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Draft Explanatory Report

IFRS 17 Expenses

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Draft Explanatory Report

IFRS 17 Expenses

Committee on Life Insurance Financial Reporting and Committee on Property and Casualty Insurance Financial Reporting

April 2021

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The actuary should be familiar with relevant other guidance. They expand or update the guidance provided in an educational note. They do not constitute standards of practice and are, therefore, not binding. They are, however, intended to illustrate the application of the Standards of Practice, so there should be no conflict between them. The actuary should note however that a practice that the other guidance describe for a situation is not necessarily the only accepted practice for that situation and is not necessarily accepted actuarial practice for a different situation. Responsibility for the manner of application of standards of practice in specific circumstances remains that of the members. As standards of practice evolve, other guidance may not reference the most current version of the Standards of Practice; and as such, the actuary should cross-reference with current Standards. To assist the actuary, the CIA website contains an up-to-date reference document of impending changes to update other guidance.

Canadian Institute of Actuaries / Institut canadien des actuaires

MEMORANDUM

To: Members in the life and health and property and casualty practice areas

From: Steven W. Easson, Chair
Actuarial Guidance Council

Marie-Andrée Boucher, Co-Chair
Steve Bocking, Co-Chair
Committee on Life Insurance Financial Reporting

Sarah Chevalier, Chair
Committee on Property and Casualty Insurance Financial Reporting

Date: April 27, 2021

Subject: **Draft Explanatory Report: IFRS 17 Expenses**

The Committee on Life Insurance Financial Reporting (CLIFR) and the Committee on Property and Casualty Insurance Financial Reporting (PCFRC) have prepared this draft report to provide information concerning expenses in accordance with IFRS 17 requirements.

The draft explanatory report is structured into six sections. Section 1 introduces the content presented in this explanatory report. The second section highlights the differences between IFRS 4 and IFRS 17 with regards to expenses. Section 3 constitutes the main section of the report, and presents considerations related to expenses under IFRS 17 with a focus on the concept of directly attributable expenses. The fourth section presents specific examples and considerations related to potential grey areas regarding classification of expenses as directly versus non-directly attributable, while Section 5 discusses other miscellaneous topics. The sixth and final section recommends disclosures that could be included in the Appointed Actuary's report to enable regulators to assess the range of practice regarding directly attributable expense classification in Canada.

A preliminary version of the draft explanatory report was shared with the following committees:

- Committee on Risk Management and Capital Requirements (CRMCR)
- Appointed Actuary (AA) Committee
- International Insurance Accounting Committee (IIAC)
- Worker's Compensation Committee.

A preliminary version of the draft explanatory report was also shared with the staff of the Accounting Standards Board (AcSB) to broaden consultations with the accounting community. Given that this draft report provides actuarial guidance rather than accounting guidance, the

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AcSB staff review was limited to citations of and any inconsistencies with IFRS 17. CIA reports do not go through the AcSB's due process and therefore, are not endorsed by the AcSB.

The draft explanatory report was also presented several times at the Actuarial Guidance Council (AGC) in the months preceding this request for approval. CLIFR and PCFRC are satisfied it has sufficiently addressed the material comments received by the various committees.

The creation of this cover letter and draft explanatory report has followed the AGC's protocol for the adoption of educational notes and other material. In accordance with the Institute's *Policy on Due Process for the Approval of Guidance Material other than Standards of Practice and Research Documents*, this draft report has been prepared by CLIFR and PCFRC and has received approval for distribution from the AGC on April 6, 2021.

CLIFR and PCFRC would like to acknowledge the contribution of its subcommittee that assisted in the development of this draft report: Wilson Ho (chair), Andrew Ryan, Boyang Liu, Claudette Cantin, Curtis Chim, David Howard, Denise Cheung, Dylan Lee, Faran Bahri, Harry Li, Louis-Philippe Morin-Lessard, Marie-Andrée Boucher, Mario St-Hilaire, Nicolas Sirois, Ping Xu, Simon Girard, and Veronika Molnar.

Questions or comments regarding this draft explanatory report are invited **by July 31, 2021** and may be directed to Wilson Ho at wilson.ho@sunlife.com, Marie-Andrée Boucher at mboucher@eckler.ca, Steve Bocking at steve.bocking@canadalife.com, or Sarah Chevalier at sarahchevalier@axxima.ca.

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1. Introduction

IFRS 17 (or the Standard) establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the Standard. This draft explanatory report provides considerations relating to expenses under IFRS 17, and presents different views related to directly attributable expenses and other expense topics. While there is currently no consensus amongst the industry and accounting firms on some of the expense topics, CLIFR and PCFRC felt that a discussion of different perspectives and considerations will help Canadian actuaries to apply professional judgment in the application of the Standard. This explanatory report implicitly assumes that the actuary is accountable for determining expenses projected for groups of insurance contracts under IFRS 17, and should be read within that context. Given that actuaries will not have full accountability for the measurement of expenses in the valuation within many Canadian entities, combined with the lack of clear consensus on some key expense topics, CLIFR and PCFRC agreed to publish this paper as an explanatory report rather than as an educational note. This explanatory report may still provide helpful support when the actuary is not directly responsible for determining the expenses but must rely on that work in his/her valuation and opinion on the policy liabilities.

References to specific paragraphs of IFRS 17 are denoted by IFRS 17.XX, where XX represents the relevant paragraph number.

The guiding principles that the joint CLIFR/PCFRC subcommittee followed in writing this draft explanatory report were:

- consider Canadian-specific perspectives, rather than simply repeating international actuarial material;
- provide application options that are consistent with the IFRS 17 standard and applicable Canadian actuarial standards of practice and educational notes, without unnecessarily narrowing the choices available in the IFRS 17 standard; and
- consider practical implications associated with the implementation of potential methods; in particular, ensure that due consideration is given to options that do not require undue cost and effort to implement.

As a general statement, IFRS 17 valuation includes cash flows that relate directly to the fulfilment of an insurance contract. Refer to the CLIFR draft educational note *IFRS 17 Estimates of Future Cash Flows* for further guidance and the PCFRC draft educational note *IFRS 17 – Actuarial Considerations Related to Liability for Remaining Coverage in P&C Insurance Contracts*, which is expected to be published in 2021.

Expenses, like other cash flows, are allocated to *groups* of contracts under IFRS 17. Expense cash flows would include expenses related to particular contracts within the group. There would also be an allocation of other expenses directly attributable to the larger portfolio to which the group belongs. The latter requires more judgment than the former, and as such is the primary focus in this explanatory report.

Expense cash flows allocated to a group include costs of acquiring insurance contracts (acquisition expenses), and costs of fulfilling the obligations under insurance contracts (maintenance expenses). The distinction between acquisition and maintenance expenses is important for presentation and disclosure purposes.

- IFRS 17.B65 provides examples of cash flows that would be included in insurance contract valuation, including expense cash flows. Expenses specifically addressed in IFRS 17.B65 include claim handling costs, policy administration and maintenance costs, costs of paying benefits, allocations of acquisition costs, and allocations of overhead directly attributable to fulfilling insurance contracts. Transaction based taxes[1] and levies would also be included in insurance contract valuation.
- IFRS 17.B65(m) indicates that any other costs specifically chargeable to the policy-holder under the terms of the contract would also be included in the estimates of future cash flows. This could be relevant for example for participating insurance contracts. More details are provided in section 5.2.5 of the *IFRS 17 Measurement and Presentation of Canadian Participating Insurance Contracts* draft educational note.

Expenses related to non-insurance business (such as the costs of issuing investment contracts or service contracts, and an associated share of overhead to these contracts), and expenses that do not relate directly to the acquisition or fulfilment of insurance contracts are referred to in this draft explanatory report as non-directly attributable expenses, and they are excluded from the measurement of insurance contracts under IFRS 17.

- IFRS 17.B66 provides examples of the types of cash flows that would *not* be included in the insurance contract valuation of direct contracts. Specific exclusions addressed in IFRS 17.B66 are expenses outside of the contract boundary, expenses not directly attributable to the fulfilment of insurance contracts, expenses from abnormal amounts of wasted labour, income tax payments (unless paid in a fiduciary capacity or specifically chargeable to the policy-holder under the terms of the contract) and cash flows that arise under reinsurance contracts held.

Questions 2.20 to 2.27 of the *Application of IFRS 17 Insurance Contracts* draft educational note provides further guidance on expenses. This draft educational note, published in February 2019, is an adoption without modification of the exposure draft of International Actuarial Note (IAN) 100. A revised exposure draft of the IAN 100, expected to be published in 2021, will address the comments made by the different actuarial bodies in addition to providing guidance related to the June 2020 amendments to the Standard.

2. Comparison between IFRS 4 and IFRS 17

Current practice: Life and health

Prior to the effective date of IFRS 17, insurance contract liabilities are subject to IFRS 4, which for life and health insurance contracts in Canada was the Canadian Asset Liability Method

[1] Canadian sales tax charged on insurance premiums (e.g., provincial sales tax or retail tax) would be included in the fulfilment cash flows, but may not need to be explicitly modeled as the ins and outs of the sales tax would usually net to zero. An exception could be segregated funds where explicit modeling of the sales tax would influence the account value projection and any corresponding guarantee cost. Furthermore, sales tax would be excluded from the measurement of both insurance revenue and insurance service expense per IFRS 17.B124(a)(iii).

(CALM) as guided by CIA *Standards of Practice* and educational notes. Under IFRS 4, future policy-related maintenance expense cash flows are included in the valuation of the liabilities. Acquisition expenses would only be included if they are expected to be incurred after the valuation date.

Current practice: Property and casualty

Under IFRS 4, the P&C insurance contract liabilities are comprised of premium and claims liabilities valued in accordance with accepted actuarial practice in Canada including the selection of appropriate assumptions and methods.

Claim liabilities include "the portion of insurance contract liabilities in respect of claims incurred on or before the calculation date." Claim liabilities comprise unpaid claims and claims-related expenses (including allocated and unallocated loss adjustment expenses), but do not include general maintenance or other unpaid expenses.

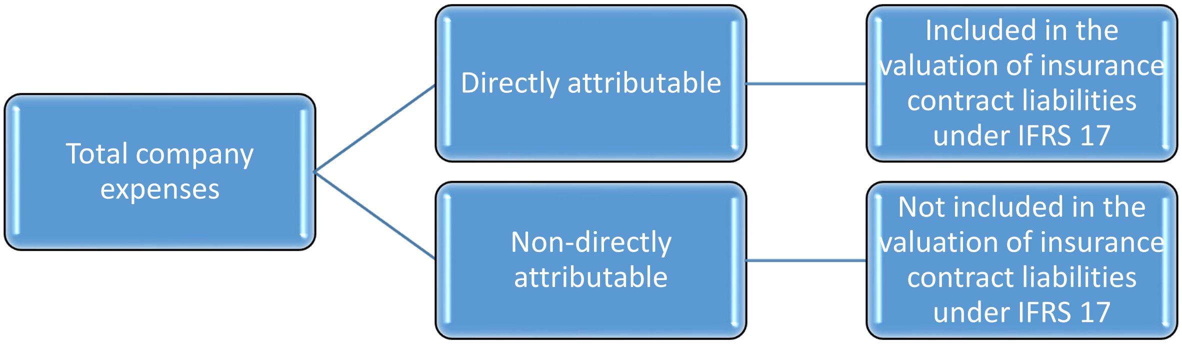
The premium liabilities are the net obligations of an insurer with respect to its insurance contracts other than claim liabilities. For the estimation of premium liabilities, acquisition and future general and claims-related expenses are taken into consideration. The premium liabilities are calculated as the sum of the expected losses, loss adjustment expenses, maintenance expenses, and other costs (e.g., profit commission, reinsurance) related to the policies in force at the valuation date. While premium liabilities are part of the Appointed Actuary's (AA) expression of opinion, they are not explicitly shown the financial statements[2].

For financial statement presentation, acquisition costs are either recognized as expenses when incurred, or are deferred as an asset and recognized over the coverage period. Other expenses associated with insurance operations, such as general and claims related expenses, are recognized as expenses when incurred.

Comparison between IFRS 17 and IFRS 4

IFRS 17 introduces the concept of "directly attributable expenses". The following chart illustrates how insurance contract expenses would be separated according to the Standard.

[2] The term "premium liabilities" in this context refers to an adequacy test of the unearned premium that is performed by P&C actuaries. These liabilities are included within the sum of the unearned premium, premium deficiency, and deferred policy acquisition costs (commission and premium taxes) which are presented on the balance sheet.



There could be several differences in expense treatment between IFRS 17 and IFRS 4, such as the following:

- The maintenance expenses in the scope of the valuation could differ, as IFRS 17 defines the expenses included in the fulfilment cash flows (FCF) as those that are "directly attributable" to insurance contracts. The concept of "directly attributable" is not defined in the Standard, and therefore its definition is open to interpretation (see discussion in Section 3.1). For life and health insurance, directly attributable expenses will likely be a subset of the expenses included under IFRS 4. For P&C insurance, the range of practice is relatively wide (with respect to general expenses and loss adjustment expenses) under IFRS 4, and the maintenance expenses associated with the liability for remaining coverage (LRC) and liability for incurred claims (LIC) could therefore be higher or lower under IFRS 17.

- For life and health, acquisition expenses incurred following the contract issuance affected the IFRS 4 valuation. For P&C, policy acquisition expenses could either be recognized as incurred or deferred under the IFRS 4 valuation. Under IFRS 17, except as noted below, all acquisition expense cash flows – whether pre or post contract issuance – are included in the initial measurement of the group of insurance contract valuations, primarily to facilitate the determination of the initial FCF, and for presentation of financial results. The following exception applies:

    - Under the premium allocation approach (PAA), there is an option to recognize insurance acquisition cash flows as expenses when incurred if the coverage period of all contracts in the groups is one year or less (as per IFRS 17.59(a)). If this option is elected, acquisition costs have no impact on the measurement of the LRC. If the entity does not choose to recognize insurance acquisition cash flows as expenses when incurred, acquisition costs incurred will impact the LRC.

  For each group, as per IFRS 17.28B, the entity shall recognize as an asset insurance acquisition cash flows paid before the related group of insurance contracts is recognized unless the entity chooses to apply IFRS 17.59(a).

  Under IFRS 4, for life and health, maintenance expenses may have been allocated to direct contracts only, given the primary focus is on the appropriateness of the net liabilities. However, under IFRS 17, it is necessary to allocate some expenses to groups of reinsurance contracts held (i.e., those expenses that are directly attributable to portfolios of reinsurance contracts held, such as reinsurance administration costs). See Section 5.1 for further discussion of the IFRS 17 treatment of such expenses.

- Under IFRS 17, the investment expenses included in the projection of FCF are described under IFRS 17.B65(ka). Some investment expenses currently included in the IFRS 4 valuation may be out of scope under IFRS 17. Refer to Section 4 for further discussion of the IFRS 17 treatment of investment expenses.

The IFRS 17 treatment of expenses is explored further in the following sections.

3. General considerations

3.1 Directly attributable expenses

IFRS 17 introduces the concept of directly attributable expenses, but the term "directly attributable" is not formally defined in the Standard. Directly attributable expenses are included in the IFRS 17 measurement of insurance contract liabilities, whereas non-directly attributable expenses are not. The interpretation of "directly attributable" is therefore critical to the IFRS 17 valuation.

The key IFRS 17 application guidance regarding the inclusion of expenses in the measurement of insurance contract liabilities is found in IFRS 17.B65 and B66, and within the definition of insurance acquisition cash flows in Appendix A of the Standard. According to IFRS 17.B65, the following cash flows would be within the contract boundary and therefore be included in the measurement of insurance contract liabilities:

- IFRS 17.B65(e): an allocation of insurance acquisition cash flows attributable to the portfolio to which the contract belongs.
  - Appendix A: "Insurance acquisition cash flows" are defined as "Cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are **directly attributable (emphasis added)** to the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio."
- IFRS 17.B65(l): "an allocation of fixed and variable overheads (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) **directly attributable (emphasis added)** to fulfilling insurance contracts".

Expenses that are not directly attributable would be excluded from the measurement of insurance contract liabilities – i.e., recognized in profit and loss as incurred per IFRS 17.B66(d).

- IFRS 17.B66(d): cash flows relating to costs that **cannot be directly attributed (emphasis added)** to the portfolio of insurance contracts that contain the contract, such as some product development and training costs. Such costs are recognised in profit or loss when incurred.

Some expenses would clearly be directly attributable, and be included in the estimates of future cash flows within the IFRS 17 contract boundary, such as:

- claim handling costs, per IFRS 17.B65(f);
- policy administration and maintenance costs, per IFRS 17.B65(h); and
- cost specifically chargeable to the policy-holder under the terms of the contract, per IFRS 17.B65(m).

Expenses attributable to non-insurance business (such as the costs of issuing investment contracts or service contracts, and an associated share of overhead allocated to these contracts) would clearly not be directly attributable to insurance contracts.

However, between the expenses that are and are not clearly directly attributable, there can be a grey area in the classification of costs. For example, expenses for investment management, asset liability management and risk management would be incurred by an entity that issues and maintains insurance contracts, but would those expenses qualify as <u>directly</u> attributable to issuing contracts or fulfilling contractual obligations? Inclusion or exclusion of some expenses from the IFRS 17 valuation requires an interpretation of the meaning of “directly attributable.”

- One potential view is that an expense would only be considered directly attributable if it is incurred for the clear purpose of either issuing insurance contracts or fulfilling obligations under insurance contracts. From this perspective, expenses such as investment management, asset liability management and risk management would *not* be considered directly attributable. While these expenses are incurred to support the profitable operation of an insurance entity, the primary purpose of these functions is one or two steps removed from acquiring insurance contracts or fulfilling obligations under insurance contracts.
- The counter argument to the view above is that an insurance entity could not plausibly fulfil its obligations under its insurance contracts without expenses such as investment management, asset liability management, and risk management. Furthermore, while the primary purpose of incurring these costs may not be acquisition of insurance contracts or fulfilling obligations under insurance contracts, neither is the primary purpose of overhead expenses such as rent and HR costs, but these overhead costs are considered directly attributable under IFRS 17.B65(l). From this perspective, a wider interpretation of the scope of “directly attributable” could potentially be adopted.

Section 4 of this draft explanatory report provides specific examples and considerations related to the potential grey areas regarding classification of expenses as directly versus non-directly attributable. Grey areas in the interpretation of the meaning of “directly attributable” along with an entity’s specific facts and circumstances, have the potential to lead to a wide range of practice, which could diminish one of the primary objectives of IFRS 17 – the comparability of financial results between entities. Therefore, Section 6 of this explanatory report makes some recommendations for disclosures in the Appointed Actuary’s Report, to provide regulators the data to assess the degree to which a wide range of practice actually emerges from different interpretations of the meaning of directly attributable.

Treatment of directly attributable expenses would depend on the measurement model, as discussed in the following sections. Non-directly attributable expenses related to the direct insurance contracts would generally be recognized as incurred, regardless of the classification (acquisition or maintenance) or the measurement model.

3.1.1 General measurement approach and variable fee approach

Under the general measurement approach (GMA) and the variable fee approach (VFA), directly attributable acquisition and maintenance expenses would be included in the FCF.

Directly attributable maintenance costs are generally incurred at a higher level of aggregation than the group of contracts; these costs would need to be allocated to groups of contracts in a systematic and rational manner. Expected future allocations within the boundary of the contract would be included in the FCF.

Directly attributable acquisition costs, known or anticipated at recognition of the group, regardless of when they are incurred (pre-recognition, concurrent to recognition or post-recognition), are included in the initial measurement of insurance contract liabilities. The Standard requires allocations of all directly attributable acquisition costs in a portfolio to groups in that portfolio, and of any acquisition costs directly attributable to any future renewals of contracts (outside the boundary of the new contracts) to future groups using a systematic, consistent, and rational basis as per IFRS 17.28A and IFRS 17.B35A-B35B.

Insurance acquisition cash flows incurred before the recognition of their related insurance contracts are held as an asset per IFRS 17.28B (where incurred in this context means either an amount paid or a payable amount for which an accounting liability has been established). This asset will be referred to as the asset for insurance acquisition cash flows. In 2021, CLIFR and PCFRC are expected to publish an explanatory report on the topic of the asset for insurance acquisition cash flows and its recoverability. The following is an overview of the requirements:

- The asset for insurance acquisition cash flows (or a portion of it) is derecognized when the insurance acquisition cash flows are allocated to the group of insurance contracts at the group's initial recognition per IFRS 17.28C. To the extent that additional contracts are expected to be added to the group in future accounting periods, the entity would continue to recognize the portion of the asset related to those future contracts per IFRS 17.B35C.
- Two recoverability tests are required per IFRS 17.28E and B35D. As a result of these recoverability tests, the asset would be adjusted to reflect the loss of recoverability if the insurance acquisition cash flows are no longer expected to be recovered by future cash flows. That loss of recoverability is reflected in insurance results in the period that determination is made.
- Once the asset is adjusted down, the impairment can be reversed if a future assessment indicates that the cost is then recoverable, per IFRS 17.28F.

3.1.2 Premium allocation approach

If an insurance contract is measured using the PAA, the calculation of FCF is not required for the LRC unless the insurance contract is onerous. However, FCF calculations may be required for the calculation of the LIC; directly attributable expense classifications would be required in these calculations. Furthermore, a split between directly attributable and non-directly attributable expenses would be required for presentation purposes – directly attributable expenses are part of the insurance service result, whereas non-directly attributable expenses are not. Non-directly attributable expenses are presented outside the insurance service result as “Other expenses” in the statement of financial performance.

For groups of contracts with a coverage period of one year or less, the insurer may elect to recognize the acquisition cash flows as expenses when they are incurred, as per IFRS 17.59(a). The LRC calculated on non-onerous contracts at initial and subsequent measurement would be impacted by this choice as per IFRS 17.55 (a) and (b). Appendix 1 includes a simple example that illustrates the impact of the application of IFRS 17.59(a) on the LRC at initial and subsequent measurement. Directly attributable maintenance expenses associated with the remaining coverage will be recognized as incurred.

3.1.3 Liabilities for incurred claims

The treatment of expenses for the measurement of the LIC is the same between the GMA, VFA and PAA; future maintenance expenses associated with the LIC, such as future claims related expenses associated with incurred claims and overheads, would be included in the measurement.

3.2 Measurement and presentation

3.2.1 Contracts measured using the GMA

__Initial measurement__

Expected directly attributable acquisition and maintenance expenses are both included in the FCF at initial recognition, and therefore impact the amount of the contractual service margin (CSM) or loss component. As a result, the more expenses that are included in the FCF at initial recognition, the lower the CSM will be for the group; furthermore, the probability increases for contracts in the group to be classified as onerous.

Acquisition expenses incurred *prior* to the initial recognition of a group of insurance contracts are deferred and recognized as an asset for insurance acquisition cash flows. In 2021, CLIFR and PCFRC are expected to publish an explanatory report on the topic of the asset for insurance acquisition cash flows and recoverability of acquisition expenses.

Non-directly attributable expenses are excluded from the measurement of the group of insurance contracts.

__Subsequent measurement__

As per IFRS 17.B96a, “experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows” are not recognized in profit/loss immediately, but instead adjust the CSM (if available).

Therefore, actual versus expected differences in directly attributable acquisition expenses will be reflected in profit/loss in subsequent periods through the amortization of the CSM.

Directly attributable maintenance expenses are typically incurred throughout the contract boundary and continue to be part of the FCF at subsequent measurement. Differences between actual versus expected directly attributable maintenance expenses in the current period relate to current service, and therefore will be recognized in profit or loss each period as actual expenses are incurred (as the difference between insurance revenue and insurance service expense described further below).

Presentation of profit or loss

Insurance revenue will include the expected directly attributable maintenance expenses and an amount for the amortization of directly attributable insurance acquisition expenses. Since insurance contracts are priced to recover these costs effectively, the portion of the premium that covers these expenses is recognized as revenue each period.

Actual directly attributable maintenance expenses are recognized as incurred in insurance service expenses. An amount equal to the amortization of directly attributable insurance acquisition expenses included in revenue is also included in insurance service expenses. This effectively recognizes the amount for the amortization of the directly attributable acquisition expenses over the coverage period rather than when the cash flows occur.

Therefore, the difference between actual and expected directly attributable maintenance expenses affects the current period insurance service result. Conversely, the amortization of directly attributable acquisition expenses does not impact profit/loss because an equal amount is reported in insurance revenue and insurance service expense.

The presentation of expenses in insurance revenue and insurance service expenses is illustrated below:

Insurance Revenue	
Expected claims and other expenses (excluding investment components and amounts allocated to loss component)	**Expected directly attributable maintenance expenses**
Release of the risk adjustment (excluding amounts allocated to loss component)	
CSM recognized for services provided	
Amortization of insurance acquisition cash flows	**Equal to amount below in expenses**
Premium experience adjustments	
Total Insurance Revenue	
Insurance Service Expenses	
Incurred claims (excluding investment components) and other incurred insurance service expenses	**Actual directly attributable maintenance expenses**
Amortization of insurance acquisition cash flows	**Equal to amount above in revenue**
Changes related to future service (losses on onerous groups and reversals of such losses)	
Changes related to past service (changes in FCF related to incurred claims liability)	
Total Insurance Service Expenses	
Insurance Service Result	
Other Expenses	**Non directly attributable expenses**
Profits / Losses	

Non-directly attributable expenses are recognized as incurred outside of the insurance service result. As per IFRS 17 illustrative example IE 79, non-directly attributable expenses would show under "Other expenses" and impact profits and losses. Although these expenses are excluded from the FCF, premium loads included in the FCF would generally be designed to recover these costs. The CSM that is created for non-onerous groups of contracts would therefore include the premium loads. This disconnect will create a timing mismatch, as non-directly attributable expenses are recognized as incurred while the associated premium loads are recognized in insurance revenue as the CSM is released. A presentation mismatch will also be created as the revenue is recognized in the insurance service result while the expense is recognized outside of the insurance service result in "Other expenses."

Example

The following example illustrates how directly attributable expenses impact the measurement of insurance contracts and are presented in the statement of financial performance: A group of insurance contracts are issued with a coverage period of three years. The following are details of the expected future cash flows:

Description	**Total amount**	**Additional information**
Premiums	$900	Received at inception
Claims	$450	$150 per year
Directly attributable acquisition expenses	$90	Incurred at or prior to initial recognition
Directly attributable maintenance expenses	$150	$50 per year
Non-directly attributable acquisition expenses	$30	Incurred at inception
Non-directly attributable maintenance expenses	$75	$25 per year

For simplicity, assume the following:

- No risk adjustment or discounting,
- CSM is run-off on a straight-line basis
- Insurance acquisition cash flows are amortized evenly over the three years.

Calculation of CSM at initial recognition (positive numbers are inflows, negative numbers are outflows)**:**

Premiums:	$900
Claims:	($450)
Directly attributable acquisition expenses:	($90)
Directly attributable maintenance expenses:	($150)
Net inflow = CSM:	$ 210

Scenario A: Assume all events occur as expected. The insurance service result for **Year 1** would be as follows:

Insurance Revenue		
Expected claims and other expenses (excluding investment components and amounts allocated to loss component)	**200**	**$150 claims plus $50 maintenance expenses**
CSM recognized for services provided	**70**	**$210 over 3 years**
Amortization of insurance acquisition cash flows	**30**	**$90 over 3 years**
Total Insurance Revenue	***300***	
Insurance Service Expenses		
Incurred claims (excluding investment components) and other incurred insurance service expenses	**200**	**$150 claims plus $50 maintenance expenses**
Amortization of insurance acquisition cash flows	**30**	**equals amount in revenue**
Total Insurance Service Expenses	***230***	
Insurance Service Result	***70***	
Other Expenses	***55***	**$30 acquisition and $25 maintenance non directly attributable expenses**
Profits / Losses	***15***	

For this scenario (where all events occur as expected), the insurance service result is equal to the amortization of the CSM.

Non-directly attributable expenses of $55 ($30 of acquisition and $25 of maintenance) would be recognized as expenses outside of the insurance service result. Total profit would be $15 ($70 insurance service result less $55 of non-directly attributable expenses).

Scenario B: Assume actual directly attributable maintenance expenses incurred in Year 1 are $75 instead of the expected $50. The insurance service result for **Year 1** would be as follows:

Insurance Revenue		
Expected claims and other expenses (excluding investment components and amounts allocated to loss component)	200	**$150 claims plus $50 maintenance expenses**
CSM recognized for services provided	70	**$210 over 3 years**
Amortization of insurance acquisition cash flows	30	**$90 over 3 years**
Total Insurance Revenue	***300***	
Insurance Service Expenses		
Incurred claims (excluding investment components) and other incurred insurance service expenses	225	**$150 claims plus $75 maintenance expenses**
Amortization of insurance acquisition cash flows	30	**equals amount in revenue**
Total Insurance Service Expenses	***255***	
Insurance Service Result	***45***	
Other Expenses	***55***	**$30 acquisition and $25 maintenance non directly attributable expenses**
Profits / Losses	***(10)***	

Insurance revenue is the same as in Scenario A since revenue includes the expected amount of expenses. Insurance service expenses are higher by $25 since insurance service expenses represent the actual amounts incurred. As a result, insurance service result is lower by $25.

Non-directly attributable expenses of $55 ($30 of acquisition and $25 of maintenance) would be recognized as expenses outside of the insurance service result. Total profit would be a loss of $10 ($45 insurance service result less $55 of non-directly attributable expenses).

Scenario C: Assume actual directly attributable acquisition expenses incurred at initial recognition are $105 instead of $90. As noted previously, differences between expected and actual directly attributable acquisition expenses adjust the CSM.

The CSM would be adjusted as follows:

Premiums – cash inflow:	$ 900
Claims (cash outflow):	($450)
Directly attributable acquisition expenses (cash outflow):	**($105)**
Directly attributable maintenance expenses (cash outflow):	($150)
Net inflow = CSM:	**$ 195**

Insurance Revenue		
Expected claims and other expenses (excluding investment components and amounts allocated to loss component)	200	**$150 claims plus $50 maintenance expenses**
CSM recognized for services provided	65	**$195 over 3 years**
Amortization of insurance acquisition cash flows	35	**$105 over 3 years**
Total Insurance Revenue	***300***	
Insurance Service Expenses		
Incurred claims (excluding investment components) and other incurred insurance service expenses	200	**$150 claims plus $50 maintenance expenses**
Amortization of insurance acquisition cash flows	35	**equals amount in revenue**
Total Insurance Service Expenses	***235***	
Insurance Service Result	***65***	
Other Expenses	***55***	**$30 acquisition and $25 maintenance non directly attributable expenses**
Profits / Losses	***10***	

For this scenario, the insurance service result is equal to the amortization of the CSM. The amortization of the CSM is less than Scenario A due to the higher amount of acquisition expenses incurred, which reduces the expected profit from the group of insurance contracts.

Non-directly attributable expenses of $55 ($30 of acquisition and $25 of maintenance) would be recognized as expenses outside of the insurance service result. Total profit would be $10 ($65 insurance service result less $55 of non-directly attributable expenses).

3.2.2 Contracts measured using the PAA

Expenses are classified as acquisition expenses or maintenance expenses, similar to under the GMA. However, the measurement of the LRC is based on premiums received and recognition of revenue through expected premium receipts rather than a projection of future cash flows.

Directly attributable acquisition expenses can be deferred and amortized, or can be recognized as incurred when the coverage period is one year or less as per IFRS 17.59(a). Under the 59(a) election, acquisition expenses incurred prior to or at the measurement date of a contract would be excluded from the assessment of whether the contract is onerous. The 59(a) election therefore reduces the likelihood of onerous contract classifications; however, it does result in the immediate recognition in P&L of those expenses, which would be similar to the front-ended recognition of losses under onerous contracts. For non-onerous contracts, the 59(a) election accelerates the recognition of acquisition expenses which would otherwise be amortized over the remainder of the contract.

Maintenance expenses are recognized as incurred. Both directly attributable acquisition expenses (amount incurred or amortized, depending on the policy elected) and directly attributable maintenance expenses incurred are reported as insurance service expenses and impact the insurance service result. Revenue is the expected premium receipts (adjusted for time value of money and investment components, if required) recognized over the coverage period. Similar to the GMA, non-directly attributable expenses are recognized as “Other expenses” outside of the insurance service result.

If facts and circumstances indicate that a contract may be onerous, a projection of FCF is required. Therefore, classification of expenses as directly attributable (or not), and the 59(a) election, can affect whether contracts are considered onerous.

Example

A group of insurance contracts are issued with a coverage period of two years and is eligible for the PAA. The following are details of the cash flows:

Description	**Total amount**	**Additional information**
Expected premiums	\$1,000	Received at inception
Directly attributable acquisition expenses	\$200	Incurred at inception
Directly attributable maintenance expenses	\$50	Incurred in year 1
Non-directly attributable acquisition expenses	\$30	Incurred at initial recognition
Non-directly attributable maintenance expenses	\$50	\$25 per year

Also assume the following:

- No claims are incurred in Year 1
- Expected premium receipts are allocated on the basis of the passage of time
- Acquisition costs are deferred and amortized over the two-year coverage period
- There is no discounting

Insurance service result for **Year 1**:

Insurance Revenue		
Revenue recognized under the premium allocation approach	500	**\$1,000 expected premiums over 2 years**
Total Insurance Revenue	***500***	
Insurance Service Expenses		
Incurred claims (excluding investment components) and other incurred insurance service expenses	50	**\$50 maintenance expenses**
Amortization of insurance acquisition cash flows	100	**\$200 amortized over 2 years**
Total Insurance Service Expenses	***150***	
Insurance Service Result	***350***	
Other Expenses	***55***	**\$30 acquisition and \$25 maintenance non directly attributable expenses**
Profits / Losses	***295***	

4. Expense classification considerations – directly vs. non-directly attributable expenses

This section provides some examples of expenses that would generally be considered directly attributable for insurance contracts issued, and expenses that would be considered grey areas. These examples are reviewed from the perspectives of the two views of interpretation of the meaning of “directly attributable” expenses articulated in Section 3.1. These examples are not meant to be an exhaustive list of every possible expense, the nature/terminology of expenses could be different across companies and the actuary would apply professional judgment in the setting of principles and classification of directly attributable expenses. In practice, some of the expense breakdown may not be available at a very granular level and materiality would be considered in the classification of such expenses.

4.1. Examples of expenses that *would* generally be considered directly attributable

Regardless of which of the two views an actuary takes, the following expenses would generally be considered directly attributable based on the principles outlined in Section 3.1. The first set of bullets would generally be considered acquisition expenses, while the second set would generally be considered maintenance expenses.

- Expenses incurred with the primary purpose being issuance or renewal of insurance contracts, such as:
    - costs related to pricing activities;
    - costs related to underwriting activities;
    - costs associated with policy issuance or renewal;
    - costs related to sales and distribution, including salaries, commissions, bonuses and agency costs;
    - contingent profit commissions (except if qualify as non-distinct investment component), transfer/overwrite commissions (associated with procurement of new insurance contracts) (P&C only);
    - training and/or HR costs directly related to any of the above functions[3]; and
    - overhead attributed to issuance or renewal of insurance contracts.
- Expenses incurred with the primary purpose being fulfilment of obligations under insurance contracts, such as:
    - policy maintenance costs, including salaries of administration personnel, systems maintenance costs, and customer service costs;
    - claims settlement costs;
    - recurring commissions (e.g., related to recurring premiums);
    - sliding scale and other profitability-based commissions (except if qualify as non-distinct investment component) (P&C only);
    - training and/or HR costs directly related to any of the above functions; and
    - overhead attributed to maintenance of insurance contracts.

Premium taxes would be considered within the boundary of the insurance contract and would therefore be included in FCF. Further discussion on this topic is provided in Section 5.

[3] Caution would be applied when classifying training and HR costs. For example, training costs incurred in areas with significant employee turnover may not be considered directly attributable.

4.2. Examples of grey areas that could be considered either directly or not directly attributable expenses

The following expenses may or may not be considered directly attributable, depending upon which of the two views is taken:

- Investment expenses
- Asset liability management (ALM) expenses
- Corporate governance expenses
- Regulatory and statutory reporting expenses
- Shareholder related expenses
- Generic marketing, sales conference, and events

4.2.1 Investment expenses

The term "investment expenses" refers to costs that are incurred in order to perform activities related to the management of assets/investments. Investment expenses include costs associated with the purchase and sale of assets (including personnel costs associated with an internal investment department, or fees paid to external parties), reporting and analysis of investment holdings, hedging activities, etc. ALM expenses could be viewed as an extension of investment expenses.

The classification of investment expenses as directly attributable or not directly attributable can have a very significant impact on IFRS 17 measurement, especially for entities with a long investment horizon for assets supporting long-duration liabilities. As such, consistency of practice within Canada would be the preferred goal, to facilitate comparison between entities; however, the potential for different interpretations does exist, as outlined in the subsections below.

It should also be noted that some investment expenses might be accounted for under IFRS 9. Expenses that are accounted for under IFRS 9 *Financial Instruments* are out of scope of this report, but the actuary would need to be aware of the IFRS 9 treatment to avoid double counting or omission of expense cash flows in the IFRS 17 valuation.

4.2.1.1 Investment expenses for products that include the management of a clear pool of underlying assets

IFRS 17.B65(ka) specifies that costs related to investment activities to enhance benefits from insurance coverage for policy-holders, and investment-return service/investment-related service provided to policy-holders of insurance contracts with/without direct participation features are included in the FCF.

Products that fall under these categories include the following:

- Contracts with direct participation features that provide an investment-related service, generally measured under the VFA, such as segregated funds and some participating contracts. These products include the management of assets in a clearly defined pool of underlying items, and the investment expenses associated with the underlying item would be considered directly attributable.

- Management of underlying assets that support account values for contracts not generally measured under the VFA, such as universal life products. These products would generally provide investment-return services, with the objective of managing underlying assets to enhance benefits of insurance coverage for the policy-holders. The investment expenses associated with the underlying assets (e.g., universal life fund value) would be considered directly attributable.

4.2.1.2 Investment expenses for products that relate to the management of assets that are not part of the underlying item

The Standard is less clear on whether these expenses would be considered directly attributable or not, hence potential exists for the two views noted in Section 3.1 of this draft explanatory report. The key consideration is whether or not the investment activities enhance benefits payable to policy-holders, per IFRS 17.B65(ka)(i).

- The intent of the IASB appears to be exclusion of investment expenses related to management of assets that are not part of an underlying item, as B65(ka)(i) describes enhancing benefits as generating “an investment return from which the policyholder will benefit if an insured event occurs.” Normally investment returns on non-underlying assets accrue to the entity, not the policyholder, hence the associated expenses would not be directly attributable.
- An alternative would be that investment activities do enhance policy-holder benefits (e.g., larger amount of coverage offered to the policy-holders for the same premium when investments are considered), in which case investment expenses could be considered directly attributable expenses.

The actuary would be mindful of the interdependency between including certain types of investment expenses in the FCF and the identification of investment-return services in insurance contracts. As per IFRS 17.B65(ka)(ii), costs incurred by the entity providing investment-return services would be included in the contract boundary. For example, if a life insurance product that has a cash surrender value component is considered to provide investment-return service, the investment expenses related to the assets supporting the cash surrender value may be considered as directly attributable.

4.2.2 Corporate governance, regulatory/statutory reporting and shareholder-related expense

The corporate governance and shareholder-related expenses are essential expenses for insurance companies (listed companies for the shareholder-related expense), these expenses are generally related to improving the overall performance of the entities and not directly related to issuance or fulfilment of insurance contracts. As such, these expenses would generally be considered non-directly attributable expenses as articulated in the first view in Section 3.1. However, given that these expenses are essential for insurance companies (listed companies for the shareholder-related expenses), there could be a rationale for classifying them as directly attributable expenses as articulated in the second view in Section 3.1.

Regulatory and statutory reporting are generally designed to protect policy-holders' interests and are mandatory expenses and therefore directly related to the issuance or fulfilment of insurance contracts. As such, these expenses may be considered directly attributable expenses. However, given that these expenses are one or two steps removed from acquiring or fulfilling insurance contracts, there could be a rationale for classifying them as non-directly attributable expenses as articulated in the first view in section 3.1.

4.2.3 Generic marketing, sales conference, and events

For generic marketing expenses, the ultimate purpose of these costs is issuance of insurance contracts, hence these expenses could be classified as directly attributable as articulated in the first view in Section 3.1. However, that purpose is generally one or two steps removed from directly selling or enabling acquisition of specific new contracts or portfolios of contracts, and therefore these expenses could be classified as non-directly attributable expenses unless there is stronger direct linkage to the issuance of insurance contracts, as articulated in the second view presented in Section 3.1.

Similarly for sales conference and events expenses, the classification of these expenses into directly attributable expenses could be dependent on their nature. For example, if the conference is focused on specific product(s), it could be considered as directly related to issuance of insurance contracts and would therefore be part of the directly attributable expenses. On the other hand, conferences on general strategy would be considered non-directly attributable expenses as the purpose is one or two steps removed from issuance of insurance contracts. Judgment would be applied if the level of granularity required to assess the nature of these expenses is not available.

5. Other expense related topics

5.1. Reinsurance contract held expenses

As per paragraph IFRS 17.82 and paragraphs IFRS 17.BC345-346 of the Basis for Conclusions on IFRS 17, an entity is prohibited from offsetting reinsurance contract assets held against related underlying insurance contract liabilities in the statement of financial position. Consistently with such principle, income and expenses from reinsurance contracts held are presented separately from expenses or income incurred from insurance contract issued.

Companies would need to identify and track expenses incurred from reinsurance contracts held separately. Reinsurance contract held expenses include expenses incurred by the ceding company on the reinsurance contracts held as well as an allocation of applicable overheads. These expenses would not be included in the valuation of the insurance contracts issued per IFRS 17.B66 (b), but rather would be attributable to groups of reinsurance contracts held.

Examples of reinsurance-related expenses include:

- reinsurance administration system costs; and
- employee costs for individuals negotiating/pricing treaties, and performing administration tasks related to reinsurance contract management, as well as overhead expenses allocated to these individuals.

5.2. Productivity and economies of scale

Question 2.20 in the draft educational note *Application of IFRS 17 Insurance Contracts* states "It is also appropriate to allow for expected future economies (or diseconomies) of scale, consistent with the likelihood of these scenarios and unbiased mean… Future unit costs will also consider the likelihood of the entity being measured as a going concern. Unit costs may therefore need to reflect a reasonable development of future new business, if appropriate, in deriving an unbiased estimate of the mean."

When estimating the FCF for a group of contracts, the actuary would consider how directly attributable expense allocations to that group are expected to change over the boundary of the contract. The two primary factors affecting directly attributable expense projections would be the following:

- The entity's expected overall expense growth: expense growth would be influenced by general inflation and by the entity's cost management strategy. It may be reasonable to assume that the entity's fixed cost base would increase over time at the expected rate of general inflation, unless the entity has a credible cost containment (or expansion) strategy.
- The entity's expected policy growth strategy: a growing aggregate policy base over time could result in lower fixed expense allocations to the group, as the entity's fixed costs would be spread over a broader base of contracts. Variable costs would grow proportionally to the growth in the policy base, perhaps adjusted for general inflation.

In a growing entity, it may be possible that unit cost allocations would decrease over time if the entity's policy growth exceeds its fixed expense growth. Conversely, in an entity that is not growing (runoff of inforce exceeds new business), unit cost allocations would likely increase at a faster rate than the entity's expense growth. For these reasons, reasonable new business and inforce run off projections, and an understanding of the fixed/variable nature of the entity's expenses, are likely to be fundamental inputs into the projection of expenses in the FCF.

5.3. Abnormal costs used to fulfil the contracts

According to IFRS 17.B66(e), any abnormal amount of wasted labor or other resources that are used to fulfil the contracts would not be classified as directly attributable expenses. They would therefore be excluded from the FCF.

5.4. Systematic and rational allocations of expenses

IFRS 17.28A states that "an entity shall allocate insurance acquisition cash flows to groups of insurance contracts using a systematic and rational method…". The same concept would apply to maintenance expenses. The International Accounting Standards Board® Basis of Conclusions BC113 suggested other IFRS requirements such as IFRS 15 and IAS 2 – Inventories as reference when performing systematic allocations.

According to IAS 2,

- "The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities".

- "Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance".
- "The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant."

As a practical example of how an overly simple allocation methodology could result in an allocation that is not rational, consider an entity with relatively fixed acquisition costs (e.g., flat cost of underwriters' salaries) but fluctuating sales volumes. Allocation of flat costs to a varying volume base could result in an over-allocation of expenses to groups of contracts when the volume is low, and an under-allocation of expenses to groups of contracts when the volume is high. Such over or under-allocations could affect the IFRS 17.16 classification of the group of contracts at initial recognition. One way to achieve a more reasonable allocation would be to base per contract directly attributable expense allocations on normal capacity expectations.

If the actuary chooses to take a seriatim contract grouping approach at initial recognition to satisfy IFRS 17.16, then a more sophisticated mechanism may be needed to allocate expenses to the contract level, or alternatively to unitize costs at a finer level of granularity such that the expected profitability of the contract is reasonably assessed. For example, if policy size and/or issue age significantly affect the level of acquisition and maintenance expenses for a contract, failure to recognize those dimensions in the allocation (or unitization) process could result in systematic misclassification of profitability for some contracts.

5.5. Frequency to review directly vs. non-directly attributable expense

Once the expense classification principles of directly versus non-directly attributable expenses and expense allocation methodologies are determined, those principles and methodologies would not be expected to be modified frequently. The actual dollar expense allocation between directly versus non directly attributable expenses could vary periodically and it would be reviewed as part of the entity's internal expense review process.

Some situations may trigger updating of the expense classifications and/or allocation methodologies. For example, a major restructuring within a company, and/or a fundamental change to the company's internal expense study, could lead to substantial differences in the tracking and/or classification of expenses that could trigger a review of the expense allocation or classification methodologies. The launch of a new line of products could shift some of the cost base or allocations of expenses, but may not change the allocation methodology itself.

5.6. Premium taxes

Premium taxes are part of the FCF. There are two views on the presentation of premium taxes under IFRS 17. The first view excludes premium taxes from both insurance service expense and insurance revenue, while the second view includes premium tax in both insurance service expense and insurance revenue.

Under the first view, premium tax cash flows would be excluded from insurance service expenses and insurance revenue per IFRS 17.B124(a)(iii) and IFRS 17.B124(d). According to this paragraph, "amounts that relate to transaction-based taxes collected on behalf of third parties" are excluded from insurance service expenses and insurance revenue. Premium taxes are specifically listed as an example. Per IFRS 17.B96(a), experience adjustments arising from cash flows related to premiums received in the period that relate to future service such as premium-based taxes adjust the CSM and are not recognized as insurance service expenses and insurance revenue. The premium tax would qualify as a premium-based tax. Also, IFRS 17.B96 (a) refers to premium-based taxes separately from insurance acquisition cash flows, which may imply they are not insurance acquisition cash flows.

The second view is based on premium tax as a component cost cash flow of the insurance contract and is factored in the determination of the policy premium. Under this view, the insurer would be a principal with respect to the premium tax and incurs the tax liability at the time of sale, which is then payable to the tax authorities periodically as required. Under this view, premium taxes would not be considered as "transaction-based taxes collected on behalf of third parties" per IFRS 17.B124(a)(iii), and they would meet the IFRS 17 definition of insurance acquisition cash flows as the sale of the contract will trigger the tax liability payable by the insurer; and the tax is an underwriting component of the policy premium charged. The expected premium tax would therefore be presented in the insurance revenue and the actual premium tax incurred would be presented in the insurance service expense.

6. Suggested disclosures in the Appointed Actuary's Report

Directly attributable expenses are key components of the estimates of future cash flows impacting many aspects of the financial statements. The decisions to include or exclude expenses from the definition of "directly attributable" will affect both the level of the FCF and the CSM; the greater the exclusions, the lower the FCF and the higher the CSM. These amounts impact the Life Insurance Capital Adequacy Test (LICAT/LIMAT) and Capital Adequacy Requirements Guideline (CARLI) capital ratios for life and health. Under the PAA the decisions to include or exclude expenses from the definition of "directly attributable" will affect the LIC and the onerous assessment. For P&C practitioners the Minimum Capital Test (MCT) could be impacted by the "directly attributable" expense included in the LIC and in the unexpired coverage calculations. As a result, it is recommended that the actuary include information in the Appointed Actuary's Report (AAR) pertaining to expenses under IFRS 17. The final AAR disclosure requirements will be specified by OSFI/AMF and supersede this suggested expense disclosure in this report to the extent that OSFI/AMF's requirements are more comprehensive than the ones described in this report.

The following suggested disclosures would be included in the AAR:

1. Total company expenses (annual expenses in the current year) as shown in the annual statement.
2. Annual expenses in the current year related to IFRS 9 *Investment Contracts*, IFRS 15 *Service Contracts*, and other IFRS standards (expenses that are not within the scope of IFRS 17).
3. Remaining expenses = 1 – 2. These expenses are potentially within the scope of IFRS 17, if they are considered directly attributable to insurance contracts.
4. Expenses that are directly attributable to insurance contracts under IFRS 17.

5. Percentage of directly attributable expenses = 4 / 3.

Here is an example that illustrates the suggested disclosures in the AAR:

		Year 20XX
1.	Total company expenses (annual expenses in the current year) as shown in the annual statement	150
2.	Annual expenses in the current year related to IFRS 9 Investment Contracts, IFRS 15 Service Contracts and other IFRS standards	50
3	Total company expenses excluding expenses related to IFRS 9, IFRS 15 etc. (expenses that are potentially within the scope of IFRS 17)	100
4	Directly attributable expenses under IFRS 17	80
5	Percentage of directly attributable expenses = 4 / 3	80%

The AAR disclosure would also include qualitative comments on whether the grey area expense items discussed in Section 4 of this report (and other company specific grey areas that are material) are considered as directly attributable expenses or not. Moreover, actuaries would be expected to outline the rationale for categorizing these expenses as directly or non-directly attributable expenses.

Appendix 1 – Liability for remaining coverage at initial and subsequent measurement under the premium allocation approach

The following simple examples illustrate the impact on the LRC at initial and subsequent measurement of the application of IFRS 17.59(a). The following examples assume one year of coverage period (with two intervals within one year) and no discounting.

	Entity does not apply paragraph 59a **Example 1** **Cash flows at beginning of period**				Entity applies paragraph 59a **Example 2** **Cash flows at beginning of period**		
t	0	1	2	t	0	1	2
Premiums	100			Premiums	100		
Claims		40	40	Claims		40	40
Acq exp	10			Acq exp	10		

LRC at inception and at the end of period - GMA

t	0	1	2	t	0	1	2
GMA				GMA			
FCF	-10	40	0	FCF	-10	40	0
CSM	10	5	0	CSM	10	5	0
GMA LRC	**0**	**45**	**0**	**GMA LRC**	**0**	**45**	**0**

LRC at initial recognition - PAA

		Example 1	Example 2
55(a)(i) -	Premiums received at initial recognition	100	100
55(a)(ii) -	minus Insurance acq CF at that date unless the entity chooses to recognize the payments as an expense as per 59a	-10	0
55(a)(iii) -	any amount arising from the derecognition of an asset or liability at that date	0	0
	LRC under the PAA	**90**	**100**

LRC at the end of each subsequent reporting period

		Example 1 (1)	Example 1 (2)	Example 2 (1)	Example 2 (2)
	LRC at the start of the reporting period	90	45	100	50
55(b)(i) -	plus the premiums received in the period	0	0	0	0
55(b)(ii) -	minus the insurance acquisition cash flows unless the entity chooses to recognize the payments as an expense applying 59a	0	0	0	0
55(b)(iii) -	plus any amounts relating to the amortisation of insurance acquisiton cash flows recognised as an expense in the reporting period unless the entity chooses to recognize insurance acquisition cash flows as an expense	5	5	0	0
55(b)(iv) -	plus any adjustment to a financing component	0	0	0	0
55(b)(v) -	minus the amount recognised as insurance revenue for services provided in the period	-50	-50	-50	-50
55(b)(vi) -	minus any investment component paid or transferred to the LIC	0	0	0	0
	LRC under the PAA	**45**	**0**	**50**	**0**

	Example 1 (1)	Example 1 (2)	Example 2 (1)	Example 2 (2)
Insurance Revenue	50	50	50	50
Insurance Service Expense	45	45	50	40
Insurance Service Result	5	5	0	10