

Insurance Contracts (IFRS 17)

Table of Contents

1. Objective and background
2. Scope and key definitions
3. Level of aggregation
4. Recognition of insurance contracts
5. Measurement — the general model (building block approach)
6. Premium allocation approach (PAA)
7. Onerous contracts
8. Reinsurance contracts held
9. Investment contracts with discretionary participation features (DPF)
10. Modification and derecognition
11. Presentation in the financial statements
12. Disclosure requirements
13. Illustrative examples
14. Summary and exam focus points
15. 20 MCQs with Answers
16. Comprehensive Question Bank

1. Objective and background

Objective of IFRS 17: IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts. Its aim is to provide relevant information that faithfully represents insurance contracts and enables users of financial statements to assess their effect on an entity's financial position, performance and cash flows.

Why IFRS 17 was issued:

- To **replace IFRS 4**: IFRS 4 allowed a wide variety of existing local GAAP practices, leading to lack of comparability and sometimes weak linkage between accounting and underlying economics.
- To **introduce a consistent model**: IFRS 17 requires current measurement of future cash flows, explicit risk adjustment, and a contractual service margin (CSM) representing unearned profit.
- To **align with other IFRS standards**: It improves consistency with IFRS 9 (financial instruments) and the Conceptual Framework.

Key idea: Insurance contracts are viewed as a combination of:

- **Service contract**: Provision of insurance coverage over time.
- **Financial instrument**: Cash flows that can be highly variable and long-term.

IFRS 17 tries to capture both aspects in a single, coherent measurement model.

2. Scope and key definitions

2.1 Scope

IFRS 17 applies to:

- **Insurance contracts** issued by an entity.
- **Reinsurance contracts held** (i.e., an entity as policyholder).
- **Investment contracts with discretionary participation features** issued by an entity that also issues insurance contracts.

It does **not** apply to:

- Warranties issued directly by a manufacturer, dealer or retailer (IAS 18/IFRS 15/IAS 37).
- Employers' obligations under employee benefit plans (IAS 19).
- Financial guarantee contracts that meet IFRS 9's definition and are accounted for under IFRS 9 (unless the entity chooses IFRS 17).
- Some fixed-fee service contracts that do not transfer significant insurance risk.

2.2 Insurance contract

An **insurance contract** is 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 (insured event) adversely affects the policyholder.

Significant insurance risk: Insurance risk is significant if an insured event could cause the insurer to pay **significantly more** than it would if the event did not occur. This is assessed on a contract-by-contract basis.

Example:

- A life insurance contract that pays R1 000 000 on death within 20 years clearly transfers significant insurance risk.
- A deposit contract that pays back the same amount plus fixed interest, regardless of events, does **not** transfer insurance risk—it is a financial instrument under IFRS 9.

2.3 Other key terms

- **Policyholder:** The party that has a right to compensation under an insurance contract.
- **Insured event:** The uncertain future event covered by the contract.
- **Fulfilment cash flows:** Present value of future cash inflows and outflows that arise as the entity fulfils the contract, including an explicit risk adjustment.
- **Contractual service margin (CSM):** The unearned profit that the entity will recognise as it provides insurance coverage.

3. Level of aggregation

IFRS 17 requires insurance contracts to be grouped for measurement and recognition purposes.

3.1 Groups of contracts

Contracts are first divided into **portfolios**:

- **Portfolio:** Contracts subject to similar risks and managed together (e.g., motor insurance, term life, medical insurance).

Within each portfolio, contracts are divided into **groups**:

1. **Onerous contracts at initial recognition** (loss-making).
2. **Contracts that have no significant possibility of becoming onerous.**
3. **Other contracts** (neither clearly onerous nor clearly non-onerous).

Groups must contain contracts issued within **one year** of each other.

3.2 Why level of aggregation matters

- Prevents offsetting profitable and loss-making contracts in a way that hides losses.
- Ensures timely recognition of onerous contracts.
- Provides a structured basis for tracking CSM and fulfilment cash flows.

Example: An insurer issues motor policies throughout 2026. All 2026 motor policies form a portfolio. Within that portfolio, policies expected to be loss-making (e.g., high-risk drivers) form one group; profitable policies form another group.

4. Recognition of insurance contracts

4.1 When to recognise a group of contracts

A group of insurance contracts is recognised at the **earliest** of:

- The beginning of the coverage period.
- The date when the first payment from a policyholder is due.
- The date when the group becomes onerous.

4.2 Insurance acquisition cash flows

Insurance acquisition cash flows (e.g., commissions, underwriting costs) that are directly attributable to a group of contracts are included in the measurement of that group. If acquisition cash flows relate to expected future contracts, they may be recognised as an asset and then allocated when those contracts are recognised.

Example: An insurer pays R100 000 in commissions to brokers to sell a portfolio of one-year motor policies. These commissions are capitalised as insurance acquisition cash flows and allocated to the groups of contracts issued.

5. Measurement — the general model (building block approach)

5.1 Overview

The **general measurement model** (also called the building block approach) is the default model in IFRS 17. It measures a group of insurance contracts as:

$$\text{Liability (or asset)} = \text{Fulfilment cash flows} + \text{Contractual service margin}$$

Where:

- **Fulfilment cash flows (FCF) =**

Present value of future cash flows + Risk adjustment for non-financial risk

- **Contractual service margin (CSM)** = unearned profit.

5.2 Fulfilment cash flows

Components:

1. **Estimate of future cash flows:**
 - Expected premiums.
 - Expected claims and benefits.
 - Expected expenses (claims handling, administration, acquisition).
 - Policyholder options and guarantees.
2. **Discounting:**
 - Cash flows are discounted using current, market-consistent discount rates that reflect the characteristics of the cash flows (e.g., timing, currency, liquidity).
3. **Risk adjustment for non-financial risk:**
 - Explicit adjustment for uncertainty in non-financial variables (e.g., mortality, morbidity, lapses, expenses).
 - Represents the compensation the entity requires for bearing that uncertainty.

5.3 Contractual service margin (CSM)

The **CSM** is the amount that eliminates any day-one profit at initial recognition. It represents the profit the entity expects to earn as it provides insurance coverage.

At initial recognition:

$$\text{CSM} = \max(-, \text{Fulfilment cash flows}, 0)$$

- If the present value of fulfilment cash flows is a **net liability** (i.e., expected outflows exceed inflows), the CSM is positive (unearned profit).
- If the group is **onerous** (loss-making), the CSM is **zero** and a loss is recognised immediately in profit or loss.

5.4 Subsequent measurement

At each reporting date, the carrying amount of a group of contracts is:

$$\text{Liability} = \text{Fulfilment cash flows (updated)} + \text{CSM (updated)}$$

Updates include:

- Changes in estimates of future cash flows.
- Changes in discount rates.
- Release of risk adjustment as uncertainty reduces.
- Release of CSM as services are provided.

5.5 Release of CSM (recognising insurance revenue)

The CSM is recognised in profit or loss over the coverage period in a way that reflects the **pattern of services** provided (usually the passage of time or expected claims pattern).

Example:

- Initial CSM for a group of 5-year term life contracts: R500 000.
- Coverage is evenly provided over 5 years.
- Each year, R100 000 of CSM is recognised as part of the **insurance service result**.

6. Premium allocation approach (PAA)

6.1 Purpose and eligibility

The **Premium Allocation Approach (PAA)** is an optional simplified measurement model for certain short-duration contracts (often non-life insurance). It is broadly similar to the “unearned premium” approach used under many previous GAAPs.

A group of contracts may use the PAA if:

- The coverage period is **one year or less**, or
- The PAA produces a measurement that is not materially different from the general model.

6.2 Key features of PAA

Under the PAA:

- The liability for remaining coverage is measured mainly as **premiums received** minus **acquisition cash flows** and **amounts recognised as revenue**.
- The liability for incurred claims is measured similarly to the general model (discounted, with risk adjustment).
- CSM is not explicitly calculated; instead, the unearned premium implicitly includes unearned profit.

6.3 Example — one-year motor insurance

An insurer issues one-year motor policies:

- Premium per policy: R5 000.
- 1 000 policies issued on 1 January 20X1.
- Total premiums: R5 000 000.
- Acquisition cash flows: R300 000.

At initial recognition:

- Liability for remaining coverage $\approx R5\,000\,000 - R300\,000 = R4\,700\,000$.
- Acquisition cash flows are deferred and allocated over the coverage period.
- Revenue is recognised over the year as coverage is provided (e.g., straight-line).

7. Onerous contracts

7.1 Identification

A group of contracts is **onerous** if, at initial recognition or subsequently, the fulfilment cash flows (including acquisition cash flows) exceed the carrying amount of the liability for remaining coverage (including CSM).

7.2 Accounting for onerous contracts

- **General model:**
 - CSM is set to **zero**.
 - The excess (loss) is recognised immediately in profit or loss.
- **PAA:**
 - An additional **loss component** is recognised in the liability for remaining coverage.

7.3 Example — onerous group

An insurer issues a group of contracts with:

- Present value of expected premiums: R1 000 000.
- Present value of expected claims and expenses plus risk adjustment: R1 100 000.

Fulfilment cash flows = –R100 000 (net outflow). Since the group is loss-making, CSM = 0 and a loss of R100 000 is recognised immediately.

8. Reinsurance contracts held

8.1 Overview

Reinsurance contracts held are measured separately from underlying insurance contracts. The objective is to reflect the rights and obligations arising from reinsurance, not simply mirror the underlying contracts.

8.2 Measurement

Reinsurance contracts held are measured using a similar model:

$$\text{Asset or liability} = \text{Fulfilment cash flows} + \text{CSM}$$

Key points:

- The CSM for reinsurance held represents the net cost or net gain from the reinsurance.
- Losses on underlying onerous contracts may be partially offset by gains on reinsurance contracts held, but **offsetting is limited**—the reinsurance asset is measured independently.

8.3 Example — reinsurance of an onerous portfolio

An insurer has a group of onerous contracts with expected loss of R200 000. It holds a reinsurance contract that reimburses 80% of claims above a certain threshold, expected to recover R150 000.

- Underlying group: loss of R200 000 recognised.
- Reinsurance held: CSM and fulfilment cash flows reflect expected recoveries; a gain of R150 000 may be recognised over time or at initial recognition depending on the contract terms.

9. Investment contracts with discretionary participation features (DPF)

9.1 What are DPF contracts?

These are contracts that:

- Do **not** transfer significant insurance risk, but
- Provide the policyholder with a contractual right to receive additional amounts (bonuses/dividends) that are:
 - Expected to be a significant portion of the total benefits.
 - Discretionary in amount and timing, but based on the performance of a pool of contracts or assets.

IFRS 17 applies to such contracts if the entity also issues insurance contracts.

9.2 Measurement

Measurement is similar to insurance contracts:

- Fulfilment cash flows include expected discretionary payments.
- CSM reflects unearned profit from providing investment-related services.

10. Modification and derecognition

10.1 Modification

A contract is **modified** when its terms are changed (e.g., coverage extended, benefits increased, premiums adjusted). IFRS 17 requires an assessment of whether the modification results in:

- A **substantial change** (treated as derecognition of the old contract and recognition of a new one), or
- A **non-substantial change** (accounted for as an adjustment to the existing contract's measurement).

10.2 Derecognition

A contract (or group) is derecognised when:

- The contract is extinguished (all obligations discharged, cancelled or expired).
- The entity is relieved of its obligations by a legal release.

Any difference between the carrying amount and the consideration received (if any) is recognised in profit or loss.

11. Presentation in the financial statements

11.1 Statement of financial position

IFRS 17 requires separate presentation of:

- **Insurance contract assets and insurance contract liabilities.**
- These may be disaggregated into:
 - Liability for remaining coverage.
 - Liability for incurred claims.

Reinsurance contracts held are presented separately as **reinsurance contract assets/liabilities**.

11.2 Statement(s) of financial performance

The standard introduces the **insurance service result** and **insurance finance income or expenses**.

Insurance service result includes:

- **Insurance revenue:**
 - Represents consideration for services provided in the period.

- Excludes receipts of investment components (amounts that must be repaid to policyholders regardless of insured events).
- **Insurance service expenses:**
 - Claims and benefits incurred.
 - Acquisition and administration expenses.
 - Changes in fulfilment cash flows relating to past and current service.
 - Losses on onerous contracts.

Insurance finance income or expenses:

- Arise from the effect of discounting and changes in financial assumptions (e.g., interest rates).
- The entity may choose an accounting policy to recognise all such effects in profit or loss, or split between profit or loss and other comprehensive income (OCI).

12. Disclosure requirements

IFRS 17 requires extensive disclosures to help users understand:

1. **Recognised amounts:**
 - Reconciliation of opening and closing balances of insurance contract assets and liabilities.
 - Analysis of CSM movements.
 - Explanation of insurance revenue and service result.
2. **Significant judgements:**
 - Methods and inputs used to estimate fulfilment cash flows.
 - Approach to risk adjustment.
 - Assumptions about discount rates, lapses, mortality, expenses, etc.
3. **Nature and extent of risks:**
 - Sensitivity analyses.
 - Claims development information.
 - Concentrations of risk.
 - Risk mitigation strategies (e.g., reinsurance).

These disclosures are crucial because measurement relies heavily on estimates and judgement.

13. Illustrative examples

13.1 Example 1 — Initial measurement under the general model

Scenario: An insurer issues a group of 10-year term life contracts on 1 January 20X1.

- Present value of expected premiums: R2 000 000.
- Present value of expected claims and expenses: R1 600 000.
- Risk adjustment: R100 000.

Step 1: Fulfilment cash flows

$$\begin{aligned}\text{FCF} &= \text{PV of inflows} - \text{PV of outflows} - \text{Risk adjustment} \\ \text{FCF} &= \text{R}2000000 - \text{R}1600000 - \text{R}100000 = \text{R}300000\end{aligned}$$

Because inflows exceed outflows plus risk adjustment, the group is profitable.

Step 2: CSM at initial recognition

To avoid day-one profit:

$$\text{CSM} = -\text{FCF (if FCF is negative)} \text{ but here FCF is positive}$$

In practice, the liability is measured as:

$$\text{Liability} = \text{FCF (as a liability)} + \text{CSM}$$

We treat FCF as a liability of R1 700 000 (claims + expenses + risk adjustment – premiums) and set CSM such that total liability equals net outflows. Conceptually, the CSM equals the expected profit (R300 000) to be recognised over the coverage period.

Step 3: Subsequent recognition

If coverage is evenly provided over 10 years:

- CSM released each year $\approx$ R30 000.
- Insurance revenue each year includes:
 - Release of CSM (R30 000).
 - Release of risk adjustment.
 - Allocation of expected claims and expenses.

13.2 Example 2 — Premium allocation approach

Scenario: One-year travel insurance contracts:

- Premiums received: R1 200 000.
- Acquisition cash flows: R100 000.
- Coverage period: 1 year.

At initial recognition:

- Liability for remaining coverage = R1 200 000 – R100 000 = R1 100 000.

During the year:

- Revenue recognised on a straight-line basis: $\text{R}1\,100\,000 \div 12 \approx \text{R}91\,667$ per month.
- Claims incurred are recognised as insurance service expenses when they occur.
- At year-end, liability for remaining coverage is nil (coverage completed).

13.3 Example 3 — Onerous group under PAA

Scenario: Same travel insurance, but expected claims and expenses are R1 300 000.

- Liability for remaining coverage at initial recognition: R1 100 000.
- Expected fulfilment cash flows (including risk adjustment) exceed this amount by R200 000.

Result:

- Recognise a **loss component** of R200 000 in profit or loss.
- Liability for remaining coverage includes this loss component.
- As coverage is provided, revenue and expenses are recognised, and the loss component is released.

14. Summary and exam focus points

To wrap IFRS 17 into a study-ready set of anchors:

- **Objective:** Consistent, current, and transparent accounting for insurance contracts.
- **Scope:** Insurance contracts, reinsurance held, and certain investment contracts with DPF.
- **Core model:**
 - Fulfilment cash flows (discounted, risk-adjusted).
 - Contractual service margin (unearned profit).
- **Level of aggregation:** Portfolios and groups (onerous, non-onerous, other).
- **Measurement approaches:**
 - General model (building block).
 - Premium allocation approach (simplified for short-duration contracts).
- **Onerous contracts:** Immediate loss recognition; CSM cannot be negative.
- **Reinsurance held:** Measured separately; may mitigate but not fully offset losses.
- **Presentation:** Insurance service result vs insurance finance income/expenses; separate assets/liabilities.
- **Disclosure:** Reconciliations, judgements, risk information.

15. 20 MCQs with Answers

1. What is the primary objective of IFRS 17?

- A. Standardise insurance premium calculations
- B. Provide relevant information that faithfully represents insurance contracts
- C. Increase insurance company profitability
- D. Remove actuarial judgement entirely

- **Answer: B**
- **Explanation:** IFRS 17 aims to improve transparency and comparability of insurance contract reporting.

2. IFRS 17 applies to which of the following?

- A. All insurance products
- B. Insurance contracts issued, reinsurance contracts held, and investment contracts with DPF
- C. Life insurance only
- D. Property insurance only

- **Answer: B**
- **Explanation:** These are the three categories within IFRS 17's scope.

3. Which of the following are the three measurement models under IFRS 17?

- A. Fair value, cost, amortised cost
- B. Present value, future value, historical cost
- C. General Model, Premium Allocation Approach, Variable Fee Approach
- D. Risk-based, rule-based, principle-based

- **Answer: C**
- **Explanation:** IFRS 17 uses GMM/BBA, PAA, and VFA.

4. Under the General Model, insurance contract liabilities are measured as:

- A. Fulfilment cash flows plus Contractual Service Margin
- B. Premiums received minus claims paid
- C. Fair value adjustments
- D. Regulatory reserves

- **Answer: A**
- **Explanation:** $GMM = FCF + CSM$.

5. Fulfilment cash flows include which of the following?

- A. Premiums and claims only
- B. Only premiums and acquisition costs
- C. Only claims and expenses
- D. Expected future cash flows + risk adjustment + discounting

- **Answer: D**
- **Explanation:** FCF includes PV of future cash flows, risk adjustment, and discounting.

6. The Contractual Service Margin (CSM) represents:

- A. Claims payable
- B. Unearned profit from a group of insurance contracts
- C. Premiums due from policyholders
- D. The risk adjustment for non-financial risk

➤ **Answer: B**

➤ **Explanation:** CSM is the unearned profit recognised over the coverage period.

7. Which of the following best describes an insurance contract under IFRS 17?

- A. A contract that transfers significant financial risk
- B. Any contract with variable returns
- C. Any contract issued by an insurer
- D. A contract that transfers significant insurance risk

➤ **Answer: D**

➤ **Explanation:** Insurance risk must be significant.

8. Liability for Remaining Coverage + Liability for Incurred Claims equals:

- A. Premium revenue
- B. Insurance contract liabilities
- C. CSM
- D. Risk adjustment

➤ **Answer: B**

➤ **Explanation:** IFRS 17 defines total contract liability as LRC + LIC.

9. Under IFRS 17, contracts must be grouped into portfolios based on:

- A. Profitability
- B. Similar risks and management together
- C. Contract size
- D. Geographic location

➤ **Answer: B**

➤ **Explanation:** Portfolios consist of contracts with similar risks and managed together.

10. Under the PAA, discounting of the liability for incurred claims is required when:

- A. Claims are expected to be settled within one year
- B. The insurer chooses to discount
- C. Claims are expected to be settled after more than one year
- D. Premiums exceed claims

- **Answer: C**
- **Explanation:** Discounting is required when settlement is expected after more than one year. (Inference based on IFRS 17 principles.)

11. A group of contracts is onerous when:

- A. Premiums exceed claims
- B. Fulfilment cash flows exceed the carrying amount of the liability
- C. The CSM is positive
- D. The risk adjustment is zero

- **Answer: B**
- **Explanation:** Onerous groups occur when expected losses exceed expected inflows.

12. For onerous groups under the General Model:

- A. CSM is set to zero, and a loss is recognised
- B. CSM becomes negative
- C. CSM increases
- D. CSM is ignored

- **Answer: A**
- **Explanation:** CSM cannot be negative; losses are recognised immediately.

13. Reinsurance contracts held are measured:

- A. Identically to underlying contracts
- B. Separately, using fulfilment cash flows and CSM
- C. Only using premiums paid
- D. Only using expected recoveries

- **Answer: B**
- **Explanation:** Reinsurance held uses its own FCF + CSM model. (Inference based on IFRS 17 principles.)

14. Insurance revenue under IFRS 17 includes:

- A. Premiums received
- B. Release of CSM, risk adjustment, and expected claims/expenses
- C. Investment income
- D. Reinsurance recoveries

- **Answer: B**
- **Explanation:** Insurance revenue reflects services provided, not cash received. (Inference based on IFRS 17 principles.)

15. The risk adjustment reflects:

- A. Financial risk
- B. Non-financial risk uncertainty
- C. Market volatility
- D. Premium volatility

➤ **Answer: B**

➤ **Explanation:** Risk adjustment covers non-financial risk such as mortality, morbidity, lapses.

16. Under the PAA, the liability for remaining coverage is broadly similar to:

- A. Fair value
- B. Claims development tables
- C. Unearned premium
- D. Discounted cash flows

➤ **Answer: C**

➤ **Explanation:** PAA resembles the traditional unearned premium approach. (Inference based on IFRS 17 principles.)

17. Which of the following is *not* part of fulfilment cash flows?

- A. Expected future cash flows
- B. Risk adjustment
- C. Discounting
- D. Contractual Service Margin

➤ **Answer: D**

➤ **Explanation:** CSM is separate from fulfilment cash flows.

18. Under IFRS 17, acquisition cash flows:

- A. Must be capitalised and allocated to groups of contracts
- B. Are always expensed immediately
- C. Are ignored under the PAA
- D. Are treated as claims

➤ **Answer: A**

➤ **Explanation:** Acquisition costs directly attributable to contracts are capitalised. (Inference based on IFRS 17 principles.)

19. The Variable Fee Approach (VFA) applies to:

- A. All life insurance contracts
- B. Contracts with direct participation features

- C. Motor insurance contracts
- D. Reinsurance contracts

- **Answer: B**
- **Explanation:** VFA applies to contracts where policyholders share in underlying items. (Inference based on IFRS 17 principles.)

20. Insurance finance income or expenses arise from:

- A. Claims incurred
- B. Changes in discount rates and financial assumptions
- C. Premium increases
- D. Reinsurance commissions

- **Answer: B**
- **Explanation:** Insurance finance income/expense reflects discounting and financial assumption changes. (Inference based on IFRS 17 principles.)

16. Comprehensive Question Bank

A. Basic concepts and objective

Question 1: What is the primary objective of IFRS 17?

Solution: The primary objective of IFRS 17 is to ensure entities provide **relevant information** that faithfully represents insurance contracts, enabling users of financial statements to assess the effect of those contracts on the entity's financial position, performance and cash flows.

Question 2: List the main measurement models under IFRS 17 and briefly describe each.

Solution: The three main measurement models are:

1. **General Measurement Model (GMM) / Building Block Approach (BBA):**
 - Default model.
 - Measures insurance contract liabilities as fulfilment cash flows plus contractual service margin (CSM).
2. **Premium Allocation Approach (PAA):**
 - Simplified model for short-duration contracts (often non-life).
 - Liability for remaining coverage is similar to an unearned premium approach.
3. **Variable Fee Approach (VFA):**
 - Applied to insurance contracts with direct participation features.
 - Focuses on the entity's variable fee for managing underlying items for policyholders.

Question 3: Explain the term “fulfilment cash flows” in IFRS 17.

Solution: **Fulfilment cash flows** are the risk-adjusted, probability-weighted present value of future cash flows that arise as the entity fulfils its obligations under a group of insurance contracts. They comprise:

- Estimates of future cash inflows (e.g., premiums) and outflows (claims, benefits, expenses).
- An explicit risk adjustment for non-financial risk.
- The effect of discounting using current, market-consistent discount rates.

Question 4: What is the contractual service margin (CSM), and why can it never be negative?

Solution: The **CSM** represents the unearned profit that the entity expects to earn from a group of insurance contracts as it provides insurance coverage and other services. IFRS 17 prohibits a negative CSM—if expected cash outflows exceed inflows (i.e., the group is onerous), the CSM is set to zero and a loss is recognised immediately in profit or loss. This ensures losses are not deferred.

B. Scope and definitions

Question 5: Which contracts are within the scope of IFRS 17?

Solution: IFRS 17 applies to:

- Insurance contracts issued by an entity.
- Reinsurance contracts held.
- Investment contracts with discretionary participation features (DPF) issued by an entity that also issues insurance contracts.

Question 6: Give three examples of items that are **not** accounted for under IFRS 17.

Solution:

1. **Product warranties** issued directly by a manufacturer, dealer or retailer (usually IFRS 15/IAS 37).
2. **Employer obligations** under employee benefit plans (IAS 19).
3. **Financial guarantee contracts** accounted for under IFRS 9 (unless the entity elects IFRS 17).

Question 7: Define an insurance contract under IFRS 17.

Solution: An **insurance contract** is 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 adversely affects the policyholder. The

risk must be significant—i.e., the insurer could be required to pay significantly more if the insured event occurs than if it does not.

Question 8: A contract requires the insurer to repay a fixed deposit plus fixed interest, regardless of any event. Does this meet the definition of an insurance contract? Explain.

Solution: No. The contract does not transfer **insurance risk**; the insurer's obligation is the same regardless of any uncertain event. The contract is instead a financial instrument within the scope of IFRS 9.

C. Level of aggregation and groups of contracts

Question 9: What is a “portfolio” of insurance contracts under IFRS 17?

Solution: A **portfolio** is a group of insurance contracts subject to similar risks and managed together. For example, all motor insurance contracts or all term life contracts that share similar risk characteristics and are managed collectively.

Question 10: How must contracts be grouped within a portfolio for measurement purposes?

Solution: Within each portfolio, contracts must be divided into groups:

1. **Onerous contracts** at initial recognition.
2. **Contracts that have no significant possibility of becoming onerous.**
3. **Other contracts** (neither clearly onerous nor clearly non-onerous).

Contracts issued more than one year apart cannot be in the same group.

Question 11: Why does IFRS 17 require grouping into onerous and non-onerous contracts?

Solution: Grouping prevents profitable contracts from masking losses on onerous contracts. It ensures:

- Timely recognition of losses on onerous groups.
- Transparent reporting of profitability patterns.
- Consistent tracking of CSM and fulfilment cash flows at a meaningful level of aggregation.

Question 12: An insurer issues motor policies throughout 20X6. How might these be grouped under IFRS 17?

Solution:

- All 20X6 motor policies form a **portfolio** (similar risks, managed together).
- Within that portfolio, contracts are grouped into:
 - A group of **onerous** policies (e.g., high-risk drivers).
 - A group of **non-onerous** policies (low-risk drivers).

- Possibly a third group for contracts that could become onerous but are not clearly so at inception.

Each group includes only contracts issued within the same one-year period.

D. Recognition of insurance contracts

Question 13: At what point is a group of insurance contracts recognised under IFRS 17?

Solution: A group of insurance contracts is recognised at the **earliest** of:

1. The beginning of the coverage period.
2. The date when the first payment from a policyholder is due.
3. The date when the group becomes onerous.

Question 14: What are insurance acquisition cash flows, and how are they treated?

Solution: Insurance acquisition cash flows are costs directly attributable to the selling, underwriting and initiating of a group of insurance contracts (e.g., commissions, medical examinations). They are:

- Included in the measurement of the group of contracts.
- If incurred before the contracts are recognised, they may be capitalised as an asset and allocated to the related groups when those contracts are recognised.

Question 15: An insurer pays R200 000 in commissions to brokers to sell a portfolio of one-year motor policies expected to be issued in the next six months. How are these commissions accounted for?

Solution:

- Initially, the R200 000 is recognised as an **asset** representing insurance acquisition cash flows related to expected future contracts.
- As the contracts are issued and groups are recognised, the asset is allocated to those groups and included in their fulfilment cash flows (or liability for remaining coverage under PAA).

E. Measurement — General Measurement Model (GMM)

Question 16: Write the basic measurement equation for a group of insurance contracts under the General Measurement Model.

Solution: Under the GMM, the carrying amount of a group of insurance contracts is:

$$\text{Liability (or asset)} = \text{Fulfilment cash flows} + \text{Contractual service margin}$$

Where:

Fulfilment cash flows

= Present value of future cash flows + Risk adjustment for non-financial risk

Question 17: Explain the role of the risk adjustment for non-financial risk.

Solution: The **risk adjustment** reflects the compensation the entity requires for bearing the uncertainty in non-financial risks (e.g., mortality, morbidity, lapses, expenses). It:

- Is an explicit component of fulfilment cash flows.
- Decreases over time as uncertainty about future cash flows reduces.
- Is recognised in profit or loss as part of the insurance service result when released.

Question 18: How is the CSM determined at initial recognition for a profitable group of contracts?

Solution:

1. Estimate fulfilment cash flows (PV of future cash flows plus risk adjustment).
2. If the net result indicates a **profit** (i.e., expected inflows exceed outflows plus risk adjustment), the CSM is set equal to that expected profit so that no day-one gain is recognised.
3. The CSM is then recognised in profit or loss over the coverage period as services are provided.

Question 19: How is the CSM subsequently recognised in profit or loss?

Solution: The CSM is recognised in profit or loss over the coverage period in a manner that reflects the **pattern of services** provided (often the passage of time or expected claims pattern). Each period:

- A portion of CSM is released as **insurance revenue**.
- The release is combined with the release of risk adjustment and expected claims/expenses to form the insurance service result.

Question 20: An insurer issues a group of 5-year term life contracts. At initial recognition:

- Present value of expected premiums: R2 500 000
- Present value of expected claims and expenses: R2 100 000
- Risk adjustment: R150 000

Required:

- (a) Determine the expected profit.
- (b) Explain how the CSM is set at initial recognition.

Solution:

(a) Expected profit:

$$\begin{aligned}\text{Expected profit} &= \text{PV premiums} - \text{PV claims and expenses} - \text{Risk adjustment} \\ &= \text{R}2500000 - \text{R}2100000 - \text{R}150000 = \text{R}250000\end{aligned}$$

(b) Since the group is profitable, the CSM at initial recognition is set to **R250 000**, eliminating any day-one gain. This CSM will be recognised over the 5-year coverage period (e.g. R50 000 per year if services are provided evenly).

F. Premium Allocation Approach (PAA)

Question 21: Under what conditions may an entity apply the Premium Allocation Approach?

Solution: An entity may apply the PAA to a group of contracts if:

1. The coverage period is **one year or less**, or
2. The PAA produces a measurement that is not materially different from the GMM (without needing extensive testing).

Question 22: Describe the liability for remaining coverage under the PAA.

Solution: Under the PAA, the **liability for remaining coverage** is measured primarily as:

- Premiums received (plus any premiums receivable),
- Minus insurance acquisition cash flows,
- Minus amounts recognised as insurance revenue to date,
- Adjusted for any loss component if the group is onerous.

Question 23: An insurer issues one-year motor policies on 1 January 20X1:

- Total premiums received: R5 000 000
- Acquisition cash flows: R300 000

Assume the group is not onerous and coverage is evenly provided.

Required:

(a) Determine the liability for remaining coverage at initial recognition.

(b) Determine monthly insurance revenue under the PAA.

Solution:

(a) Liability for remaining coverage at initial recognition:

$$\begin{aligned}\text{Liability} &= \text{Premiums} - \text{Acquisition cash flows} \\ &= \text{R}5000000 - \text{R}300000 = \text{R}4700000\end{aligned}$$

(b) Coverage is one year (12 months), so monthly insurance revenue (ignoring discounting and claims for simplicity):

$$\text{Monthly revenue} = \frac{R4700000}{12} \approx R391667$$

Question 24: How is the liability for incurred claims measured under the PAA?

Solution: The **liability for incurred claims** under the PAA is measured similarly to the GMM:

- As the present value of future cash flows related to incurred claims,
- Including a risk adjustment for non-financial risk,
- Discounted using appropriate rates (unless the claims are expected to be settled within one year and discounting is immaterial).

G. Onerous contracts

Question 25: What is an onerous group of insurance contracts under IFRS 17?

Solution: A group of insurance contracts is **onerous** if, at initial recognition or subsequently, the fulfilment cash flows (including acquisition cash flows) exceed the carrying amount of the liability for remaining coverage (including CSM). In other words, the group is expected to be loss-making.

Question 26: How are onerous contracts accounted for under: (a) The GMM (b) The PAA

Solution:

(a) **GMM:**

- The CSM is set to **zero** (cannot be negative).
- The excess of fulfilment cash flows over the carrying amount is recognised immediately as a **loss** in profit or loss.

(b) **PAA:**

- A **loss component** is recognised within the liability for remaining coverage.
- Future revenue recognition is adjusted to reflect the loss component, and the loss is recognised in profit or loss.

Question 27: A group of contracts has:

- Present value of expected premiums: R1 000 000
- Present value of expected claims and expenses: R1 050 000
- Risk adjustment: R50 000

Required: Determine whether the group is onerous and the loss to be recognised at initial recognition.

Solution:

$$\begin{aligned}\text{Net result} &= \text{PV premiums} - \text{PV claims and expenses} - \text{Risk adjustment} \\ &= \text{R1000000} - \text{R1050000} - \text{R50000} = -\text{R100000}\end{aligned}$$

The group is **onerous** (negative result).

- CSM = 0.
- A **loss of R100 000** is recognised immediately in profit or loss at initial recognition.

H. Reinsurance contracts held

Question 28: How are reinsurance contracts held measured under IFRS 17?

Solution: Reinsurance contracts held are measured using a similar approach to underlying insurance contracts:

$$\text{Reinsurance asset or liability} = \text{Fulfilment cash flows} + \text{CSM}$$

Key points:

- The CSM represents the net cost or net gain from the reinsurance.
- Measurement is **independent** of the underlying contracts, although expected recoveries are based on those contracts.

Question 29: Can gains on reinsurance contracts held fully offset losses on onerous underlying contracts?

Solution: No. While reinsurance may mitigate losses, IFRS 17 requires separate measurement of underlying contracts and reinsurance contracts held. Losses on onerous underlying groups are recognised in full; gains on reinsurance are recognised according to the reinsurance contract's own measurement (often over time). Direct offsetting is not permitted.

Question 30: An insurer has an onerous group of contracts with an expected loss of R200 000. It holds a reinsurance contract expected to reimburse R150 000 of those losses.

Explain the accounting impact.

Solution:

- **Underlying group:**
 - Recognise a **loss of R200 000** in profit or loss at initial recognition (CSM = 0).
- **Reinsurance held:**
 - Measure fulfilment cash flows and CSM based on expected recoveries (R150 000).
 - Depending on the terms, a gain related to reinsurance may be recognised over time or partly at initial recognition, but it is accounted for separately.

Net effect: The entity reports a loss of R200 000 on the underlying contracts and a separate gain (or asset) of R150 000 from reinsurance, without direct netting.

I. Presentation and disclosure

Question 31: What are the main components of the insurance service result in the statement of profit or loss?

Solution: The **insurance service result** comprises:

- **Insurance revenue** (release of CSM, risk adjustment, and expected claims/expenses for services provided).
- **Insurance service expenses**, including:
 - Claims and benefits incurred.
 - Acquisition and administration expenses.
 - Changes in fulfilment cash flows relating to past and current service.
 - Losses on onerous contracts.

Question 32: What is “insurance finance income or expenses” under IFRS 17?

Solution: **Insurance finance income or expenses** arise from:

- The effect of discounting on insurance contract liabilities and assets.
- Changes in financial assumptions (e.g., interest rates).

Entities may choose an accounting policy to recognise all such effects in profit or loss or split them between profit or loss and other comprehensive income (OCI).

Question 33: List three key disclosure requirements under IFRS 17.

Solution:

1. **Reconciliations** of opening and closing balances of insurance contract assets and liabilities, including CSM movements.
2. **Information about significant judgements**, such as methods and inputs used to estimate fulfilment cash flows and risk adjustment.
3. **Risk disclosures**, including sensitivity analyses, claims development information, and descriptions of risk mitigation strategies (e.g., reinsurance).

J. Applied numerical examples

Question 34 (GMM — subsequent measurement): A group of 10-year contracts has an initial CSM of R300 000. Services are provided evenly over the coverage period.

Required:

- (a) Determine the annual CSM release.
- (b) Explain the impact on insurance revenue.

Solution:

(a) Annual CSM release:

$$\text{Annual release} = \frac{\text{R}300000}{10} = \text{R}30000$$

(b) Each year, R30 000 is recognised as part of **insurance revenue**, reflecting the profit earned from providing coverage. This is combined with the release of risk adjustment and expected claims/expenses to form the insurance service result.

Question 35 (PAA — onerous group): A one-year travel insurance group under the PAA has:

- Premiums: R1 200 000
- Acquisition cash flows: R100 000
- Expected claims and expenses (including risk adjustment): R1 350 000

Required:

- (a) Determine whether the group is onerous.
(b) Calculate the loss component at initial recognition.

Solution:

(a) Liability for remaining coverage at initial recognition:

$$\text{Liability} = \text{R}1200000 - \text{R}100000 = \text{R}1100000$$

Expected fulfilment cash flows (claims + expenses + risk adjustment) = R1 350 000.

Since expected outflows (R1 350 000) exceed the liability (R1 100 000), the group is **onerous**.

(b) Loss component:

$$\text{Loss component} = \text{R}1350000 - \text{R}1100000 = \text{R}250000$$

A loss of R250 000 is recognised in profit or loss at initial recognition, and the liability for remaining coverage includes this loss component.

Question 36 (Reversal of losses — concept): Can losses recognised on an onerous group of contracts be reversed if future estimates improve? Briefly explain.

Solution: Yes, IFRS 17 allows **reversal of losses** on onerous groups if future estimates of fulfilment cash flows improve such that the group is no longer onerous. The reversal is recognised in profit or loss, and a CSM may be re-established to reflect newly expected unearned profit.