANT NOTE

This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard.

IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IFRS 4 is applicable for annual reporting periods commencing on or after 1 January 2005.

OBJECTIVE

The objective of IFRS 4 is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in IFRS 4 as an insurer).

SCOPE

IFRS 4 applies to:

- insurance contracts that an entity issues and reinsurance contracts that it holds
- financial instruments that it issues with a discretionary participation feature

IFRS 4 does not apply to the following insurance contracts:

- product warranties issued directly by a manufacturer, dealer or retailer – refer IAS 18 / IAS 37
- employers' assets and liabilities under employee benefit plans – refer IAS 19 / IFRS 2
- retirement benefit obligations reported by defined benefit retirement plans
- contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item, as well as a lessee's residual value guarantee embedded in a finance lease – refer IAS 17 / IAS 18 / IAS 38
- financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts
- contingent consideration payable or receivable in a business combination – refer IFRS 3
- direct insurance contracts that the entity holds

PRESCRIBED ACCOUNTING TREATMENT

Embedded derivatives

As an exception to the rules in IAS 39, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), and if the exercise price differs from the carrying amount of the host insurance liability.

However, the requirement in IAS 39 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract.

Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

Unbundling of deposit components

Some insurance contracts contain both an insurance component and a deposit component. In some cases, an insurer is required or permitted to unbundle those components.

Further guidance is provided in paragraphs 10 – 12 of IFRS 4.

Recognition and measurement

Temporary exemption from some other IFRS

Paragraphs 10 – 12 of IAS 8 specify criteria for an entity to use in developing an accounting policy if no Standard applies specifically to an item.

IFRS 4 exempts an insurer from applying those criteria to its accounting policies for:

a. insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described in paragraph 31 and 32); and
b. reinsurance contracts that it holds.

Nevertheless, IFRS 4 does not exempt an insurer from some implications of the criteria in paragraphs 10 – 12 of IAS 8. Specifically, an insurer:

a. shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions);
b. shall carry out the liability adequacy test described in paragraphs 15 – 19;
c. shall remove an insurance liability (or a part of an insurance liability) from its statement of financial position when, and only when, it is extinguished – that is, when the obligation specified in the contract is discharged or cancelled or expires;

d. shall not offset:
   i. reinsurance assets against the related insurance liabilities, or
   ii. income or expenses from reinsurance contracts against the expense or income from the related insurance contracts; and
e. shall consider whether its insurance assets are impaired (paragraph 20).

Liability adequacy test

At each reporting date, an insurer shall assess whether the carrying amount of an insurance liability is sufficient by comparing its carrying amount (less related deferred acquisition costs and related intangible assets) with the current estimates of future cash flows under the insurance contracts. Any deficiency is recognised in the profit or loss.

Changes in accounting policies

An insurer may change accounting policies for insurance contracts if, and only if the change makes the financial statements more relevant to the economic decision-making needs of users without loss of reliability or relevance.

Relevance and reliability is judged by the criteria in IAS 8.

IFRS 4 provides more information on the following specific issues:

- current interest rates – paragraph 24
- continuation of existing practices – paragraph 25
- prudence – paragraph 26
- future investment margins – paragraphs 27 – 29
- shadow accounting – paragraph 30

Discretionary participation features

The issuer of an insurance contract with a discretionary participation feature and a guaranteed element may but need not choose to recognise the elements separately with the following consequences:

- if not recognised separately, the whole contract is classified as a liability
- if recognised separately
  - the guaranteed element is classified as a liability, and
  - the discretionary participation feature can be classified as either a liability or a separate component of equity
- all premiums may be recognised as revenue without separating any portion applying to an equity component
- If the contract contains an embedded derivative within the scope of IAS 39, apply IAS 39 to that embedded derivative

DISCLOSURES

Refer to Appendix 1 for a checklist to assist with IFRS 4 disclosure requirements.

DEFINITIONS

Cedant	The policyholder under a reinsurance contract.
Direct insurance contract	An insurance contract that is not a reinsurance contract.
Discretionary participation feature	A contractual right to receive, as a supplement to guaranteed benefits, additional benefits: • That are likely to be a significant portion of the total contractual benefits. • Whose amount or timing of the additional benefits is contractually at the issuer's discretion. • That are contractually based on the performance of a specified pool of contracts or a specified type of contract; realised and/or unrealised investment returns on a specified pool of the insurer's assets; or the profit or loss of the company, fund or other entity that issues the contract.
Financial guarantee contract	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.
Financial risk	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
Guaranteed benefits	Payments or other benefits to which a particular policyholder or investor has an unconditional right that is not subject to the contractual discretion of the issuer.
Insurance contract	A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. Further guidance is in Appendix B of IFRS 4.
Insurance risk	Risk, other than financial risk, transferred from the holder of a contract to the issuer.
Insured event	An uncertain future event that is covered by an insurance contract and creates insurance risk.
Insurer	The party with an obligation under an insurance contract to compensate a policyholder if an insured event occurs.
Liability adequacy test	An assessment of whether the carrying amount of an insurance liability needs to be increased (or the carrying amount of related deferred acquisition costs or related intangible assets decreased), based on a review of future cash flows.

Policyholder	A party that has a right to compensation under an insurance contract if an insured event occurs.
Reinsurer	The party that has an obligation under a reinsurance contract to compensate a cedant if an insured event occurs.
Reinsurance contract	An insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.
Unbundle	To account for the components of a contract as if they were separate contracts.

AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 4 *Insurance Contracts* and is applicable for annual reporting periods commencing on or after 1 January 2005.

ADDITIONAL SCOPE EXEMPTIONS:

AASB 4 is not applied to:

- general insurance contracts (refer to AASB 1023 *General Insurance Contracts*), except for fixed-fee service contracts that meet the definition of an insurance contract under AASB 4
- life insurance contracts (refer to AASB 1038 *Life Insurance Contracts*)

AUSTRALIAN DEFINED TERMS

General insurance contract	An insurance contract that is not a life insurance contract
Life insurance contract	An insurance contract, or a financial instrument with a discretionary participation feature, regulated under the *Life Insurance Act 1995*, and similar contracts issued by entities operating outside Australia.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards* (and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*) which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

a. Tier 1: Australian Accounting Standards; and

b. Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a 'reporting entity' as defined in SAC 1 *Definition of the Reporting Entity* that does not have 'public accountability' as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

When developing AASB 1053, the AASB concluded that the Australian Government and state, territory and local governments should be subject to Tier 1 requirements. The AASB also decided that General Government Sectors of the Australian Government and state and territory governments should continue to apply AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, without the reduction in disclosures provided by Tier 2. Other public sector entities are able to apply Tier 2 reporting requirements.

Disclosure requirements under Tier 2 are the same as those under Tier 1 for this Standard.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the "Yes / No / N/A" column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for "No" answers.

CODE		YES / NO / N/A	EXPLANATION (*If required*)
IFRS 4.36	Has the insurer disclosed information that identifies and explains the amounts in its financial statements arising from insurance contracts?		
IFRS 4.37	Has the insurer disclosed: a. its accounting policies for insurance contracts and related assets, liabilities, income and expenses; b. the recognised assets, liabilities, income and expense (and, if it presents its statement of cash flows using the direct method, cash flows) arising from insurance contracts. Furthermore, if the insurer is a cedant, it shall disclose: i. gains and losses recognised in profit or loss on buying reinsurance, and ii. if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period. c. the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). Where practical, has the insurer given quantified disclosure of those assumptions; d. The effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial statements; and e. Reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs?		
IFRS 4.38	Has the insurer disclosed information to enable users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts?		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
IFRS 4.39	Has the insurer disclosed: a. its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks; b. (deleted by the IASB) c. Information about insurance risk (both before and after risk mitigation by reinsurance), including information about: i. Sensitivity to insurance risk ii. Concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared concentrations and each concentration (e.g. type of insured events, geographical areas, or currency) and iii. Actual claims compared with previous estimates. (i.e. claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. d. Information about credit risk, liquidity risk and market risk that paragraphs 31 – 42 of IFRS 7 would require if the insurance contracts were within the scope of IFRS 7; and e. Information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value?		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
IFRS 4.39A	Has the insurer disclosed either (a) or (b) to comply with paragraph 39(c)(i): a. a sensitivity analysis that shows how profit or loss and equity would have been affected if changes in the relevant risk variable that were reasonably possible at the end of the reporting period had occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used? However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of IFRS 7. b. qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows?		

OTHER MATTERS

CPAH1814 07-16