Co-funded by the
Erasmus+ Programme
of the European Union

PASSFR.EU
A Digital Learning Platform for Generation Z:
Passport to IFRS®

A Digital Learning Platform for Generation Z: Passport to IFRS®

IFRS® Standard 17 Insurance Contracts

Funded by the Erasmus+ Program of the European Union. However, European Commission and Turkish National Agency cannot be held responsible for any use which may be made of the information contained therein.

CASE STUDY - IFRS 17 INSURANCE CONTRACTS

Introduction

The insurance industry has a very complex structure. The most important reason for this is that insurance contracts cover many risks and uncertainties. Moreover, it is very difficult to predict these uncertainties and calculate their results. So IFRS 17 Insurance Contracts Standard is a standard published to regulate the complex applications of the insurance industry, and includes comprehensive regulations regarding the accounting and reporting of insurance contracts.

With this case study, it is aimed to eliminate the uncertainties that arise in understanding and applying the IFRS 17 Insurance Contracts Standard.

The Case Information

URAS Insurance Company was established in Turkey in 2020 and specialises only in life insurance. The company has started to apply the IFRS Standard 17 Insurance Contracts since 2022. URAS Insurance Company has written 50 - 2-years life insurance policies as of January 1st, 2022. These policies cover payments to be made in the event of death. All healthy individuals between the ages of 18-65 can benefit from this life insurance. Insurance contracts cover natural death and accidental death. Suicides are not covered by insurance contracts. Moreover, deaths due to epidemics (etc. COVID 19) were excluded from the policy since the company was established during the pandemic period and was ready for pandemic conditions. Within the scope of IFRS 17, the insurance company adopts the following assumptions:

- It is expected that a single premium of CU200 per policy will be received at the beginning of the contracts.
- At the beginning of the contract, an acquisition cost of CU300 has been accrued (for brokerage, underwriting costs and medical expenses). All of these expenses will be distributed throughout the coverage period.
- The amount of coverage per policy is CU800.
- While estimating the cash outflows for each year, the company has assumed that it will repay 3 policies for each year by looking at the past statistics.
- During the contract period, the discount rate, including financial risk adjustment, is calculated as 4%.
- The risk adjustment ratio for non-financial risk has been determined as 6% of the estimated cash flows. The changes in the economic conditions of the country and therefore the living conditions of the society are effective in determining this risk.
- Contracts will not be terminated until the end of the guarantee period.
- At the end of the first year, the entity has not changed any assumptions about future periods, as all events occurred as expected.
- All contracts aren’t expected to become onerous.
- The policyholder is obliged to inform the insurer about all important matters that should be known during the conclusion of the contract. If the issues that are not notified to the insurer, incomplete or incorrectly reported to the insurer are of a nature to affect the contract, incomplete or not receiving the compensation may occur.

- If the beneficiary of the insurance kills the insured or is complicit in his/her murder, he/she cannot receive the insurance compensation.
- Tax is neglected.

Discussion Questions

1. Explain which model should be selected and which transactions and calculations should be made, respectively, within the scope of IFRS 17.
2. Prepare the statement of profit or loss and other comprehensive income of the URAS Insurance Company by making the necessary calculations.

SOLUTION OF CASE STUDY - IFRS 17 INSURANCE CONTRACTS

At the beginning of the contract (January 1st, 2022):

Within the scope of IFRS 17, the company prefers the General Model Approach. According to this model, initially, the present value of future cash flows must be calculated. The insurance company estimated cash inflows of CU10,000 (CU200 x 50). The company calculated the cash outflows as CU2,400 based on the expected number of deaths (CU800 x 3). The net present value of the estimated cash outflows is calculated as CU 2,308 [CU2,400 / (1 + 0.04)] for the first year and CU2,219 [CU2,400 / $(1 + 0.04)^2$] at a 4% discount rate. Also, the net present value of the acquisition cost is calculated as CU288 [CU300 / (1 + 0.04)] for the first year and CU277 [CU300 / $(1 + 0.04)^2$] at a 4% discount rate. Thus, the Present Value of Future Cash Flows has been estimated at CU4,908 [CU10,000 – (CU2,308 + CU2,219) – (CU288 + CU277)].

The next step is to make a risk adjustment against non-financial risks. Risk adjustment based on assumptions is calculated as 6% of cash flows. Accordingly, the risk adjustment was calculated as CU294 (CU4,908 x 0.06). After risk adjustment, cash flows related to the fulfilment of the contract were determined (CU4,908 – CU294 = CU4,614).

Under IFRS 17, an insurer is required to measure at initial recognition the fulfilment cash flows of a group of contracts at an amount that will not result in any income or expense. Therefore, the contractual service margin at initial recognition should equal zero when added to the fulfilment cash flows.

	January 1st, 2022
Present value of future cash inflows	(CU10,000)
Present value of future cash outflows	CU4,527
Present value of contract acquisition cost	CU565
Present value of future cash flows	**(CU4,908)**
Risk adjustment for non-financial risk	CU294
Cash Flows Regarding the Fulfilment of the Contract	(CU4,614)
Contractual Service Margin	CU4,614
Insurance contract asset/liability at initial recognition	0

According to the standard, it is necessary to update the estimates of cash flows at the end of the year and recalculate the contractual service margin as:

Present value of future cash outflows: CU2,400 / (1 + 0.04) = CU2,308

Present value of contract acquisition cost: CU300 / (1 + 0.04) = CU288

Also, the risk adjustment based on assumptions is calculated as CU156 (CU 2,596 x 0.06).

	January 1st, 2022	December 31st, 2022
Present Value of Future Cash Inflows	(CU10,000)	-
Present Value of Future Cash Outflows	CU4,527	CU2,308
Present Value of Contract Acquisition Cost	CU565	CU288
Present Value of Future Cash Flows	**(CU4,908)**	**CU2,596**
Risk Adjustment for Non-Financial Risk	CU294	CU156
Cash Flows Regarding the Fulfilment of the Contract	(CU4,614)	CU2,752
Contractual Service Margin	CU4,614	-
Insurance Contract Asset / Liability at Initial Recognition	0	

From the date of the insurance contract until the end of the period, interest will be accrued on the amounts arising from the changes related to the future service at the discount rate. The said interest constitutes the insurance's financial expenses.

Calculating interest on the present value of future cash flows: CU4,908 x 0,04 = CU196

Calculating interest on the contractual service margin: CU4,614 x 0,04 = CU185

The contractual service margin recognized in the financial statements at the initial recognition, together with the accrued interest amount until the end of the period, must be amortised over the life of the insurance contract, spread over the years and converted into revenue in this way. In this example, the contractual service margin can be amortised evenly.

Amortisation of Contractual Service Margin: (CU4,614 + CU185) / 2 = CU2,400

The company will calculate the insurance contract revenue as:

Total Earnings and Costs Included in Revenue (Contractual Service Margin + Contract Acquisition Cost + Risk Adjustment) = CU2,400 + CU300 + CU294 = CU2,994

Actual Damages: CU2,400

Total contract revenue: CU2,400 + CU2,994 = CU5,394

Insurance Service Expenses (Actual Damages + Contract Acquisition Cost): CU2,400 + CU300 = CU2,700

Profit or Loss and Other Comprehensive Income Statement for the Period 01.01.2022 - 31.12.2022

URAS Life Insurance Company "Statement of Profit or Loss and Other Comprehensive Income" December 31st, 2022	
Insurance Revenue	CU5,394
Insurance Service Expenses	(CU2,700)
Insurance Financial Expenses	(CU381)
Investment Revenues	-
Profit or Loss for the Period	CU2,313
Comprehensive Income	**CU2,313**