STANDARD SETTING

HKFRS 17 *Insurance Contracts* - Journal Entries

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Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Abbreviations

The following abbreviations are used within this publication:

BEL	Best Estimate Liability
CSM	Contractual Service Margin
DPF	Discretionary Participating Features
FCF	Fulfilment Cash Flows
GMM	General Measurement Model
IACF	Insurance Acquisition Cash Flows
IASB	The International Accounting Standards Board
IFRS IC	The IFRS Interpretations Committee
IFIE	Insurance Finance Income or Expenses
IR	Insurance Revenue
ISE	Insurance Service Expenses
LIC	Liability for Incurred Claims
LRC	Liability for Remaining Coverage
NDIC	Non-distinct Investment Component
PAA	Premium Allocation Approach
PCA	Pre-Coverage Assets
P&L	Profit and Loss
RA	Risk Adjustment for Non-financial Risk
VFA	Variable Fee Approach

About this publication

HKFRS 17 *Insurance Contracts* is a comprehensive new insurance contracts financial reporting standard which fundamentally changes the accounting for insurance contracts. It is effective for annual periods beginning on or after 1 January 2023, with earlier application permitted provided that entity also applies HKFRS 9 *Financial Instruments* at the same time.

Journal entries are the cornerstone of accounting. This publication focuses on just that by illustrating the journal entries for basic insurance contract transactions, showing how these journal entries map to the movements in the insurance contract liability and how they are reflected in the income statement.

This publication aims to help the readers understand insurance accounting under HKFRS 17 'from the ground up' before they tackle the more complicated areas of HKFRS 17. It is a useful supplement to the illustrative examples accompanying HKFRS 17, and other related technical resources.

In this publication, we explain the application of the three measurement models in HKFRS 17, i.e. GMM, PAA and VFA for direct insurance contract issued. PAA is an **optional** simplified model of GMM which is specifically applicable for certain types of insurance contracts whereas VFA is a variation of the GMM and shall be **mandatorily** applied for insurance contracts with direct participation features. The backbone of this publication is built on GMM followed by comparisons of its key differences with the other two models (PAA and VFA). For each model, the illustration is structured in three parts so that readers can more easily understand the application of HKFRS 17:

- ***Part 1*** sets out the journal entries with narrative explanations of the relevant financial reporting concepts.
- ***Part 2*** shows how the journal entries map to the changes in the carrying amount of insurance contract liability comprising LRC and LIC. The reconciliation provided is for illustrative purpose only and not for meeting the disclosure requirements of HKFRS 17.97-116.
- ***Part 3*** shows an extract of statement of financial performance resulting from the journal entries recorded in ***Part 1***.

In each scenario, journal entries made on initial recognition of insurance contracts and the same recurring subsequent entries are in purple boxes. New journal entries different from recurring entries are in orange boxes.

While the publication mainly aims to explain HKFRS 17 through the use of simplified illustrative examples, there are ***'Notes for further insights'*** (denoted with ☼) for those readers who are interested in gaining deeper understanding and knowledge of HKFRS 17 in discussions of the relevant areas.

Users of the publication should note that the examples in this publication are developed based on highly simplified fact patterns for educational purposes only. As such, the illustrative approaches in this publication may not necessarily be applicable to other circumstances or fact patterns. **Entities should exercise judgement and carefully consider their specific contractual terms, facts, and circumstances when applying HKFRS 17. This publication does not prescribe, nor should it be interpreted as requiring, a specific approach to applying the requirements.** There could be other possible ways to record the journal entries for compliance with HKFRS 17 with regard to the fact pattern and assumptions given. In light of this, this publication also sets out some examples of alternative journal entries that we observe in the market practice for readers' references.

Scope of HKFRS 17

HKFRS 17 *Insurance Contracts* defines insurance contract as a contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. Accordingly, an entity assesses whether the contract transfers significant insurance risk to determine whether the contract meets the definition of an insurance contract[1]. Furthermore, an entity needs to assess and analyze whether an insurance contract falls into the scope exclusions set out in HKFRS 17.7[2] to ascertain whether such insurance contract is within the scope of HKFRS 17.

An entity shall apply HKFRS 17 to:

(a) **Insurance contracts**, including reinsurance contracts, that it issues;
(b) **Reinsurance contracts it holds**; and
(c) **Investment contracts with discretionary participation features** it issues, provided the entity also issues insurance contracts.

[HKFRS 17.3]

A point to note is that HKFRS 17 deals with the accounting for insurance contracts and hence all entities, not only insurance companies, need to apply HKFRS 17 to the extent they issue contracts that meet the definition of insurance contracts and those contracts do not fall into the scope exclusions in HKFRS 17.7. HKFRS 17 also allows an entity a choice of applying HKFRS 17 or another HKFRS Standard to some contracts, specifically (1) applying HKFRS 17 or HKFRS 15 to some fixed-fee service contracts; and (2) applying HKFRS 17 or HKFRS 9 to specified contracts such as loan contracts with death waivers[3].

Different scenarios for category (a) above are discussed in this publication for illustrative purposes only. Consistent with other HKFRSs, HKFRS 17 is principle-based and therefore there may be more than one possible approach to applying certain requirements of HKFRS 17.

1. General Measurement Model

This section focuses on application of the General Measurement Model (GMM) under HKFRS 17. It is the **default** approach for all insurance contracts irrespective of life or non-life insurance contracts, **unless** the contract is eligible for and the entity elects to apply PAA or the contracts have direct participation features for which the VFA needs to be applied (see ☼).

[1] The significance of the insurance risk is assessed on a (1) contract-by-contract; and (2) present-value basis under which the discount rate used should reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts. HKFRS 17.B17-B23 provide further guidance.

[2] HKFRS 17.7 sets out the transactions that may meet the definition of insurance contracts for which another HKFRS shall be applied instead (HKFRS 17.BC87).

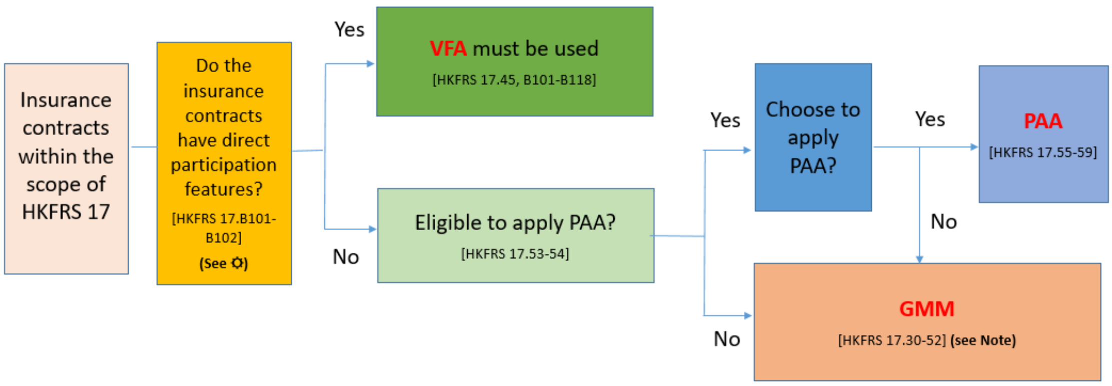
[3] See HKFRS 17.8, 8A, BC88, BC95-97 and BC94D-BC94F.

Notes for further insights

☼ In practice, GMM may probably be less relevant for non-life insurers as many non-life insurance contracts are generally eligible to apply the simplified approach, i.e. PAA. Even so, they should bear in mind that GMM always applies to the recognition and measurement of the LIC and it is also relevant when a group of insurance contracts under PAA becomes onerous, in which case insurers shall calculate the LRC using GMM and recognize a loss in profit or loss with corresponding increase in LRC if the amount so calculated under GMM is greater than LRC determined under PAA [HKFRS 17.57-58]. Accordingly, non-life insurers still need to acquire a good understanding of the mechanism of GMM, even though they are eligible to apply PAA in most cases. See more discussions in *Sections 2 and 3* of this publication for the eligibility of PAA and comparison between GMM and PAA.

The following diagram sets out the thinking process for determining the approach that should be applied by an insurer.

Diagram 1 Determination of the measurement approach for insurance contracts



Note: An entity shall apply HKFRS 17.30-52 to all groups of insurance contracts within the scope of HKFRS 17, with a few exceptions under which other paragraphs of HKFRS 17 shall be applied. Please refer to HKFRS 17.29 for those exceptions.

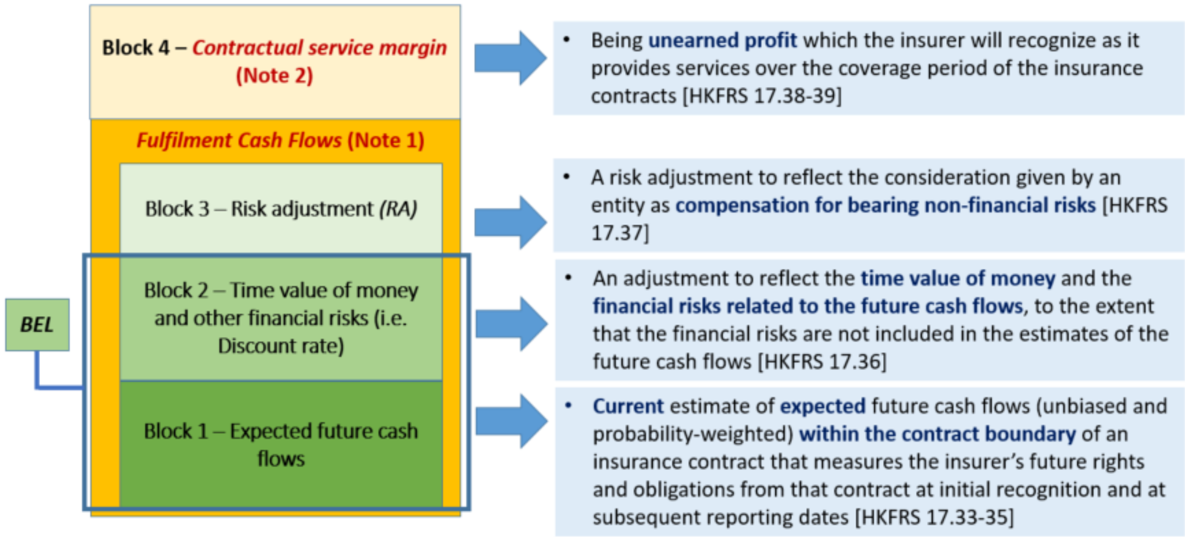
Notes for further insights

☼ HKFRS 17 does not prohibit an entity from applying PAA to eligible groups of insurance contracts which would otherwise be required to apply the VFA ('VFA contracts'). However, in practice, it is generally not expected that VFA contracts would meet the eligibility criteria of PAA (see *Section 2* of this publication). In order to apply PAA, VFA contracts should have a coverage period of one year or less. If they have a coverage period of more than one year, the entity needs to demonstrate that the measurement of the LRC under the PAA will not be materially different from that under the VFA. Accordingly, either of the criteria may not be met for VFA contracts given the specific nature of contracts with direct participation features.

GMM is also known as the 'Building Block Approach' because it is developed using four building blocks for measuring a group of insurance contracts. Before we go into details of the illustrative examples, the following diagram provides a recap of the four blocks.

Diagram 2 Measurement of liability of a group of insurance contracts on initial recognition

On initial recognition, the insurance contract liability of a group of insurance contracts consists of the FOUR components (blocks):



Notes

1 The diagram shows that FCF are **estimates** of amounts that the insurer **expects** to collect from premiums and pay out for claims, benefits and expenses (Block 1) and the expectations also include an adjustment for the timing and risk of those amounts (Blocks 2 and 3).

Although HKFRS 17.36 sets out the criteria for discount rate, HKFRS 17 does not prescribe a particular estimation technique for determining the discount rate [HKFRS 17.B78]. Hence, either a bottom-up approach or a top-down approach may be used [HKFRS 17.B80-B81].

The risk adjustment for non-financial risk conveys information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk affecting the amount and timing of cash flows [HKFRS 17.B87]. It is an **entity-specific** assessment which relies on an entity's own perception of its degree of risk aversion, rather than on a market participant's perception [HKFRS 17.BC215].

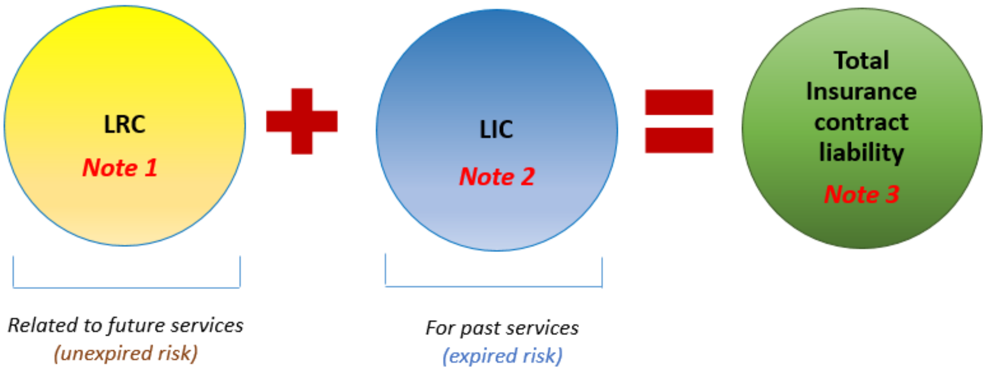
A group of insurance contracts is onerous if total FCFs (i.e. Blocks 1, 2 and 3) at the date of initial recognition are a net cash outflow. Such net cash outflow represents an onerous insurance contract which is immediately recognized in profit or loss.

2 CSM is a new concept under HKFRS 17. As shown in the diagram, it is a **component** of the asset or liability for a group of insurance contracts. On initial recognition of a group of insurance contracts, it is **the equal and opposite amount** of the net inflow that arises from the total of (a) the initial recognition of the FCF, (b) any cash flows arising from the contracts in the group at that date; and (c) the derecognition at the date of initial recognition of any asset recognized for IACF and any other assets or liability previously recognized for cash flows related to the group of contracts. This treatment ensures that no income or expenses arises from the group of contracts on initial recognition [HKFRS 17.38].

On subsequent measurement, insurance contract liability (which consists of the four blocks as referred to in *Diagram 2*) is split into a liability for remaining coverage (LRC) and a liability for incurred claims (LIC).

LRC is an insurer's obligation to provide insurance contract services and therefore represents FCF relating to **future** services that will be provided under the contract in future period as well as CSM [HKFRS 17.32, 40(a)]. CSM is the unearned profit component of the insurance contract liability presented in the statement of financial position and is recognized in the income statement as an entity provides services under insurance contracts. On the other hand, LIC is the insurer's obligation to pay amounts related to services already provided, and therefore FCF of the LIC relate to **past** services for incurred claims and expenses.

Diagram 3 Subsequent measurement of insurance contract liability of a group of insurance contracts



Notes

1 LRC is defined in HKFRS 17, LRC = FCF + CSM
i.e. LRC = BEL[4] (Blocks 1 and 2) + RA (Block 3) + CSM (Block 4) [HKFRS 17.32]. The changes in the carrying amount of the LRC are recognized in insurance revenue, insurance service expenses in the case of changes in the loss component of the LRC for groups of onerous contracts or IFIE as appropriate [HKFRS 17.41(a), (b) & (c)].

As with initial recognition, CSM (Block 4) cannot be negative. At each reporting date, the changes in FCF relating to future service for insurance contracts without direct participation features as specified in HKFRS 17.B96-B100 are accounted for against the CSM [HKFRS 17.44(c)]. If such changes in FCF exceeds the carrying amount of the CSM, any excess will be separately recognized as a loss within the insurance service expense line item in profit or loss [HKFRS 17.44(c)(i), 48(a)].

2 LIC comprises the same building blocks as LRC except that LIC does not contain CSM because LIC relates to past services only (e.g. FCF for claims and expenses already incurred but not yet paid). The changes in the carrying amount of the LIC are recognized as insurance service expenses or IFIE as appropriate [HKFRS 17.42(a), (b) &(c)].

LIC is subsequently measured by applying HKFRS 17.33-37 and B36-B92 [HKFRS 17.40(b)].

3 This diagram assumes that the sum of LRC and LIC results in insurance liability position. HKFRS 17 requires an entity to present separately in the statement of financial position the carrying amount of portfolios of insurance contracts issued that are assets and portfolios of insurance contracts issued that are liabilities [HKFRS 17.78][5].

[4] BEL (Best Estimate Liability) referred to in this publication represents estimates of the present value of future cash flows.

[5] Before the 2020 amendments to IFRS 17 (HKFRS equivalent), an entity was required to present separately groups of insurance contracts issued that are assets and groups of insurance contracts issued that are liabilities. Feedback on the 2019 Exposure Draft on the 2020 amendments, including from users of financial statements, suggested that the amendments would not significantly diminish the usefulness of information compared to that which would have been provided without the amendments [HKFRS 17.BC328, BC330A-B].

We illustrate the journal entries and related impact on the presentation of financial statements in respect of the following five highly simplified scenarios. Scenarios 1.2 to 1.5 are developed based on changes in some fact pattern and assumptions of the base scenario:

- Scenario 1.1: Base scenario
- Scenario 1.2: Change in expenses or claims
- Scenario 1.3: Change in premium
- Scenario 1.4: IACF
- Scenario 1.5: Investment components

Scenario 1.1 – Base scenario: accounting on initial recognition and subsequent periods

Entity A issues a group of insurance contracts with the following simplified fact pattern and assumptions. This table will be referred to again in other scenarios (which are developed based on the base scenario) to be discussed later.

Fact pattern and assumptions	
Reporting environment	• HKFRS
Coverage period	• Three years • Starts when the insurance contracts are issued (1 January of Year 1)
Expected cash flows	i. Expected cash inflows • Generated from premiums of HK$3,000 • Due at the beginning of the coverage period and expected to be received immediately after initial recognition of the group of insurance contracts; therefore the estimate of the present value of future cash inflows is HK$3,000 ii. Expected cash outflows • Comprise expected pay-outs of claims of HK$700 per year, amounting to HK$2,100 in total during the coverage period • All amounts settled when incurred at the end of each year • No other expenses in this example for simplicity iii. No differences in expected and actual future cash flows
Insurance contract services	• Provided evenly throughout the coverage period
Financial statement items	• No profit or loss nor balance sheet items other than items arising from accounting for insurance contracts
Foreign exchange	• All cash flows in the group of insurance contracts are in a single currency, which is also the same as the functional currency of the insurer (see ☼ below)
Risk adjustment for non-financial risk	i. LRC • At initial recognition = HK$180 • Recognized evenly during the coverage period ii. LIC • Negligible
Time value of money	• None for simplicity, so no discount rate is applied (i.e. Block 2 in *Diagram 2* is not reflected in this example)
Experience adjustments	• None
Investment components	• None
Acquisition cash flows	• None
Onerous contract or not	• Non-onerous

Notes for further insights

☼ The group of insurance contracts of this simplified example generates cash flows in the same currency of the contracts. Note that an entity shall apply HKFRS 17.30 & 92 to measure insurance contracts involving foreign currency cash flows. In particular, HKFRS 17.30 specifies that an entity shall treat the group of insurance contracts, including CSM, as a monetary item when applying HKAS 21 *The Effects of Changes in Foreign Exchange Rates* to a group of insurance contracts that generate cash flows in a foreign currency.

Recent development of IFRS 17

In practice, the transactions of insurance contracts are far more complex. An entity that issues insurance contracts often conducts activities in more than one currency, e.g. it may issue insurance contracts in more than one jurisdiction with contracts denominated in the currency of the jurisdiction in which they are issued. Other entities may issue an individual contract with cash flows in more than one currency; or issue insurance contracts in only one currency but incur costs in a different currency. The IFRS IC received a request about how to account for insurance contracts that generate cash flows in more than one currency and concluded its discussions at its September 2022 meeting. Readers may refer to the project page for the latest development regarding this agenda decision by the IFRS IC.

The unit of account for recognition and measurement under HKFRS 17 is **a group of insurance contracts** [HKFRS 17.24]. HKFRS 17 requires an entity to identify portfolios of insurance contracts and, in each portfolio, an entity divides the contracts into at least three separate groups, i.e. (1) onerous at initial recognition; (2) no significant possibility of becoming onerous subsequently and (3) remaining contracts in the portfolio[6]. An entity may further subdivide these three groups if it considers that it is appropriate for its internal reporting but this is not compulsory. We can imagine that a group is a subset of a portfolio and insurance contracts are measured at the group level within each portfolio[7].

Insurers should also pay attention to the 'annual cohort' requirements, under which entities are not permitted to group contracts issued more than one year apart [HKFRS 17.22].

An entity shall not reassess the composition of the groups subsequently once they have been established at initial recognition. However, an entity can add contracts to the groups applying HKFRS 17.28 [HKFRS 17.24].

Part 1 – illustration of the journal entries with narrative explanation

(a) Initial recognition

An entity shall recognize a group of insurance contracts it issues from the **earliest** of the following:
(a) the beginning of the coverage period of the group of contracts;
(b) the date when the first payment from a policyholder in the group becomes due; and
(c) for a group of onerous contracts, when the group becomes onerous.
[HKFRS 17.25]

[6] Although a portfolio is required to be further disaggregated into the three minimum groups as specified in HKFRS 17.16, there might be situations in practice where there are no contracts in one or even two of the three minimum groups for an individual portfolio because, e.g. there is no onerous contract in the portfolio.

[7] A portfolio comprises contracts subject to similar risks and managed together. Subdividing the portfolio into separate groups is a challenging task which should be performed based on reasonable and supportable information. Please refer to HKFRS 17.14-24 for detailed guidance on level of aggregation of insurance contracts.

In the base scenario, Entity A recognizes the group of insurance contracts when the premium is due [HKFRS 17.25(b)] which is also the beginning of the coverage period [HKFRS 17.25(a)]. The group of contracts is not onerous. The following are the accounting entries:

JE1 – Initial measurement of a group of insurance contracts [HKFRS 17.32, 37 & 38]						
					HK$	HK$
DR		LRC – BEL		*(a)*	900	
	CR		LRC – RA	*(b)*		180
	CR		LRC – CSM	*(c)*		720

(a) BEL comprises expected cash inflows of premium of HK$3,000 and expected cash outflows of HK$2,100. The balance is recorded under LRC as it relates to future insurance contract services.

(b) Entity A adjusts the estimates of present value of future cash flows to reflect the compensation that it requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk (e.g. insurance risk) [HKFRS 17.37].

(c) On initial recognition, Entity A measures the CSM of a group of insurance contracts at an amount that results in no income or expenses, i.e. FCF (DR) + CSM (CR) = 0. In this base scenario, CSM = BEL (HK$900) – RA (HK$180) = HK$720. [HKFRS 17.38]

JE2 – Recognition of premium received					
				HK$	HK$
DR		Cash		3,000	
	CR		LRC – BEL		3,000

(b) Subsequent measurement

When an entity provides insurance contract services in a period, it reduces LRC for the services provided and recognizes insurance revenue [HKFRS 17.B123]. This is consistent with the requirement in HKFRS 15 that an entity derecognizes the performance obligation for services provided and recognizes revenue. A point to note is that a reduction in LRC giving rise to insurance revenue **excludes** changes[8] in the liability that **do not** relate to services expected to be covered by the consideration received by the entity.

The following accounting entries show the recognition of insurance revenue and associated changes in insurance contract liabilities at each reporting date after the initial recognition of the group of insurance contracts. There are no changes in current estimates in the subsequent accounting periods.

[8] Please refer to HKFRS 17.B123 (a) and (b) for the list of examples of the changes which do not relate to services provided in the period. See Scenario 1.4 for illustration of an example of such changes due to accounting for IACF asset.

End of Year 1, Year 2 and Year 3

The same sets of entries, i.e. **JE3** to **JE7** are posted at the end of Year 1 to 3:

JE3 – Release of risk adjustment for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]

					HK$	HK$
DR		LRC – RA		*(d)*	60	
	CR		Insurance revenue	*(d)*		60

(d) Insurance revenue results from the reduction in the carrying amount of LRC because of services provided in the period, measured applying HKFRS 17.B120-B124 [HKFRS 17.41(a)]. This entry illustrates Entity A's release of RA for non-financial risk (Block 3) expired in Year 1 to insurance revenue. In the base scenario, **RA released to insurance revenue = HK$180 / 3 = HK$60 per year**, applying HKFRS 17.B121(a)(ii) and B124(b).

JE4 – Release of expected claims for the year [HKFRS 17.41(a), B124(a)]

					HK$	HK$
DR		LRC – BEL		*(e)*	700	
	CR		Insurance revenue	*(e)*		700

(e) BEL (Blocks 1 and 2) is a component of LRC and therefore reduction of BEL because of insurance contract services provided leads to recognition of insurance revenue. In this base scenario, **expected claims released = HK$2,100 / 3 = HK$700 per year**, applying HKFRS 17.B124(a).

JE5 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]

					HK$	HK$
DR		LRC – CSM		*(f)*	240	
	CR		Insurance revenue	*(f)*		240

(f) Applying HKFRS 17.B119, Entity A recognizes an amount of CSM for a group of insurance contracts as insurance revenue in each period to reflect the insurance contract services provided under the group of insurance contracts in that period.

Such amount is determined by (1) identifying the **coverage units** (see ☼) in the group, (2) allocating the CSM at the end of the period (before recognizing any amounts in profit or loss to reflect the insurance contract services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future; and (3) recognizing in profit or loss the amount allocated to coverage units provided in the period.

In this base scenario, the CSM (HK$720) is allocated equally to each coverage unit in the group of insurance contracts in accordance with HKFRS 17.B119. Revenue is recognized over time on a straight-line basis, i.e. **HK$720 / 3 = HK$240 for Year 1** and HK$720 / 3 X 2 = HK$480 as the remaining total amount for services expected to be provided in Year 2 and Year 3 and Entity A recognizes in profit or loss (HK$240) the amount allocated to coverage units provided in Year 1.

Notes for further insights

☼ Determination of coverage units to reflect the services provided under a group of insurance contracts is often a complex topic. It is not an accounting policy choice but involves judgements and estimates based on facts and circumstances to best achieve the principle of reflecting the services provided in each period. Those judgements and estimates should be applied reasonably and systematically.

HKFRS 17.B119(a) requires an entity to determine the services provided by the group of insurance contracts 'by considering for each contract the quantity of benefits under a contract and its expected coverage period'. There are no prescribed methods in HKFRS 17 for determining the quantity of benefits provided in the group of insurance contracts and thus involves more judgement. At its February 2018 and May 2018 meetings, the IASB's Transition Resource Group (TRG)[9] for IFRS 17 discussed the definition of 'quantity of benefits' in IFRS 17.B119(a) and how coverage units should be determined to reflect the service provided under a group of contracts. Readers are recommended to refer to the meeting materials of both meetings for more understanding of the determination of coverage units.

The pattern of release of CSM may not be the same as the straight-line basis as illustrated in the base scenario (i.e. based on the passage of time) if coverage units as determined based on the quantity of benefits and expected coverage period are different in all periods. Example 6 to HKFRS 17 illustrates the allocation of CSM in a situation when the entity expects contracts in a group to have different durations[10].

The HKICPA published the following guidance on determination of CSM illustrated by common challenges when applying the relevant HKFRS 17 requirements:
- HKFRS 17 Insurance Contracts – Contractual service margin educational guidance
- A Plus: HKFRS 17 Insurance Contracts: Contractual service margin

JE6 – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]

				HK$	HK$
DR		Insurance service expenses	*(g)*	700	
	CR	LIC – BEL	*(g)*		700

(g) Entity A recognizes actual claims incurred during Year 1. Given that the amount of actual claims is the same as originally expected in this base scenario, the amount equals **HK$2,100 / 3 years = HK$700 per year**, being the same amount as in **JE4** above.

JE7 – Payment of actual claims and other expenses

				HK$	HK$
DR		LIC – BEL	*(h)*	700	
	CR	Cash	*(h)*		700

(h) Entity A fully settles the actual claims incurred at each reporting date, resulting in no outstanding LIC.

At the end of each reporting period, the measurement of insurance contract liability should reflect current estimates of the LRC and LIC (see ☼).

[9] TRG is one of the ways the IASB is supporting the implementation of the new standard. The purpose of the group is to provide public forum for stakeholders to follow the discussion of questions raised on implementation; and inform the IASB in order to help the IASB determine what, if any, action will be needed to address those questions. Possible actions include providing supporting materials such as webinars, case studies and/or referral to the IASB or IFRS IC.

[10] IFRS 17 (HKFRS 17 equivalent) requires the CSM remaining at the end of the reporting period to be allocated equally to the coverage units provided in the period and the expected remaining coverage units. IFRS 17 does not specify whether an entity should consider the time value of money in determining that equal allocation and consequently does not specify whether that equal allocation should reflect the timing of the expected provision of the coverage units. The IASB concluded that should be a matter of judgement by an entity (HKFRS 17.BC282).

Notes for further insights

☼ In this simplified base scenario, it is assumed that the time value of money is negligible. However, this is unlikely to be the case in real life. Accordingly, after initial recognition, there would be an interest accretion to reflect the time value of money and other financial risks (assuming there is no change in the discount rates) for BEL *(i.e. Dr. IFIE, Cr. LRC – BEL, or Dr. LRC – BEL, Cr. IFIE)* and CSM (*i.e. Dr. IFIE, Cr. LRC – CSM)* in Year 1, 2 and 3 to reflect the time value of money for the respective years. For the RA, if the technique to measure it uses the time value of money, there will be a third component in the IFIE *(i.e. Dr. IFIE, Cr. LRC – RA)*[11]. The resulting BEL, RA and CSM released to insurance revenue when services are provided would be after having accounted for the accreted interests.

At the reporting date, an entity re-measures the FCF (i.e. BEL + RA) using updated assumptions (i.e. current estimates) including the discount rate. The discount rate is a yield curve estimated in line with the requirements of HKFRS 17.B79-B85. However, the way in which a financing effect is included in CSM differs between insurance contracts without direct participation features and insurance contracts with direct participation features [HKFRS 17.BC271]. For *insurance contracts without direct participation features*, HKFRS 17 requires an entity to calculate interest on CSM, i.e. CSM is accreted using a **'locked-in'** discount rate, which is not adjusted (remeasured) subsequently. The reference to a 'locked-in' discount rate refers to the discount rate determined on initial recognition of the group of insurance contracts and that the rate should be a rate applicable to nominal cash flows that do not vary based on asset returns [HKFRS 17.44(b), B72(b), BC273]. On the other hand, the VFA applies for *insurance contracts with direct participation features*. Under VFA, an entity remeasures CSM for an entity's share in the change in the fair value of the underlying items. The remeasurement of CSM reflects current rates and changes in the value of the consideration received [HKFRS 17.45(b), BC276]. The application of VFA are explained in more detail in *Sections 4 and 5* of this publication.

Part 2 **–** Movements in insurance contract liabilities

HKFRS 17.100 requires an entity to disclose a reconciliation from the opening to closing balances separately for each of (a) the net liabilities (or assets) for the remaining coverage component, excluding any loss component, (b) any loss component, and (c) the LIC. In this example, there is no relevant disclosure of the reconciliation of the loss components as the group of insurance contracts is profitable. HKFRS 17.101 further requires that, for insurance contracts other than those to which PAA has been applied, an entity shall also disclose a reconciliation from the opening to the closing balances separately for each of (a) the estimates of the present value of the future cash flows (BEL); (b) the risk adjustment for non-financial risk (RA); and (c) the contractual service margin (CSM).

HKFRS 17.98 to 109A set out detailed disclosure requirements regarding explanation of recognized amounts.

The following table demonstrates how the accounting entries discussed in ***Part 1*** above are reflected in the changes of Entity A's insurance contract liabilities comprising the LRC and LIC in the statement of financial position. The reconciliation provided is for illustrative purpose only and not for meeting the disclosure requirements of HKFRS 17.97-116.

[11] This entry is not mandatory. An entity shall include the entire change in RA as part of the insurance service result if it applies HKFRS 17.81 not to disaggregate the change in RA between the insurance service result and IFIE.

Scenario 1.1: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr							LIC (Dr) /Cr		Total insurance contract liabilities
	BEL	JE	RA	JE	CSM	JE	Total LRC		JE	
	(a)		(b)		(c)		(d) = (a) + (b) + (c)	(e)		**(f) = (d) + (e)**
	HK$		HK$		HK$		HK$	HK$		**HK$**
Beginning of Year 1	**-**		**-**		**-**		**-**	**-**		**-**
New contracts recognized	(900)	1	180	1	720	1	-	-		**-**
Premium received	3,000	2	-		-		3,000	-		**3,000**
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	4	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	3	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(240)	5	(240)	-		**(240)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	6	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	7	**(700)**
End of Year 1 / Beginning of Year 2	***1,400***		***120***		***480***		***2,000***	**-**		***2,000***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	4	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	3	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(240)	5	(240)	-		**(240)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	6	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	7	**(700)**
End of Year 2 / Beginning of Year 3	***700***		***60***		***240***		***1,000***	**-**		***1,000***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	4	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	3	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(240)	5	(240)	-		**(240)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	6	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	7	**(700)**
End of Year 3	**-**		**-**		**-**		**-**	**-**		**-**

The following table shows how the accounting entries discussed in ***Part 1*** are reflected in the relevant items in Entity A's statement of financial performance (extract), applying HKFRS 17.41(a) and 42(a)[12].

Scenario 1.1: Illustrative statement of financial performance (extract)

	Year 1 HK$	*JE*	Year 2 HK$	*JE*	Year 3 HK$	*JE*	Total HK$
Insurance revenue #	1,000		1,000		1,000		3,000
Insurance service expenses	(700)	*6*	(700)	*6*	(700)	*6*	(2,100)
Insurance service result	**300**		**300**		**300**		**900**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***300***		***300***		***300***		***900***

\# *Analysis of insurance revenue arising from changes in LRC:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Risk adjustment for the risk expired	60	*3*	60	*3*	60	*3*	180
• Release of expected claims	700	*4*	700	*4*	700	*4*	2,100
• Release of CSM	240	*5*	240	*5*	240	*5*	720
	1,000		**1,000**		**1,000**		**3,000**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

The above is an illustration based on the simplified base scenario. There are more complications in reality. The following diagram summarizes the composition of insurance revenue and insurance service expenses recognized from changes in the carrying amount of LRC and LIC as required by HKFRS 17. We have selected some of the items in the diagram for further illustrations of the relevant accounting entries and financial impact. See **Notes 1** to **3** in the diagram for those items.

[12] HKFRS 17.41(a) and 42(a) explain that an entity shall recognize insurance revenue for the reduction in the carrying amount of LRC because of services provided in the period, measured applying HKFRS 17.B120-B124; and recognize insurance service expenses for the increase in the carrying amount of LIC because of claims and expenses incurred in the period, excluding any investment components.

Diagram 4 Profit or loss of insurer's income statement (extract)

	Insurance revenue (IR)	• Insurance claims and expenses incurred in the period (measured at the amounts expected at the beginning of the period), ***excluding***: -
		  • amounts allocated to the loss component of LRC applying HKFRS 17.51(a)
		  • repayments of investment components **(Note 1)**
		  • amounts that relate to transaction-based taxes collected on behalf of third parties (see HKFRS 17.B65(i))
		  • Insurance acquisition expenses (see HKFRS 17.B125)
		• Changes in risk adjustment for non-financial risk, ***excluding***: -
		  • changes included in IFIE
		  • changes that adjust the CSM because they relate to future service
		  • amounts allocated to the loss component of LRC
		• Amount of CSM recognized in profit or loss **(Note 2)**
		• Amounts related to amortization of IACF under HKFRS 17.B125 **(Note 3)**
		• Other amounts e.g. experience adjustments for premium receipts other than those that relate to future service
		[HKFRS 17.83, 85, 106, B120-B127]

−	Insurance service expense (ISE)	• Incurred claims ***excluding*** repayments of investment components • Other incurred insurance service expenses • Amortization of IACF **(Note 3)** • Changes relating to past service i.e. changes in FCF relating to LIC **(Note 4)** • Changes relating to future service i.e. losses or reversals on onerous groups of contracts [HKFRS 17.84, 85, 103, B125]
=	Insurance service result (ISR)	
+/−	Insurance finance income or expenses (IFIE)	Comprise the effect of: - • time value of money (e.g. interest accretion on all of FCF, RA for non-financial risk and CSM) • Financial risks and changes in financial risks **(Notes 5 & 6)** [HKFRS 17.81, 87-92]

Notes:

1 The total insurance revenue for a group of insurance contracts is the consideration for the contracts, i.e. the amount of premium paid to the entity: (a) adjusted for a financing effect; (b) excluding any investment components [HKFRS 17.B120]. As such, the receipts and repayments of investment components are not recognized as insurance revenue and incurred claims. See ***Scenario 1.5: Investment components*** for illustration of the journal entries for accounting for a group of insurance contracts with investment components.

2 A change in the premium affects the amount of CSM to be recognized as insurance revenue. See ***Scenario 1.3: Change in premium*** for illustration of how a change in premium affects the accounting for insurance contracts.

3 HKFRS 17.B125 requires an entity to determine insurance revenue related to IACF by allocating the portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time. An entity shall recognize the same amount as insurance service expenses. See ***Scenario 1.4: IACF*** for illustration of how the IACF is accounted for under HKFRS 17.

4 Changes relating to **past** services affect ISE and LIC. See ***Scenario 1.2: Change in expenses or claims*** for illustration of the impact on the accounting due to changes in actual and expected expenses or claims relating to **future** services.

5 IFIE may or may not include changes in risk adjustment for non-financial risk. Under HKFRS 17.81, an entity is not required to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and IFIE. If an entity does not make such a disaggregation, it shall include the entire change in the risk adjustment for non-financial risk as part of the insurance service result.

6 An insurer has an accounting policy choice either to present the entire amount of IFIE for the period in the profit or loss, or disaggregate the amount partly in profit or loss and partly in other comprehensive income. An entity shall apply its policy choice to portfolios of insurance contracts [HKFRS 17.88-89, B129].

Scenario 1.2: Change in expenses or claims

Except for the following, Scenario 1.2 uses the same fact pattern and assumptions as those in the base scenario.

Changes in fact pattern and assumptions	
Actual and future cash flows	• In Year 2, the actual claim is HK$500, instead of HK$700. In view of this, Entity A revises its expected claims in Year 3 to HK$600 • No differences in the actual claims and revised expected claims in Year 3 (i.e. HK$600)
Risk adjustment for non-financial risk (RA)	• At the end of Year 2, RA related to estimates of future cash flows in Year 3 is changed to HK$40 per year, instead of HK$60 per year initially estimated • RA release for Year 2 is assessed to be still HK$60

Part 1 – illustration of the journal entries with narrative explanation

Given that the changes occur in Year 2, we demonstrate the accounting entries from Year 2. Please refer to the base scenario for the accounting entries (**JE 1** to **JE7**) in Year 1.

End of Year 2

JE8 – Release of risk adjustment for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]				
			HK$	HK$
DR	LRC – RA	*(a)*	60	
CR	Insurance revenue	*(a)*		60

(a) The same set of accounting entries is made as in the base scenario. Entity A recognizes its release of RA for non-financial risk in Year 2, applying HKFRS 17.B121(a)(ii) and B124(b).

JE9 – Release of expected claims for the year [HKFRS 17.41(a), B124(a)]				
			HK$	HK$
DR	LRC – BEL	*(b)*	700	
CR	Insurance revenue	*(b)*		700

(b) The same set of accounting entries is made as in the base scenario. Under HKFRS 17, the release of LRC – BEL to insurance revenue is measured at the amount **expected** at the beginning of the period (i.e. HK$700, which is HK$2,100/3) and not the **actual** claims incurred (HK$500) in the current period [HKFRS 17.B124(a)]. In other words, the change in actual claims in Year 2 from HK$700 to HK$500 does not affect the amount of LRC – BEL that should be released to insurance revenue for Year 2.

For insurance contracts without direct participation features, CSM at the end of the reporting period of a group of insurance contracts is adjusted for changes in FCF that relate to **future** service [HKFRS 17.44(c), B96]. Accordingly, the change in the future estimates of cash flows in Year 3 will have an impact on the CSM as shown in the following accounting entries.

JE10 – Change in expected claims [HKFRS 17.44(c), B96(b)]				
			HK$	HK$
DR	LRC – BEL	*(c)*	100	
CR	LRC – CSM	*(c)*		100

(c) Entity A adjusts CSM for the decrease in FCF because of expected claims in Year 3 are estimated to reduce by HK$100 (i.e. HK$700 – HK$600).

JE11 – Change in risk adjustment for non-financial risks [HKFRS 17.44(c), B96(d)]				
			HK$	HK$
DR	LRC – RA	*(d)*	20	
CR	LRC – CSM	*(d)*		20

(d) Given that RA related to estimates of **future** cash flows for Year 3 has reduced to HK$40, the associated impact on CSM is calculated as follows:

	HK$
RA estimated on initial recognition of the group of insurance contracts	180
Less: RA released to insurance revenue in Year 1	(60)
Less: RA released to insurance revenue in Year 2	(60)
RA before adjustment of revised estimates	**60**
Less: Revised estimates of RA to be released in Year 3	(40)
Adjustment of RA to CSM at the end of Year 2 (see JE11 above)	**20**

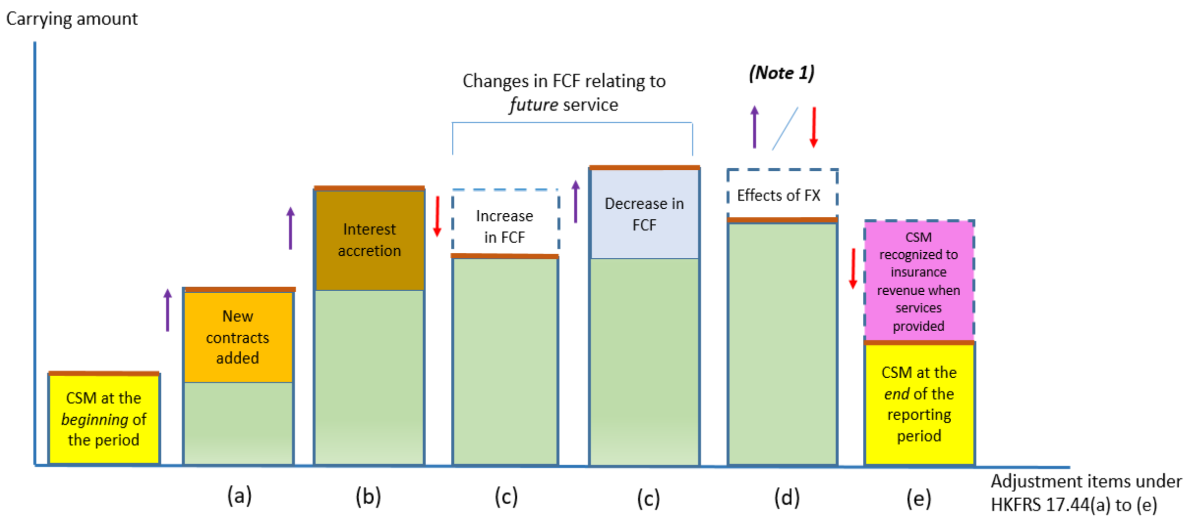
JE12 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]				
			HK$	HK$
DR	LRC – CSM	*(e)*	300	
CR	Insurance revenue	*(e)*		300

(e) The release of CSM in Year 2 is calculated after considering the impact of adjustments to the CSM (**JE10**, **JE11**) in Year 2. For the sake of simplicity, we assume the coverage is provided evenly over the remaining service period. See the calculation below:

	HK$
CSM recognized on initial recognition of the group of insurance contracts	720
Less: Release of CSM at the end of Year 1	(240)
Add: Related adjustment to BEL (see **JE10**)	100
Add: Related adjustment to RA (see **JE11**)	20
CSM at end of Year 2 before release to IR	**600**
Release of CSM to IR for Year 2 (HK$600 / 2 = HK$300) (see JE12)	**300**

The following diagram summarizes the items of adjustments in the subsequent measurement of CSM [HKFRS 17.44(a) to (e)].

Diagram 5 Subsequent measurement of contractual service margin of a group of insurance contracts



Note
1 The adjustment item (d) may lead to increase or decrease in CSM. In this diagram, we hypothetically assume that item (d) decreases CSM.

In respect of item (c), please note the following:

- subsequent increases in FCF relating to future service that adjust CSM are subject to a floor of zero CSM. The excess of any increase in FCF over the carrying amount of CSM gives rise to a loss [HKFRS 17.44(c)(i), 48(a)],

- once a loss component has been recognized, subsequent decreases in FCF relating to future service are allocated to the loss component of the LRC for the onerous group of contracts until the loss component is reduced to zero [HKFRS 17.44(c)(ii), 50(b)].

- HKFRS 17.B96 set outs the changes in FCF that relate to **future** services which adjust **CSM**. The changes in FCF set out in HKFRS 17.B97 that do **not** relate to future services do **not** adjust CSM and are recognized in **P&L** (or OCI if the entity elects to disaggregate IFIE in accordance with HKFRS 17.88 and B129) in the relevant financial reporting period.

After recording the adjustments to CSM and the recognition of insurance revenue, we move on to post the accounting entries of actual incurred claims and other expenses.

JE13 – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]					
				HK$	HK$
DR		Insurance service expenses	*(f)*	500	
	CR	LIC – BEL	*(f)*		500

(f) The amount of actual claims incurred in Year 2 is less than expected by HK$200.

JE14 – Payment of actual claims and other expenses					
				HK$	HK$
DR		LIC – BEL	*(g)*	500	
	CR	Cash	*(g)*		500

(g) Entity A fully settles the actual claims incurred, resulting in no outstanding LIC at the end of Year 2.

End of Year 3

JE15 – Release of risk adjustment (revised) for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]					
				HK$	HK$
DR		LRC – RA	*(h)*	40	
	CR	Insurance revenue	*(h)*		40

(h) Entity A releases the revised estimated RA to insurance revenue in Year 3.

JE16 – Release of expected claims (revised) for the year [HKFRS 17.41(a), B124(a)]					
				HK$	HK$
DR		LRC – BEL	*(i)*	600	
	CR	Insurance revenue	*(i)*		600

(i) Entity A recognizes insurance revenue for the reduction in LRC because of services provided in the period, measured applying HKFRS 17.B120-B124 [HKFRS 17.41(a)]. We extract the relevant part in the table in ***Part 2*** below for ease of reference.

	(Dr) / Cr HK$
LRC – BEL recognized on initial recognition of the group of insurance contracts	(900)
Premium received	3,000
Release of expected ISE for the period to IR	(700)
LRC – BEL at the end of Year 1	**1,400**
Release of expected ISE for the period to IR	(700)
Changes in FCF relating to future service (see **JE10**)	(100)
LRC – BEL at the end of Year 2	**600**
Release of expected ISE for the period (revised after **JE10**) to IR	(600)
LRC – BEL at the end of Year 3	**-**

Extracted from the table in ***Part 2***

JE17 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]				
			HK$	HK$
DR	LRC – CSM	*(j)*	300	
CR	Insurance revenue	*(j)*		300

(j) As shown in **JE12(e)**, the remaining amount of CSM to be released to IR in Year 3 is HK$300.

JE18 – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]				
			HK$	HK$
DR	Insurance service expenses	*(k)*	600	
CR	LIC – BEL	*(k)*		600

(k) In this example, the amount of actual claims incurred in Year 3 is same as the revised estimation, i.e. HK$600.

JE19 – Payment of actual claims and other expenses				
			HK$	HK$
DR	LIC – BEL	*(l)*	600	
CR	Cash	*(l)*		600

(l) Entity A fully settles the actual claims incurred, resulting in no outstanding LIC at the end of Year 3.

Part 2 – Movements in insurance contract liabilities

The following table demonstrates how the accounting entries discussed in ***Part 1*** are reflected in the changes of Entity A's insurance contract liabilities comprising the LRC and LIC in the statement of financial position.

Scenario 1.2: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr							LIC (Dr) / Cr		Total insurance contract liabilities
	BEL	*JE*	**RA**	*JE*	**CSM**	*JE*	**Total LRC**		*JE*	
	(a)		*(b)*		*(c)*		*(d) = (a) + (b) + (c)*	*(e)*		***(f) = (d) + (e)***
	HK$		HK$		HK$		HK$	HK$		**HK$**
***End of Year 1 / Beginning of Year 2* (Note)**	***1,400***		***120***		***480***		***2,000***	**-**		***2,000***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	*9*	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	*8*	-		(60)	-		**(60)**
Change in expected claims related to future service	(100)	*10*	-		100	*10*	-	-		**-**
Change in RA related to future service	-		(20)	*11*	20	*11*	-	-		**-**
Release of CSM to insurance revenue when services provided	-		-		(300)	*12*	(300)	-		**(300)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	500	*13*	**500**
Actual claims and other expenses paid	-		-		-		-	(500)	*14*	**(500)**
End of Year 2 / Beginning of Year 3	***600***		***40***		***300***		***940***	**-**		***940***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(600)	*16*	-		-		(600)	-		**(600)**
Release of RA for risk expired to insurance revenue	-		(40)	*15*	-		(40)	-		**(40)**
Release of CSM to insurance revenue when services provided	-		-		(300)	*17*	(300)	-		**(300)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	600	*18*	**600**
Actual claims and other expenses paid	-		-		-		-	(600)	*19*	**(600)**
End of Year 3	**-**		**-**		**-**		**-**	**-**		**-**

Note This table only shows the movements of insurance contract liabilities from Year 2 when the changes in fact pattern occur. Please refer to the base scenario for the movements of insurance contract liabilities before Year 2.

Part 3 – Statement of financial performance

The following is an extract of Entity A's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 1.2: Illustrative statement of financial performance (extract)

	Year 1 HK$	JE	Year 2 HK$	JE	Year 3 HK$	JE	Total HK$
Insurance revenue #	1,000		1,060		940		3,000 ☼
Insurance service expenses	(700)		(500)	13	(600)	18	(1,800)
Insurance service result	**300**		**560**		**340**		**1,200**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***300***		***560***		***340***		***1,200***

\# *Analysis of insurance revenue arising from changes in LRC:*

	HK$	JE	HK$	JE	HK$	JE	HK$
• Risk adjustment for the risk expired	60	3	60	8	40	15	160
• Release of expected claims	700	4	700	9	600	16	2,000
• Release of CSM	240	5	300	12	300	17	840
	1,000		**1,060**		**940**		**3,000**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

Notes for further insights

☼ The **total insurance revenue** for a group of insurance contracts is the **consideration for the contracts**, i.e. the amount of premiums paid to the entity (a) adjusted for a financing effect; and (b) excluding any investment components [HKFRS 17.B120]. Accordingly, although there are changes in the amount of insurance revenue recognized in Year 2 and Year 3 due to changes in estimates, the **total** amount of the insurance revenue for three years altogether remains at HK$3,000 provided there is no financing effect nor investment component.

Recent development of IFRS 17 – Interim reporting

The above scenarios discussed in this publication assume that Entity A only performs annual reporting and the changes in assumptions occur in the subsequent annual period. However, in practice there may be cases where an entity is required or elects to publish an interim financial report in accordance with IFRSs (HKFRSs equivalent) and in that case the entity shall apply IAS 34 (HKAS 34 equivalent) *Interim Financial Reporting* in the preparation of the interim report and there might be changes in estimates during the interim periods.

In June 2020, the IASB amended IFRS 17 to permit an entity to develop **an accounting policy choice** to elect whether to change the treatment of accounting estimates made in the previous interim financial statements when applying IFRS 17 in subsequent interim financial statements and in the annual reporting period [HKFRS 17.B137]. That means, an entity can choose either of the following approaches:

(i) *Year-to-date (YTD) approach*:

- The changes in estimates related to future services are assessed on **a year-to-date basis**, **as if** the previous interim periods did not exist. Accordingly, the expectations at the beginning of the period are determined by the amounts expected at the beginning of the annual period.

- CSM is released for insurance contract services provided on **an annual reporting basis**, i.e. applying coverage units for the annual period to the year-end date. For entities that prepare interim financial statements, the differences between actual and prior-period estimates during the year is recognized in profit or loss of the same year. There might be situations where the release of CSM to insurance revenue in an interim period comes up with a negative figure in order to arrive at the total amount of annual release being the same as that is determined on the YTD basis.

(ii) *Period-to-date (PTD) approach*:

- The changes in estimates related to future services are assessed at **each of the distinct interim period**. Accordingly, the entity does not change the treatment of accounting estimates made in the previous financial statements. Experience adjustments for the current interim period are determined by the amounts expected at the beginning of the current interim period.

- CSM is released for insurance contract services provided on **an interim period-to-date basis**, applying coverage units for the distinct interim period.

Before the 2020 amendments to IFRS 17, only the PTD approach was permitted.

Depending on the frequency of reporting of the entity, there could be differences in the accounting results between the YTD approach and the PTD approach under the same set of FCF. HKFRS 17.B137 requires an entity to consistently apply its accounting policy choice to all groups of insurance contracts it issues and groups of reinsurance contracts it holds. Accordingly, entities should carefully assess the practical difficulties and rigorously weigh the cost and benefits brought by the two approaches before making the choice, in particular for consolidated groups where there may be more complexities arising from varying frequencies of reporting among the group companies.

Scenario 1.3: Change in premium

Except for the following, Scenario 1.3 uses the same fact pattern and assumptions as those in the base scenario. Those changes discussed in Scenario 1.2 are not relevant here.

Changes in fact pattern and assumptions	
Future cash flows	• On 1 January of Year 2, Entity A receives an extra premium of HK$500 related to future services. This increase in premium for increased coverage was not included in the original expectation of FCF on initial recognition of the group of insurance contracts[13].

Part 1 – illustration of the journal entries with narrative explanation

Given that the changes occur in Year 2, we demonstrate the accounting entries from the beginning of Year 2. For the journal entries in Year 1, please refer to **JE1** to **JE7** in the base scenario.

On 1 January of Year 2

JE8 – Receipt of additional premium [HKFRS 17.44(c), B96(a)]

					HK$	HK$
DR		LRC – BEL		*(a)*	500	
	CR		LRC – CSM	*(a)*		500
DR		Cash		*(a)*	500	
	CR		LRC – BEL	*(a)*		500

(a) Entity A adjusts the additional premium (HK$500) received relating to future services to CSM [HKFRS 17.44(c)]. As such change in FCF is not expected in the initial recognition of the group of insurance contracts, it is regarded as 'experience adjustment' [HKFRS 17.B96(a)]. Please refer to *Diagram 5* above for illustration of the items relating to future services that adjust CSM in subsequent measurement of the group of insurance contracts as specified in HKFRS 17.44.

[13] We assume that the receipt of additional premium for increased insurance coverage in this example does not constitute modification to be accounted for as a derecognition applying HKFRS 17.72.

Readers should note that the example is highly simplified, which is set up solely for illustrating the impact on the journal entries as a result of a change in premium applying HKFRS 17.B96(a) under the GMM. Accordingly, the fact pattern given may not be consistent with reality. For instance, the example assumes that the receipt of extra premium on 1 January, Year 2 is not expected at the end of Year 1 and hence the extra premium has not been included in the estimation of future cash inflows at the end of January, Year 1. It is also assumed that there is no increase in expected claims and RA despite there is an increased coverage from receipt of extra premium.

End of Year 2 and Year 3

The following three sets of the journal entries are posted at the end of both Years 2 and 3:

JE9 – Release of risk adjustment for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]					
				HK$	HK$
DR		LRC – RA	*(b)*	60	
	CR	Insurance revenue	*(b)*		60

(b) The same set of the journal entries is made as in the base scenario given there is no change in the RA expected.

JE10 – Release of expected claims for the year [HKFRS 17.41(a), B124(a)]					
				HK$	HK$
DR		LRC – BEL	*(c)*	700	
	CR	Insurance revenue	*(c)*		700

(c) The same set of accounting entries is made as in the base scenario given there is no change in the expectation of the claims.

JE11 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]					
				HK$	HK$
DR		LRC – CSM	*(d)*	490	
	CR	Insurance revenue	*(d)*		490

(d) The release of CSM in each of Year 2 and Year 3 is calculated after considering the impact of adjustment to CSM (**JE8**) at the beginning of Year 2. For simplicity, we assume that the coverage is provided evenly over the remaining service period. See the calculation below:

	HK$
CSM recognized on initial recognition of the group of insurance contracts	720
Less: Release of CSM at the end of Year 1	(240)
Add: Related experience adjustment arising from additional premium (see **JE8**)	500
CSM at the end of Year 2 before release to IR	**980**
Release of CSM to IR for each of Year 2 and 3 (HK$980 / 2 = HK$490) (see JE11)	**490**

JE12 – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]

				HK$	HK$
DR		Insurance service expenses	*(e)*	700	
	CR	LIC – BEL	*(e)*		700

(e) Entity A recognizes actual claims incurred during the year. The same set of accounting entries is made as in the base scenario given the amount of actual claims incurred are the same as originally expected.

JE13 – Payment of actual claims and other expenses

				HK$	HK$
DR		LIC – BEL	*(f)*	700	
	CR	Cash	*(f)*		700

(f) As with the base scenario, Entity A fully settles the actual claims incurred at each reporting date, resulting in no outstanding LIC.

Part 2 – Movements in insurance contract liabilities

The following table demonstrates how the numbers gone through in the accounting entries discussed in ***Part 1*** above are reflected in the changes of Entity A's insurance contract liabilities which comprise LRC and LIC in the statement of financial position.

Scenario 1.3: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr							**LIC (Dr) / Cr**		**Total insurance contract liabilities**
	BEL	*JE*	**RA**	*JE*	**CSM**	*JE*	**Total LRC**		*JE*	
	(a)		*(b)*		*(c)*		*(d) = (a) + (b) + (c)*	*(e)*		***(f) = (d) + (e)***
	HK$		HK$		HK$		HK$	HK$		**HK$**
***End of Year 1 / Beginning of Year 2* (Note)**	***1,400***		***120***		***480***		***2,000***	**-**		***2,000***
Experience adjustments arising from premium received relating to future services	(500)	*8*	-		500	*8*	-	-		**-**
Additional premium received	500	*8*	-		-		500	-		**500**
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	*10*	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	*9*	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(490)	*11*	(490)	-		**(490)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	*12*	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	*13*	**(700)**
End of Year 2 / Beginning of Year 3	***700***		***60***		***490***		***1,250***	**-**		***1,250***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	*10*	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	*9*	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(490)	*11*	(490)	-		**(490)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	*12*	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	*13*	**(700)**
End of Year 3	**-**		**-**		**-**		**-**	**-**		**-**

Note This table only shows the movements of insurance contract liabilities from Year 2 when the change in fact pattern occurs. Please refer to the base scenario for the movements of insurance contract liabilities before Year 2.

Part 3 – Statement of financial performance

The following is an extract of Entity A's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 1.3: Illustrative statement of financial performance (extract)

	Year 1 HK$	*JE*	Year 2 HK$	*JE*	Year 3 HK$	*JE*	Total HK$
Insurance revenue # **(Note 1)**	1,000		1,250		1,250		3,500
Insurance service expenses	(700)	*6*	(700)	*12*	(700)	*12*	(2,100)
Insurance service result	**300**		**550**		**550**		**1,400**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***300***		***550***		***550***		***1,400***

\# *Analysis of insurance revenue arising from changes in LRC:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Risk adjustment for the risk expired	60	*3*	60	*9*	60	*9*	180
• Release of expected claims	700	*4*	700	*10*	700	*10*	2,100
• Release of CSM	240	*5*	490	*11*	490	*11*	1,220
	1,000		**1,250**		**1,250**		**3,500**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

Note

1 HKFRS 17.B120 states that the total insurance revenue for a group of insurance contracts is the consideration for the contracts, i.e. **the amount of premiums paid** to the entity adjusted for a financing effect and excluding any investment components. Since Entity A receives an extra premium of HK$500, the total insurance revenue is increased by HK$500 **from HK$3,000 (base scenario) to HK$3,500**.

Scenario 1.4: IACF

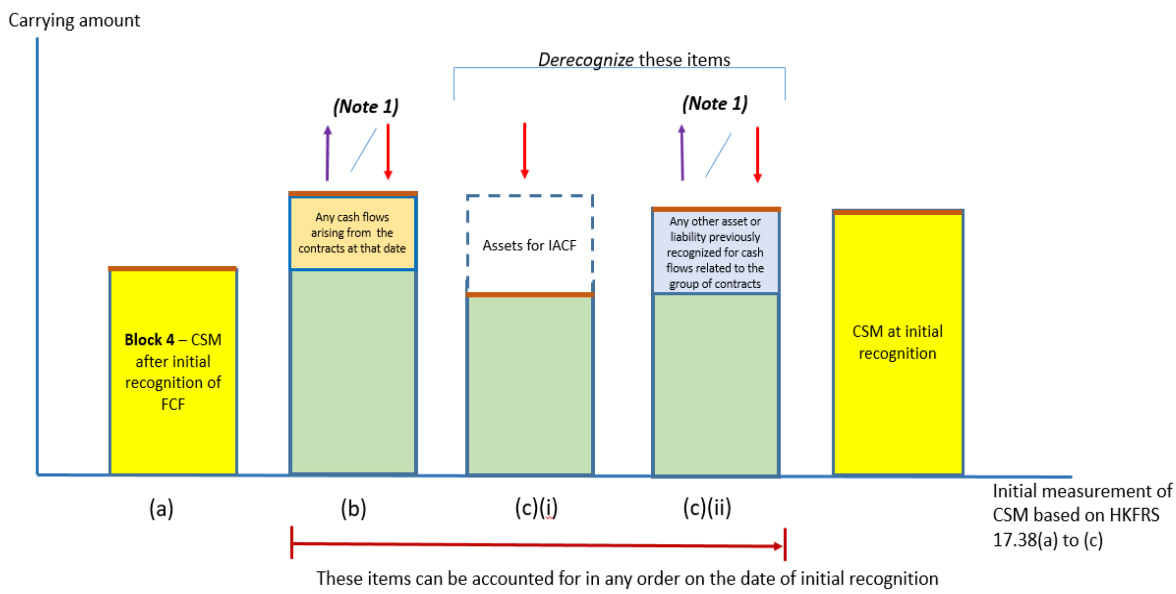
An entity may incur various costs before it could successfully acquire an insurance contract. IACF as referred to in HKFRS 17 are cash flows arising from the **costs** of selling, underwriting and starting a group of insurance contracts (issued or expected to be issued) that are **directly attributable** to the **portfolio** of insurance contracts to which the group belongs. IACF also include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio [HKFRS 17 Appendix A]. Judgement may be required to determine which cash flows meet the definition of IACF.

IACF incurred before recognition of the related group of contracts are initially recognized as an asset and accounted for under HKFRS 17. An entity shall include any IACF assets recognized applying HKFRS 17.28B in the carrying amount of the related portfolios of insurance contracts issued [HKFRS 17.79]. Once the related group of contracts is recognized, the IACF asset is allocated to the group of insurance contracts. Here are some points to note for IACF:

<table>
<tr><th colspan="2">Some key points to note:</th></tr>
<tr><td>A.</td><td><u>Characteristics of IACF</u>
Can arise internally (e.g. incurred in internal sales department) or externally (e.g. incurred through outsourcing sales to external agents) [HKFRS 17.BC182(a)]
Include both incremental costs and other direct costs and a proportion of indirect costs incurred in originating insurance contracts e.g. costs of underwriting, medical tests and inspection and issuing the policy [HKFRS 17.BC182(b)]
Include cash flows related to both successful and unsuccessful acquisition of new or renewed insurance contracts [HKFRS 17.BC183]</td></tr>
<tr><td>B.</td><td><u>Accounting implication</u>
Recognize an asset for IACF paid or incurred relating to a group of existing or future insurance contracts, before such group of contracts is recognized. Derecognize these assets (or a portion of them) when the group of insurance contracts to which the cash flows are allocated is recognized as part of determining CSM on initial recognition [See Diagram 6 below] [HKFRS 17.28B-C]
Included as part of FCF of the group of insurance contracts if IACF are expected to be paid or incurred after that group is recognized [HKFRS 17.33]
Can choose to recognize all IACF as an expense as incurred when PAA is applied, provided that the coverage period of each contract in the group at initial recognition is no more than one year [HKFRS 17.59(a)]
Apply a systematic and rational method to allocate IACF:
i) If IACF directly attributable to a group of contracts
➢ Then allocate IACF to that group and to the groups that will include contracts expected to arise from renewals of contracts in that group
ii) If IACF directly attributable to a portfolio of contracts but not to individual contracts or a group of contracts
➢ Then allocate IACF to existing and future groups within that portfolio [HKFRS 17.B35A]
Perform impairment assessment at each reporting date if facts and circumstances indicate that an asset arising from IACF may be impaired [HKFRS 17.28E, B35D]</td></tr>
</table>

As highlighted in the second point of Part B in the above table, IACF are included as part of FCF of the group of insurance contracts if they are expected to be paid or incurred after the recognition of the related group. Furthermore, IACF is deducted from CSM on the initial recognition of the group of insurance contracts if they are paid or incurred at that date [HKFRS 17.38(c)]. For these reasons, IACF affects the initial measurement of CSM. The following diagram expands on the initial measurement of CSM which is developed based on Block 4 in *Diagram 2*.

Diagram 6 Initial measurement of contractual service margin of a group of insurance contracts



Note

1 The adjustment items (b) and (c)(ii) may increase or decrease CSM in practice. In this diagram, we hypothetically assume that these two items increase CSM.

The following example illustrates how IACF impacts the journal entries of a group of insurance contracts after modifying the base scenario. Scenario 1.4 uses the same fact pattern and assumptions as those in the base scenario except for following changes:

Changes in fact pattern and assumptions	
IACF	• Entity A incurred expenses of HK$90 which are directly attributable to a future group of insurance contracts, i.e. the expenses were incurred **prior to** the initial recognition of that group of insurance contracts. These expenses have been paid at the time of incurrence.
Future cash flows	Expected cash outflows • Acquisition cash flows of HK$170, including HK$120 that are directly attributable to the portfolio to which the group of insurance contracts belongs, are incurred and paid at the **beginning** of the coverage period. The remaining HK$50 relates to acquisition costs that are not directly attributable acquisition costs.

Part 1 – illustration of the journal entries with narrative explanation

We first illustrate the accounting starting from the recognition of the IACF paid **prior to** the initial recognition of a group of insurance contracts[14]. Under GMM, the initial recognition of IACF paid or incurred has no P&L effect. Under PAA, an entity may **elect** to recognize IACF as expenses when it incurs those costs under specific circumstances [HKFRS 17.59]. GMM is applied in this example. The accounting for IACF under PAA is discussed in *Section 2*.

JE0 – Recognition of IACF asset paid [HKFRS 17.28B]					
				HK$	HK$
DR		IACF asset (see ☼)	*(a)*	90	
	CR	Cash	*(a)*		90

(a) In practice, some entities call the assets IACF paid (or IACF for which a liability has been recognized applying another HKFRS) as Pre-coverage Assets (PCA), which are the same as 'IACF asset' as referred to in this publication. Under HKFRS 17.28B, an entity shall recognize such asset for each related group of insurance contracts. In this example, Entity A recognizes an IACF asset of HK$90 incurred and paid before the related group of insurance contracts is recognized, applying HKFRS 17.28B. If the IACF asset is unpaid, a liability applying another HKFRS (e.g. HKFRS 9) is recognized, i.e. Cr. Liability, instead of Cr. Cash, in **JE0** above.

Notes for further insights

☼ IACF assets, being the main cash flows before the initial recognition of a group of insurance contracts, may be material assets in some insurance companies and therefore the impairment assessment of IACF assets is an important topic.

In June 2020, the IASB issued Amendments to IFRS 17 for a number of specific areas including specific requirements in relation to IACF assets recognized before a group of insurance contracts is recognized. The HKICPA issued equivalent Amendments to HKFRS 17 in October 2020. The Amendments specify the requirements for impairment tests and the accounting for impairment losses. An entity assesses the recoverability of the IACF asset if facts and circumstances indicate that the asset may be impaired. [HKFRS 17.28E] Note that once the related group of insurance contracts is recognized, the IACF asset is derecognized and forms part of the measurement of the group of contracts and thus no longer subject to an impairment test.

Applying HKFRS 17.B35D, the Amendments require an entity to perform **two impairment tests**:
1) at the level of a group of insurance contracts [HKFRS 17.B35D(a)]
2) an additional impairment specific to IACF allocated to expected contract renewals [HKFRS 17.B35D(b)]

The impairment assessment of IACF assets is not covered in this publication. However, given the importance of this topic, readers are advised to refer to HKFRS 17 for a full understanding of the requirements.

[14] For this example, we note that there are alternative possible ways in practice to account for the group of insurance contracts with IACF that would also arrive at the same accounting result. Please refer to ***Part 4*** – Supplementary illustration of alternative journal entries for information.

(a) Initial recognition

JE1 – Initial measurement of a group of related insurance contracts with derecognition of IACF asset [HKFRS 17.28C, 32, 37, 38(c)(i), B65(a), (b)&(e)]

						HK$	HK$
DR		LRC – BEL			*(b)*	780	
	CR		LRC – RA		*(c)*		180
	CR		IACF asset		*(d)*		90
	CR		LRC – CSM		*(e)*		510

(b) Cash flows within the boundary of an insurance contract are those that are directly to the fulfilment of the contract (i.e. FCF). LRC = FCF + CSM = BEL + RA + CSM.

LRC – BEL of HK$780 is arrived at by:

	HK$
Expected cash inflows from premium [HKFRS 17.B65(a)]	3,000
Less: **Expected** cash outflows of future claims [HKFRS 17.B65(b)]	(2,100)
LRC – BEL before IACF allocation (same as the base scenario)	900
***Less:* An allocation of IACF attributable to the portfolio to which the contract belongs (see note #)** [HKFRS 17.B65(e)]	**(120)**
LRC – BEL after IACF allocation (see JE1 as above)	**780**

\# HKFRS 17.B65(e) requires entities to include an allocation of IACF that are attributable to the portfolio to which an insurance contract belongs in the FCFs of an insurance contract.

(c) The recognition of LRC – RA is the same as in the base scenario [HKFRS 17.37].

(d) HKFRS 17.B65(e) requires entities to include an allocation of IACF that are directly attributable to the portfolio to which an insurance contract belongs in the FCF of an insurance contract. Thus, Entity A derecognizes IACF asset of HK$90 and includes IACF in the initial measurement of the insurance contract liability [HKFRS 17.28C]. Entity A also includes the directly attributable acquisition cost of HK$120 paid at the beginning of the coverage period. In total, IACF allocated to the group amounts to HK$210 (HK$90 + HK$120). See also *Diagram 6*, item (c)(i) and point (e) below for the related impact on the initial measurement of CSM [HKFRS 17.38(c)(i)].

(e) No gain or loss is recognized on initial recognition of a group of insurance contracts. CSM, being the unearned profit of a group of insurance contracts, is calculated as follows on initial recognition [HKFRS 17.38]

	HK$
LRC – BEL (see (b) above)	780
Less: LRC – RA (see (c) above)	(180)
Less: Derecognition of IACF asset (see (d) above)	(90)
CSM (see JE1 as above)	**510**

Alternatively, CSM can be reconciled by accounting for the changes in *Scenario 1.4* on top of the base scenario:

	HK$
CSM determined in the base scenario on initial recognition	720
Less: Derecognition of IACF asset (see (d) above)	(90)
Less: IACF incurred and paid at the beginning of the coverage period and directly attributable to the portfolio	(120)
CSM (see (e) above)	**510**

CSM in this example is lower as compared to the base scenario because of the incurrence of IACF relating to the group of contracts which represents an additional cost to the entity and thus, impacting the profitability of the group of contracts.

JE2 – Recognition of premium received

					HK$	HK$
DR		Cash		*(f)*	3,000	
	CR		LRC – BEL	*(f)*		3,000

(f) The same set of accounting entries is used in the base scenario as there is no change in the amount of premium (i.e. HK$3,000) received.

JE3 – Payment of acquisition cash flows of HK$170, including HK$120 which are cash flows directly attributable to the portfolio to which the group of insurance contracts belongs, are made at the beginning of the coverage period

					HK$	HK$
DR		LRC – BEL		*(g)*	120	
DR		Other expenses		*(h)*	50	
	CR		Cash			170

(g) As required by HKFRS 17, the reduction in LRC that gives rise to insurance revenue **excludes** changes in the liability that do not relate to services expected to be covered by the consideration received by the entity. The changes in LRC relating to IACF does not go against revenue because such changes do not relate to provision of services in the period [HKFRS 17.B123(a)(v)]. Entity A determines its insurance revenue related to IACF by allocating a portion of premiums that relates to recovering those cash flows to each accounting period in a systematic way on the basis of the passage of time (see **JE9** below). In addition, unlike the treatment of other expenses (e.g. claims) which is charged to LIC (see **JE7** below), the cash payment of IACF is charged against LRC as shown in **JE3** here.

(h) Acquisition cash flows not directly attributable to the portfolio of insurance contracts to which the contracts belong is expensed immediately or accounted for in accordance with the relevant HKFRS as appropriate. [HKFRS 17.IE79(c)].

(b) Subsequent measurement – End of Year 1, Year 2 and Year 3

JE4 – Release of risk adjustment for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]

					HK$	HK$
DR		LRC – RA		*(i)*	60	
	CR		Insurance revenue	*(i)*		60

(i) The same set of the journal entries as in **JE3** of the base scenario is put through here as there is no change in the assumption on RA for non-financial risk.

JE5 – Release of expected claims for the year [HKFRS 17.41(a), B124(a)]

						HK$	HK$
DR		LRC – BEL			*(j)*	700	
	CR		Insurance revenue		*(j)*		700

(j) The same set of the journal entries as in **JE4** of the base scenario is put through here. As in the base scenario, **expected claims released = HK$2,100 / 3 = HK$700 per year**, applying HKFRS 17.B124(a).

JE6 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]

						HK$	HK$
DR		LRC – CSM			*(k)*	170	
	CR		Insurance revenue		*(k)*		170

(k) As shown in **JE1**, CSM is initially recognized as HK$510. Hence, the release of CSM for the year is **HK$510 / 3 years = HK$170 per year**, assuming the coverage is provided evenly over the period of 3 years.

JE7 – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]

						HK$	HK$
DR		Insurance service expenses			*(l)*	700	
	CR		LIC – BEL		*(l)*		700

(l) Entity A recognizes the actual claims incurred in Year 1, putting through the same set of the journal entries as in **JE6** of the base scenario. Given that the amount of actual claims is the same as originally expected, the amount equals **HK$2,100 / 3 years = HK$700 per year**, being the same amount as in **JE5**.

JE8 – Payment of actual claims and other expenses

						HK$	HK$
DR		LIC – BEL			*(m)*	700	
	CR		Cash		*(m)*		700

(m) The same set of the journal entries as **JE7** of the base scenario. Entity A fully settles the actual claims incurred at each reporting date, resulting in no outstanding LIC.

JE9 – Allocation of a portion of premiums that relates to the recovery of IACF [HKFRS 17.B121(b) & B125]

						HK$	HK$
DR		Insurance service expense			*(n)*	70	
	CR		Insurance revenue		*(n)*		70

(n) Applying HKFRS 17.B121(b), the entity should reflect the amounts for IACF as part of the total consideration that is reflective of the insurance revenue for that group.

Entity A determines its insurance revenue related to the IACF by allocating a portion of the premiums that relates to recovering those cash flows to each accounting period in a systematic way on the basis of the passage of time. **Entity A recognizes the same amount as insurance services expenses** [HKFRS 17.B125].

In this example, the coverage period of the insurance contracts is three years. Entity A determines and recognizes the insurance service expense with insurance revenue of the same amount in each of the three years over the passage of time as follows:

	HK$
Acquisition cash flows directly attributable to the group of insurance contracts (see **JE1**)	120
Inclusion of IACF in the initial measurement of LRC from derecognizing the IACF asset (see **JE1**)	90
Total IACF (see note ^)	210
IACF recognized as insurance revenue in each year (HK$210 / 3 years = HK$70) (see JE9)	**70**

^ As IACF is no longer a separate asset after being allocated as part of LRC, Entity A needs to keep track of the unamortized portion of IACF, e.g. in a separate spreadsheet in the simplest scenario in order to recognize a relevant portion in insurance revenue and insurance service expense every period.

Part 2 **–** Movements in insurance contract liabilities

The following table demonstrates how the accounting entries discussed in ***Part 1*** above are reflected in the changes of Entity A's insurance contract liabilities comprising the LRC and LIC in the statement of financial position.

Scenario 1.4: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr							LIC (Dr) / Cr		Total insurance contract liabilities
	BEL	JE	RA	JE	CSM	JE	Total LRC		JE	
	(a)		(b)		(c)		(d) = (a) + (b) + (c)	(e)		(f) = (d) + (e)
	HK$		HK$		HK$		HK$	HK$		HK$
Beginning of Year 1	-		-		-		-	-		-
New contracts recognized with derecognition of IACF asset	(780)	1	180	1	510	1	(90)^^	-		**(90)**
Premium received	3,000	2	-		-		3,000	-		**3,000**
Payment of IACF at the beginning of the coverage period	(120)	3	-		-		(120)	-		**(120)**
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	5	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	4	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(170)	6	(170)	-		**(170)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	7	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	8	**(700)**
End of Year 1 / Beginning of Year 2	***1,400***		***120***		***340***		***1,860***	-		***1,860***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	5	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	4	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(170)	6	(170)	-		**(170)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	7	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	8	**(700)**
End of Year 2 / Beginning of Year 3	***700***		***60***		***170***		***930***	-		***930***
Insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period)	(700)	5	-		-		(700)	-		**(700)**
Release of RA for risk expired to insurance revenue	-		(60)	4	-		(60)	-		**(60)**
Release of CSM to insurance revenue when services provided	-		-		(170)	6	(170)	-		**(170)**
Actual incurred claims and other expenses as insurance service expenses	-		-		-		-	700	7	**700**
Actual claims and other expenses paid	-		-		-		-	(700)	8	**(700)**
End of Year 3	-		-		-		-	-		-

Note ^^ The corresponding credit side of HK$90 is IACF asset. See **JE1**.

Part 3 – Statement of financial performance

The following is an extract of Entity A's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 1.4: Illustrative statement of financial performance (extract)

	Year 1 HK$	*JE*	Year 2 HK$	*JE*	Year 3 HK$	*JE*	Total HK$
Insurance revenue #	1,000		1,000		1,000		3,000
Insurance service expense **	(770)		(770)		(770)		(2,310)
Insurance service result	**230**		**230**		**230**		**690**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Other expenses **(Note 1)**	(50)	*3*	-		-		**(50)**
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***180***		***230***		***230***		***640***

\# *Analysis of insurance revenue arising from changes in LRC:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Risk adjustment for the risk expired	60	*4*	60	*4*	60	*4*	180
• Release of expected claims	700	*5*	700	*5*	700	*5*	2,100
• Release of CSM	**170**	*6*	**170**	*6*	**170**	*6*	**510**
• Allocation of a portion of premium that relates to recovery of IACF (gross up accounting)	**70**	*9*	**70**	*9*	**70**	*9*	**210**
	1,000		**1,000**		**1,000**		**3,000**

** *Analysis of the composition of ISE:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Recognition of actual claims incurred	700	*7*	700	*7*	700	*7*	2,100
• Allocation of a portion of premium that relates to recovery of IACF (gross up accounting)	**70**	*9*	**70**	*9*	**70**	*9*	**210**
	770		**770**		**770**		**2,310**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

Note

1 The amount refers to the acquisition cash flows that are not directly attributable to the portfolio of insurance contracts to which the contracts belong and is fully recognized as expense as incurred in Year 1 in P&L in this example.

Referring to the earlier discussions in this Section, in practice, there may be alternative possible journal entries to account for the group of insurance contracts with IACF under GMM. The following sets out the other possible alternatives, which are not exhaustive, for readers' reference only. Readers should read HKFRS 17 carefully and take into account their accounting system design in determining the appropriate journal entries for the compliance with HKFRS 17.

For the two alternatives set out below, **JE0** – recognition of IACF asset is the same as ***Part 1***.

Alternative 1 – initial recognition

The insurer records **JE1(a)** separated from the derecogniton of the IACF asset to arrive at the roll-forward effect of new contracts to be 0.

JE1(a) – Initial measurement of a group of related insurance contracts and derecognition of IACF asset [HKFRS 17.28C, 32, 37, B65(a), (b)&(e)]				
			HK$	HK$
DR		LRC – BEL	690	
	CR	LRC – RA		180
	CR	LRC – CSM		510
DR		LRC – BEL	90	
	CR	IACF asset		90

Alternative 2 – Initial recognition and subsequent measurement

HKFRS 17.38 sets out the requirements for the measurement of CSM on initial recognition of a group of insurance contracts, which include how IACF impacts on the amount of CSM to be recognized. It is considered that CSM effectively comprises two amounts: a 'gross of IACF CSM' amount and the IACF amount that reduces the former to the amount reported as a component of the LRC. Applying HKFRS 17.B125, an insurer shall amortize IACF and include that amortization expense in insurance service expense line item in the statement of profit or loss, while an equal and opposite amount is included in the insurance revenue line item. It is observed that there are market practices where the insurer makes use of 'suspense accounts' to control the amortization of IACF and corresponding insurance revenue recognition. Please see the following journal entries for illustration of the above practices:

(a) Initial recognition

JE1(a) – Initial measurement of a group of related insurance contracts [HKFRS 17.28C, 32, 37, B65(a), (b)&(e)]

				HK$	HK$
DR		LRC – BEL (excluding IACF)	*(a)*	900	
	CR	LRC – BEL – IACF	*(b)*		210
	CR	LRC – RA	*(c)*		180
	CR	LRC – CSM (net of IACF)	*(d)*		510

(a) Cash flows within the boundary of an insurance contract are those that are directly attributable to the fulfilment of the contract (i.e. FCF). LRC = FCF + CSM = BEL + RA + CSM. LRC – BEL, excluding IACF of HK$900 is arrived at by:

	HK$
Expected cash inflows from premium [HKFRS 17.B65(a)]	3,000
Less: **Expected** cash outflows of future claims [HKFRS 17.B65(b)]	(2,100)
LRC – BEL before IACF allocation (same as the base scenario) (see JE1(a) as above)	**900**

(b) HKFRS 17.B65(e) requires entities to include an allocation of acquisition cash flows that are attributable to the portfolio to which an insurance contract belongs in the FCFs of an insurance contract. Entity A had expenses of HK$90 incurred and paid prior to the initial recognition of the related group of insurance contracts as well as the directly attributable cost of HK$120 paid at the beginning of the coverage period. Therefore, total IACF = HK$90 + HK$120.

(c) The recognition of LRC – RA is the same as in the base scenario [HKFRS 17.37].

(d) No gain or loss is recognized on initial recognition of a group of insurance contracts. CSM, being the unearned profit of a group of insurance contracts, is calculated as follows on initial recognition [HKFRS 17.38].

	HK$
LRC – BEL (see (a) above)	900
Less: LRC – RA (see (c) above)	(180)
Less: Derecognition of IACF asset (see (b) above)	(90)
Less: IACF paid at the beginning of the coverage period and directly attributable to the portfolio (see (b) above)	(120)
CSM (see JE1(a) as above)	**510**

CSM determined at initial recognition in the base scenario i.e. HK$720

JE1(b) – Initial recognition for both LRC – CSM – IACF (to be amortized through insurance services expenses) and LRC – CSM – recovery of IACF (to be amortized through insurance revenue) [HKFRS 17.B125]

				HK$	HK$
DR		LRC – CSM – IACF	*(e)*	210	
	CR	LRC – CSM – Recovery of IACF	*(e)*		210

(e) The above accounting entry is created and posted for subsequent amortization to IR and ISE for the purposes of compliance with HKFRS 17.B125.

JE1(c) – Payment of acquisition cash flows of HK$170, including HK$120 which are cash flows directly attributable to the portfolio to which the group of insurance contracts belongs, are made at the beginning of the coverage period

					HK$	HK$
DR		Other expenses		*(f)*	50	
DR		LRC – BEL – IACF		*(g)*	120	
	CR		Cash			170

JE1(d) – Derecognition of IACF asset and inclusion into the measurement of the related group of contracts

					HK$	HK$
DR		LRC – BEL – IACF		*(g)*	90	
	CR		IACF asset	*(g)*		90

(f) Acquisition cash flows not directly attributable to the portfolio of insurance contracts to which the contracts belong is expensed immediately or accounted for in accordance with the relevant HKFRS as appropriate. [HKFRS 17.IE79(c)].

(g) Entity A derecognizes IACF asset of HK$90 and includes IACF in the initial measurement of the insurance contract liability [HKFRS 17.28C].

JE2 – recognition of premium received is the same as ***Part 1***. **JE3** – payment of IACF at the beginning of the coverage period in ***Part 1*** is replaced by **JE1(c)** above.

(b) Subsequent measurement – End of Year 1, Year 2 and Year 3

The following entries are the same as ***Part 1***:

- **JE4** – release of risk adjustment for the year
- **JE5** – release of expected claims for the year
- **JE6** – release of CSM for the year
- **JE7** – recognition of actual incurred claims and other expenses
- **JE8** – payment of actual claims and other expenses

The following entries are different from ***Part 1***:

JE9(a) – Allocation of a portion of premiums that relates to the recovery of IACF [HKFRS 17.B121(b) & B125]

					HK$	HK$
DR		LRC – CSM – Recovery of IACF		*(h)*	70	
	CR		Insurance revenue	*(h)*		70

JE9(b) – Amortization of IACF [HKFRS 17.B125]

				HK$	HK$
DR		Insurance service expense	*(h)*	70	
	CR	LRC – CSM – IACF	*(h)*		70

(h) **Entity A determines its insurance revenue related to the IACF by allocating a portion of the premiums** that **relates to recovering those cash flows to each accounting period in a systematic way on the basis of the passage of time**. **Entity A recognizes the same amount as insurance services expenses** [HKFRS 17.B125].

Same as ***Part 1***, the IACF recognized as insurance revenue in each year = HK$210 / 3 years and the same amount is recognized as insurance service expense.

Scenario 1.5 – Investment components

An insurance contract may contain one or more components that would be within the scope of another HKFRS if they were separate contracts. For example, an insurance contract may include an investment component or a component for services other than insurance contract services (or both). An entity shall apply HKFRS 17.11-13 to identify and account for the component of the contract.

This section talks about investment components. HKFRS 17 Appendix A defines investment component as the amounts that an insurance contract requires **the entity to repay to the policyholder in all circumstances**, regardless of whether an insured event occurs. This also means that an insurance contract includes an investment component only if a payment would occur in all circumstances. Saving-type insurance contracts which have a repayable contract feature are examples of insurance contracts which have investment components.

At inception, investment components are required to be separated from the host insurance contract for accounting if they are distinct and are accounted for under HKFRS 9, unless the investment component is an investment contract with discretionary participation features within the scope of HKFRS 17 [HKFRS 17.3, 10-11] in which case such investment component is accounted for separately applying HKFRS 17[15]. However, when separation is not required because the investment component is not distinct, the entity is not permitted to do such separation and apply HKFRS 9 to account for that investment component [HKFRS 17.BC114]. HKFRS 17 provides guidance on determination of whether the investment component is distinct [HKFRS 17.11(b), B31-B32].

Non-distinct investment components (NDIC) in an insurance contract are not separated from the insurance contract but are accounted for together with the insurance contract. This section focuses on illustration of the accounting entries for a group of insurance contracts which contain NDIC.

Except for the following, Scenario 1.5 uses the same fact pattern and assumptions as those in the base scenario.

Changes in fact pattern and assumptions	
Future cash flows	<u>Expected future cash outflows</u> • Comprise pay-outs of expected claims and investment components of HK$700 each year, amounting to a total of HK$2,100 in the 3-year coverage period
Investment component	• HK$300 out of HK$700 outflow in each year is expected to relate to investment components, so HK$900 in total for the 3-year coverage. The investment components are NDIC (See ☼) • For simplicity, the actual NDIC is the same as the expected amount

[15] In June 2020, the IASB amended IFRS 17.11(b) to clarify that an entity applies IFRS 17 to a separated investment component if that component meets the definition of an investment contract with discretionary participation features within the scope of IFRS 17 [HKFRS 17.BC109].

Notes for further insights

☼ At inception, an entity shall assess whether an insurance contract includes a NDIC. **Only when insurance revenue and incurred claim are recognized**[16] does HKFRS 17 require an entity to determine (1) how much of that claim is an investment component, and (2) whether it was expected to become payable in that period. The amounts so identified are excluded from insurance revenue and incurred claims.

Any unexpected repayment (or unexpected non-repayment) of an investment component adjusts the CSM [HKFRS 17.B96(c)], meaning that an entity would have to be able to determine the differences between any investment component **expected** to become payable in the period (calculated as an amount equal to the expected payment at the start of the period plus related IFIE before the amount becomes payable) and the **actual** investment component that becomes payable in the period. The CSM is also adjusted for changes in future estimates of cash flows, which will include the changes in expected future repayments of investment components [HKFRS 17.B96(b)]. The net effect of the application of both HKFRS 17.B96(b) and HKFRS 17.B96(c) on the CSM therefore reflects the changes in timing of the repayment of the investment component (e.g. interest accretion).

Part 1 – illustration of the journal entries with narrative explanation

(a) Initial recognition

JE1 – Initial measurement of a group of insurance contracts [HKFRS 17.32, 37 & 38]

					HK$	HK$
DR		LRC – BEL		*(a)*	900	
	CR		LRC – RA	*(b)*		180
	CR		LRC – CSM	*(c)*		720

The same set of the journal entries to initially recognize the group of insurance contracts is posted here as in the base scenario.

(a) BEL comprises expected cash inflows of premium of HK$3,000 and expected cash outflows of HK$2,100. The expected outflows of HK$2,100 **include estimated investment components of HK$900** during the three-year coverage period.

(b) LRC – RA represents the adjustments made by Entity A for the estimates of present value of future cash flows to reflect the compensation that it requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

(c) On initial recognition, Entity A measures CSM of a group of insurance contracts at an amount that results in no income or expenses.

JE2 – Recognition of premium received

					HK$	HK$
DR		Cash		*(d)*	3,000	
	CR		LRC – BEL	*(d)*		3,000

[16] TRG had a discussion on the determination of the **amount** of an investment component in its April 2019 meeting. TRG members observed that (i) an entity identifies amounts of NDIC only when insurance revenue and incurred claims are recognized; (ii) IFRS 17 does not specify how to determine those amounts; (iii) in some cases, it may be reasonable to determine those amounts using the explicit amounts identified by the contractual terms; and (iv) in other cases, it may be appropriate to determine the amount on a present value basis at the time of making the determination. Please see meeting agenda paper and meeting summary for details.

(d) The same set of the journal entries to recognize the premium received is put through here as in the base scenario.

(b) Subsequent measurement – End of Year 1, 2 and 3

The following entries, i.e. **JE3** to **JE9** below are posted at the end of Year 1 to 3:

JE3 – Release of risk adjustment for the year [HKFRS 17.41(a), B121(a)(ii), B124(b)]

					HK$	HK$
DR		LRC – RA		*(e)*	60	
	CR		Insurance revenue	*(e)*		60

(e) The same set of the journal entries to recognize the premium received is posted here as in the base scenario.

JE4 – Release of expected claims for the year, net of investment components [HKFRS 17.41(a), B124(a)]

					HK$	HK$
DR		LRC – BEL		*(f)*	400	
	CR		Insurance revenue	*(f)*		400

(f) Given receipts and payments of investment components are excluded from insurance revenue and expenses presented in P&L, the amount of expected claims released to insurance contract revenue in each year is net of the investment components, i.e. **HK$700 (total outflow) – HK$300 (investment components) = HK$400** [HKFRS 17.85, B120(b), B123(a)(ii), BC108(b)].

Notes for further insights

☼ The exclusion of investment components from insurance revenue in P&L might have a significant effect on some entities that previously recognized insurance revenue merely based on premium received (which included investment components) before the adoption of HKFRS 17.

JE5 – Actual NDIC payable for the year [HKFRS 17 Appendix A]

					HK$	HK$
DR		LRC – BEL (see ☼)		*(g)*	300	
	CR		LIC – BEL (see ☼)	*(g)*		300

(g) In this example, the actual payout of NDIC is the same as the expected amount, i.e. HK$300. As defined in HKFRS 17 Appendix A, the LIC includes amounts relating to any investment components or other amounts that are not related to the provision of insurance contract services, and that are not in the LRC.

Notes for further insights

☼ An investment component is defined as the amount that the insurer must repay to a policyholder in all circumstances, regardless of whether an insured event occurs [HKFRS 17 Appendix A]. Accordingly, HKFRS 17 requires that any NDIC that is not separated from an insurance contract has to be excluded from both insurance revenue and insurance service expenses. Instead, **the recognition and derecognition of a NDIC only gives rise to a balance sheet movement**.

As discussed in its meeting in April 2019 (Agenda paper no. 1), the TRG observed that the amount of payments by the insurer could be zero in some scenarios. However, this does not necessarily mean that no investment component exists and that settling amounts due on a net or gross basis should not affect the outcome of the assessment of whether an investment component exists.

JE6 – Release of CSM for the year [HKFRS 17.44(e), B119, B124(c)]

					HK$	HK$
DR		LRC – CSM		*(h)*	240	
	CR		Insurance revenue	*(h)*		240

(h) Entity A recognizes an amount of CSM as insurance revenue, same as in the base scenario.

JE7 – Recognition of actual incurred claims and other expenses, net of investment components [HKFRS 17.42(a)]

					HK$	HK$
DR		Insurance service expenses		*(i)*	400	
	CR		LIC – BEL	*(i)*		400

(i) The amount of actual incurred claims is the same as the expected amount, i.e. HK$400 (see **JE4**), which does not include investment component.

JE8 – Payment of actual incurred claims and other expenses, net of investment components

					HK$	HK$
DR		LIC – BEL		*(j)*	400	
	CR		Cash	*(j)*		400

(j) The amount of actual incurred claims and other expenses is paid.

JE9 – Repayment of NDIC for the year

					HK$	HK$
DR		LIC – BEL		*(k)*	300	
	CR		Cash	*(k)*		300

(k) The amount of actual NDIC repaid is the same as expected. Together with **JE8**, there is no outstanding LIC at the reporting date.

Part 2 **–** Movements in insurance contract liabilities

The following table demonstrates how the accounting entries discussed in ***Part 1*** above are reflected in the changes of Entity A's insurance contract liabilities comprising the LRC and LIC in the statement of financial position.

Scenario 1.5: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr							LIC (Dr) / Cr		Total insurance contract liabilities
	BEL	*JE*	**RA**	*JE*	**CSM**	*JE*	**Total LRC**		*JE*	
	(a)		*(b)*		*(c)*		*(d) = (a) + (b) + (c)*	*(e)*		***(f) = (d) + (e)***
	HK$		HK$		HK$		HK$	HK$		**HK$**
Beginning of Year 1	**-**		**-**		**-**		**-**	**-**		**-**
New contracts recognized	(900)	*1*	180	*1*	720	*1*	-	-		**-**
Premium received	3,000	*2*	-		-		3,000	-		**3,000**
ISE incurred in the period (measured at the amounts expected at the beginning of the period, net of investment component)	(400)	*4*	-		-		(400)	-		**(400)**
Release of RA for risk expired to insurance revenue	-		(60)	*3*	-		(60)	-		**(60)**
NDIC payable in the period	(300)	*5*	-		-		(300)	300	*5*	**-**
Release of CSM to insurance revenue when services provided	-		-		(240)	*6*	(240)	-		**(240)**
Actual incurred claims and other expenses, excluding NDIC, as ISE	-		-		-		-	400	*7*	**400**
Actual claims and other expenses paid and repayment of NDIC	-		-		-		-	(700)	*8, 9*	**(700)**
End of Year 1 / Beginning of Year 2	***1,400***		***120***		***480***		***2,000***	**-**		***2,000***
ISE incurred in the period (measured at the amounts expected at the beginning of the period, net of investment component)	(400)	*4*	-		-		(400)	-		**(400)**
Release of RA for risk expired to insurance revenue	-		(60)	*3*	-		(60)	-		**(60)**
NDIC payable in the period	(300)	*5*	-		-		(300)	300	*5*	**-**
Release of CSM to insurance revenue when services provided	-		-		(240)	*6*	(240)	-		**(240)**
Actual incurred claims and other expenses, excluding NDIC, as ISE	-		-		-		-	400	*7*	**400**
Actual claims and other expenses paid and repayment of NDIC	-		-		-		-	(700)	*8, 9*	**(700)**
End of Year 2 / Beginning of Year 3	***700***		***60***		***240***		***1,000***	**-**		***1,000***
ISE incurred in the period (measured at the amounts expected at the beginning of the period, net of investment component)	(400)	*4*	-		-		(400)	-		**(400)**
Release of RA for risk expired to insurance revenue	-		(60)	*3*	-		(60)	-		**(60)**
NDIC payable in the period	(300)	*5*	-		-		(300)	300	*5*	**-**
Release of CSM to insurance revenue when services provided	-		-		(240)	*6*	(240)	-		**(240)**
Actual incurred claims and other expenses, excluding NDIC, as ISE	-		-		-		-	400	*7*	**400**
Actual claims and other expenses paid and repayment of NDIC	-		-		-		-	(700)	*8, 9*	**(700)**
End of Year 3	**-**		**-**		**-**		**-**	**-**		**-**

Part 3 – Statement of financial performance

The following is an extract of Entity A's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 1.5: Illustrative statement of financial performance (extract)

	Year 1	*JE*	Year 2	*JE*	Year 3	*JE*	Total
	HK$		HK$		HK$		HK$
Insurance revenue # **(Note 1)**	700		700		700		2,100
Insurance service expense **(Note 1)**	(400)	*7*	(400)	*7*	(400)	*7*	(1,200)
Insurance service result	**300**		**300**		**300**		**900**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***300***		***300***		***300***		***900***

\# *Analysis of insurance revenue arising from changes in LRC:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Risk adjustment for the risk expired	60	*3*	60	*3*	60	*3*	180
• Release of expected claims	**400**	*4*	**400**	*4*	**400**	*4*	**1,200**
• Release of CSM	240	*6*	240	*6*	240	*6*	720
	700		**700**		**700**		**2,100**

Note

1 HKFRS 17.85 clearly states that insurance revenue and insurance service expenses presented in P&L shall **exclude** any investment components. Accordingly, the line items insurance revenue and ISE both are derived after excluding NDIC of HK$900, i.e.

	Gross premium /payment	NDIC	**Net of NDIC**
	HK$	HK$	**HK$**
	(a)	*(b)*	***(a) – (b)***
Insurance revenue	3,000	900	**2,100**
ISE	2,100	900	**1,200**
			900

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

2. Premium Allocation Approach (PAA)

As shown in *Diagram 1*, PAA is one of the measurement models under HKFRS 17 to measure a group of insurance contracts. It is an optional simplified model of GMM but permitted to be applied only when **either of the following two criteria is satisfied at inception**:

(a) The coverage period[17] of **each contract** in the group of insurance contracts is **one year or less**; or

(b) The entity reasonably expects that PAA would produce a measurement of LRC for a group that would not differ materially from the one that would be produced applying the GMM requirements (i.e. LRC = FCF + CSM under GMM).

The eligibility is assessed for each group of insurance contracts and the election is made for each eligible group (see ☼).

Many non-life insurance contracts are expected to be eligible to meet criterion (a) mainly because of their short duration. Some life insurance contracts with a duration longer than one year may still be eligible for applying the PAA so long as the life insurer can justify how criterion (a) or (b) is met[18]. However, if FCF are expected to vary significantly during the coverage period, or if there are any significant derivatives embedded in the contracts, management would not be able to reasonably expect that PAA would produce a measurement of LRC for a group of insurance contracts that would not differ materially from the LRC derived from the application of the GMM [HKFRS 17.54]. In this situation, application of appropriate management judgement is critical in assessing the likely variability of FCF of contracts with a coverage period longer than one year.

In respect of criterion (b), if the coverage period is more than one year and an entity expects that the measurement of LRC is expected to differ materially from GMM, the entity cannot apply PAA. The assessment is made at inception and is not reassessed subsequently. Also, materiality as referred to in criterion (b) should be considered at the group of contracts level.

Notes for further insights

☼ The assessment of eligibility criteria is performed for each group and the election is made for each group meeting the criteria at inception. HKFRS 17 does not require or permit reassessment of the eligibility criteria or the election to apply PAA subsequent to the initial recognition of the group of insurance contracts[19], except for cases where contracts have been modified, resulting in the modified contracts being not eligible to be measured under the PAA.

PAA is a simpler and more straightforward approach. A large benefit of PAA is that insurers are not required to estimate future claims or measure and track the CSM.

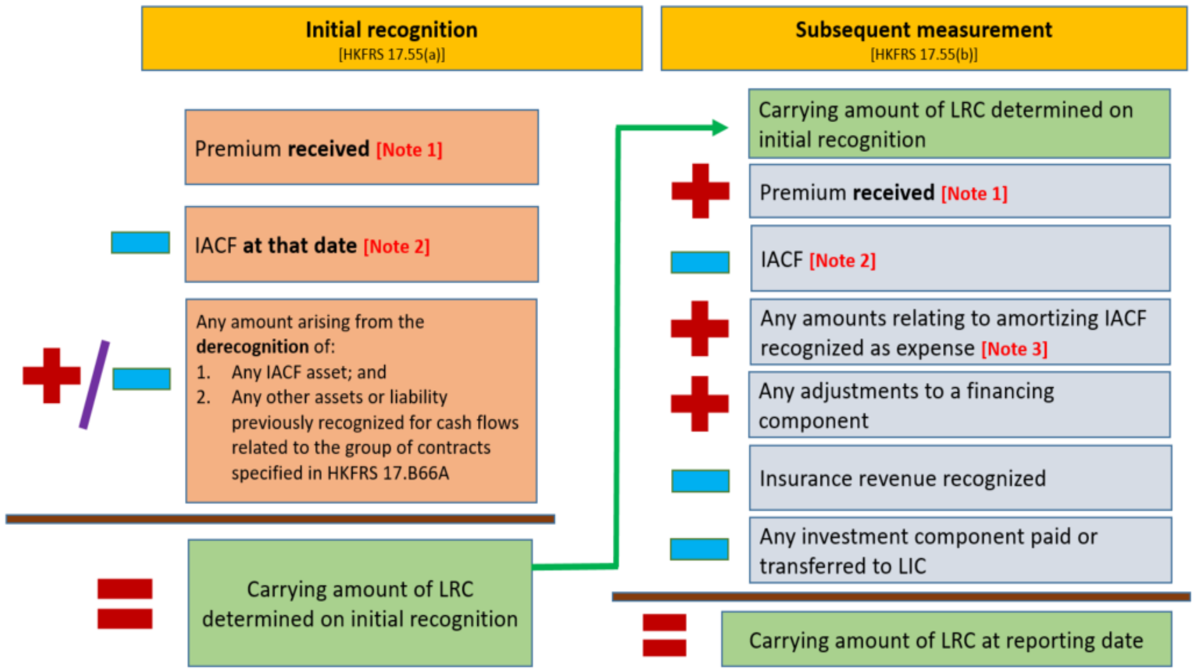
[17] Coverage period includes the insurance contract services arising from all premiums within the contract boundary determined at that date applying HKFRS 17.34 and B61-B71.

[18] Life insurers may be able to apply PAA for contracts with long duration under criterion (a) because of contractual terms such as insurer's unilateral right to cancel the contract subject to a notice period, annual repricing mechanisms. Such contract terms may render the insurance contracts to have coverage period of one year or less.

[19] The matter under IFRS 17 is discussed in TRG April 2019 meeting, Agenda Paper No.2, Log#S123, which also applies to HKFRS.

Generally, the main difference between GMM and PAA is the initial and subsequent measurement of LRC. Other than in specified circumstances (e.g. an entity chooses not to adjust the expected cash flows for the time value of money under HKFRS 17.59(b)), the measurement of LIC is generally the same in GMM and PAA. The following diagram shows the determination of LRC under PAA. No CSM is required to be measured and recognized under PAA.

Diagram 7 Measurement of the carrying amount of LRC under PAA



Notes

1 There were discussions in TRG meetings in February (Agenda paper no.7, log#S23) and May (Agenda paper no.6, log#S27) 2018. At the meetings, TRG members agreed with the IASB staff views that it is premium 'actually received' rather than due or expected based on literal reading of the standard.

There may be implication for the accounting systems built based on I/HKFRS 4 which recognized LRC based on receivable premiums and if so, insurers should update their systems to recognize LRC based on received premium only.

2 LRC is derived after deducting any IACF paid or incurred at that date (on initial recognition) or during the period (after initial recognition), unless the entity chooses to recognize the payments as an expense applying HKFRS 17.59(a), i.e. with a coverage period of one year or less.

3 LRC is derived after adding amount of amortizing IACF recognized as an expense in the reporting period, unless the entity is eligible and chooses to recognize the IACF as an expense upon incurred.

Section 3 provides an overall comparison between GMM and PAA.

The following scenarios illustrates the accounting entries applying PAA from initial recognition to subsequent measurement till the end of the coverage period. Scenarios 2.2 and 2.3 are developed based on Scenario 2.1.

- Scenario 2.1: Base scenario with IACF
- Scenario 2.2: Change in expenses or claims
- Scenario 2.3: Change in premium

Scenario 2.1: Base scenario with IACF

Entity B issues a group of insurance contracts with the following simplified fact pattern and assumptions. There is no onerous contract in the group. This table will be referred to again in discussions of other scenarios (which are developed based on this base scenario) to be discussed later in this section.

<table>
<tr><th colspan="2">Fact pattern and assumptions</th></tr>
<tr><td>Reporting environment</td><td>• HKFRS</td></tr>
<tr><td>Coverage period</td><td>• Three months
• Starts when the insurance contracts are issued on 1 January of Year 1 and ends on 31 March of Year 1</td></tr>
<tr><td>Future cash flows</td><td>i. <u>Expected cash inflows</u>
• Generated from premiums of HK$3,000
• Due at the beginning of the coverage period. Entity B receives all the premium (HK$3,000) immediately after initial recognition

ii. <u>Expected cash outflows</u>
• Comprise expected pay-outs of claims amounting to HK$2,100 in total which are incurred evenly during the coverage period
• All amounts settled at the end of March, Year 1
• No other expenses in this example for simplicity

iii. No differences in expected and actual future cash flows</td></tr>
<tr><td>IACF</td><td>• Entity B incurred and paid directly attributable acquisition cash flows of HK$120 on the date of initial recognition of the group of insurance contracts

• Accounting policy choice adopted [HKFRS 17.55(b)(iii)]: amortize IACF as an expense over the coverage period</td></tr>
<tr><td>Risk adjustment for non-financial risk</td><td>i. <u>LRC</u>
• Not applicable

ii. <u>LIC</u>
• RA recognized at the end of January, Year 1 is reduced in the following month because the example has short-tail claims
• RA at the end of January, Year 1 = HK$60 which is reduced to HK$25 at the end of February of the same year
• RA for claims incurred in February, Year 1 = HK$25, which is the same amount of the reduced RA for the claims incurred in January, Year 1 because they are expected to have the same risk pattern and remaining settlement period
• No RA recognized for the claims incurred in March, Year 1 because all claims are settled at the end of March, Year 1</td></tr>
<tr><td>Insurance contract services</td><td>• Provided evenly throughout the coverage period</td></tr>
<tr><td>Financial statement items</td><td>• No profit or loss nor balance sheet items other than items arising from accounting for insurance contracts</td></tr>
<tr><td>Time value of money</td><td>• No discount rate is applied for both LRC and LIC (Note 1)</td></tr>
<tr><td>Foreign exchange</td><td>• No effect of any exchange differences because the same currency is used (i.e. the insurance contracts generate cash flows in the same currency of the contracts)</td></tr>
<tr><td>Experience adjustments</td><td>• None</td></tr>
</table>

Note

1 An entity is **not required** to adjust the carrying amount of the LRC to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the services and the related premium due date is no more than one year [HKFRS 17.56].

A similar requirement for LIC is set out in HKFRS 17.59(b) under which an entity is **not required** to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred. However, this election is independent of the election of not discounting / reflecting the effect of financial risk for the LRC mentioned above.

The above simplifications are only applicable for PAA. Entities applying GMM are required to adjust the estimates of future cash flows to reflect the time value of money and the effect of financial risk, subject to materiality considerations[20].

In this base scenario, the LRC is not discounted because the difference between the timing of premium due (1 January of Year 1) and the coverage (Q1 of Year 1) does not exceed one year [HKFRS 17.56]. Similarly, the LIC is not discounted because the claims are paid within one year after they are incurred [HKFRS 17.59(b)].

Part 1 – illustration of the journal entries with narrative explanation

Given that the coverage period of each contract in the group is three months (i.e. within one-year coverage period), the group qualifies for PAA regardless of whether criterion (b) discussed above is met (i.e. the entity can demonstrate that applying PAA is a reasonable approximation of GMM). For better understanding, readers may refer to *Diagram 7* to follow through the accounting entries from initial recognition to subsequent measurement.

(a) Initial recognition

JE1 – Recognition of premium received [HKFRS 17.55(a)(i)]

					HK$	HK$
DR		Cash		*(a)*	3,000	
	CR		LRC – Premium	*(a)*		3,000

(a) Entity B recognizes premium received of HK$3,000 in the carrying amount of LRC. (See ☼)

JE2 – Payment of IACF at the beginning of the coverage period [HKFRS 17.55(a)(ii)]

					HK$	HK$
DR		LRC – IACF		*(b)*	120	
	CR		Cash	*(b)*		120

(b) As Entity B chooses to defer IACF instead of recognizing the amount paid as an expense, the carrying amount of LRC is deducted by the IACF paid at initial recognition of the group (i.e. any acquisition cash flow is subsumed within LRC, unless Entity B elects to expense IACF. (See ☼). Accordingly, under HKFRS 17, no separate asset is recognized for deferred acquisition cost except for IACF paid or incurred **prior to** the related group of insurance contracts is recognized.

[20] TRG September 2018 meeting, Agenda paper no.11, Log#S64.

Notes for further insights

☼ If the premiums were not received on initial recognition (i.e. they are receivable at a later date) and the IACF are expensed as incurred instead of over time, then LRC is HK$0 on initial recognition.

(b) Subsequent measurement

The following entries, i.e. **JE3** to **JE8,** are posted in the subsequent months:

JE3 – Amortization of IACF for January, February and March [HKFRS 17.55(b)(iii)]

				HK$	HK$
DR		Insurance service expense	*(c)*	40	
	CR	LRC – IACF	*(c)*		40

(c) Given Entity B chooses not to recognize the payment of IACF as an expense on initial recognition, the debit balance included in LRC – IACF (see **JE2**) is amortized evenly over the 3-month coverage period, **i.e. HK$120 / 3 months = HK$40 each month**.

JE4 – Recognition of insurance revenue for January, February and March [HKFRS 17.55(b)(v), B126]

				HK$	HK$
DR		LRC – Premium	*(d)*	1,000	
	CR	Insurance revenue	*(d)*		1,000

(d) In this base scenario, Entity B recognizes the amount of expected premium receipts as insurance revenue for the month based on the basis of the passage of time [HKFRS 17.B126(a)], **i.e. HK$3,000 / 3 months = HK$1,000 per month**. However, if the expected pattern of release of risk during the coverage period differs significantly from the passage of time (e.g. due to seasonality of claims), then Entity B should recognize the insurance revenue on the basis of the expected timing of incurred insurance service expenses [HKFRS 17.B126(b)].

Furthermore, if facts and circumstances change, Entity B shall change the basis of allocation (i.e. passage of time versus incurred insurance service expenses) as necessary [HKFRS 17.B127]. Such change will be accounted for prospectively as a change in accounting estimates if the change arises from new information.

JE5 – Recognition of actual incurred claims and other expenses for January, February and March [HKFRS 17.42(a)]

				HK$	HK$
DR		Insurance service expense	*(e)*	700	
	CR	LIC – BEL	*(e)*		700

(e) LIC under PAA is measured the same way as LIC under GMM. Entity B recognizes the actual claims incurred for the period, **i.e. HK$2,100 / 3 months = HK$700 each month**, on the assumption that the claims are incurred evenly during the coverage period and the actual amount is the same as expected.

JE6 – Accounting for risk adjustment for non-financial risk related to the actual incurred claims and other expenses for the month [HKFRS 17.59(b)]

					End of		
					January	February	March
					HK$	HK$	HK$
DR		Insurance service expense		*(f)*	60	25	-
	CR		LIC – RA	*(f)*	60	25	-

(f) Entity B records the corresponding risk adjustment for non-financial risk on the actual incurred claims for the month. See the table below which shows the movements of LIC – BEL and LIC – RA under PAA from January to March, Year 1.

	BEL	**RA**
	HK$	HK$
At 1 January, Year 1	-	-
Add: Actual claims incurred and corresponding RA (see **JE5 & 6**)	700	60
At the end of January, Year 1	**700**	**60**
Less: Changes in RA for actual claims incurred in January (see **JE7**)	-	(35)
Add: Actual claims incurred and corresponding RA (see **JE5 & 6**)	700	^^25
At the end of February, Year 1	**1400**	**50**
Add: Actual claims incurred	700	-
Less: Settlements of all claims and changes in RA for all settled incurred claims (see **JE7 & 8**)	(2,100)	**(50)
At the end of March, Year 1	**-**	**-**

HK$60-HK$35
= HK$25

^^ The newly recognized RA for the claims incurred in February is set at the same amount of the reduced RA for the claimed incurred in January (i.e. HK$25) because they are expected to have the same risk pattern and remaining settlement period.

** No RA is recognized for the claims incurred in March because all claims are settled at the end of March.

JE7 – Changes in risk adjustment for non-financial risk related to past services at the end of February and March

					End of		
					January	February	March
					HK$	HK$	HK$
DR		LIC – RA		*(g)*	-	35	50
	CR		Insurance service expense	*(g)*	-	35	50

(g) The amount represents the changes in RA in February and March, Year 1. The full remaining amount is released at the end of March, Year 1 because by that time all claims are settled.

JE8 – Payment of actual claims and other expenses at the end of March				
			HK$	HK$
DR	LIC – BEL	*(h)*	2,100	
CR	Cash	*(h)*		2,100

(h) Entity B fully settles the actual incurred claims at the end of March, Year 1.

Part 2 – Movements in insurance contract liabilities

The following table demonstrates how the accounting entries discussed in ***Part 1*** above are reflected in the changes of Entity B's insurance contract liabilities comprising the LRC and LIC in the statement of financial position.

Scenario 2.1: Insurance contract liabilities recognized in the statement of financial position

	LRC (Note) (Dr) / Cr					LIC (Dr) / Cr					Total insurance contract liabilities
	Premium	*JE*	**IACF**	*JE*	**Total LRC**	**BEL**	*JE*	**RA**	*JE*	**Total LIC**	
	(a)		*(b)*		***(c) = (a) + (b)***	*(d)*		*(e)*		***(f) = (d) + (e)***	***(g) = (c) + (f)***
	HK$		HK$		**HK$**	HK$		HK$		**HK$**	**HK$**
1 January, Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**
Premium received	3,000	*1*	-		**3,000**	-		-		**-**	**3,000**
IACF paid	-		(120)	*2*	**(120)**	-		-		**-**	**(120)**
Amortization of IACF for the month	-		40	*3*	**40**	-					**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	60	*6*	**760**	**760**
End of January, Year 1	***2,000***		***(80)***		***1,920***	***700***		**60**		***760***	***2,680***
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Changes in RA for actual claims incurred in January, Year 1	-		-		**-**	-		(35)	*7*	**(35)**	**(35)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	25	*6*	**725**	**725**
End of February, Year 1	***1,000***		***(40)***		***960***	***1,400***		***50***		***1,450***	***2,410***
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Actual incurred claims and other expenses as insurance service expense	-		-		**-**	700	*5*	-		**700**	**700**
Payment of actual claims and other expenses and changes in RA for non-financial risk	-		-		**-**	(2,100)	*8*	(50)	*7*	**(2,150)**	**(2,150)**
End of March, Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**

Note As compared to GMM, no CSM is recognized under PAA.

Part 3 – Statement of financial performance

The following is an extract of Entity B's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 2.1: Illustrative statement of financial performance (extract)

	End of January, Year 1	*JE*	End of February, Year 1	*JE*	End of March, Year 1	*JE*	Total
	HK$		HK$		HK$		HK$
Insurance revenue	1,000	*4*	1,000	*4*	1,000	*4*	3,000
Insurance service expenses# **(Note 1)**	(800)		(730)		(690)		(2,220)
Insurance service result	**200**		**270**		**310**		**780**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***200***		***270***		***310***		***780***

\# *Analysis of insurance service expenses:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Amortization of IACF	40	*3*	40	*3*	40	*3*	120
• Actual incurred claims and other expenses and related RA for non-financial risk	760	*5, 6*	725	*5, 6*	700	*5, 6*	2,185
• Changes in RA for non-financial risk	-		(35)	*7*	(50)	*7*	(85)
	800		**730**		**690**		**2,220**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another Standard.*

Note

1 In this example, the total insurance service expenses for the group of insurance contracts represents:

	HK$
Actual incurred claims and other expenses (see **JE5**, HK$700 X 3)	2,100
Amortization of IACF (see **JE3**. HK$40 X 3)	120
Total insurance service expense	**2,220**

Scenario 2.2: Change in expenses or claims

Except for the following, Scenario 2.2 uses the same fact pattern and assumptions as those in the base scenario.

Changes in fact pattern and assumptions	
Future cash flows	Expected cash outflows • On 1 February of Year 1 (i.e. beginning of the 2nd month), Entity B revises its estimates of expected total pay-out of incurred claims from HK$2,100 to HK$2,500 (i.e. claims for February and March are expected to each increase by HK$200). Note: We assume no change in the corresponding risk adjustment for incurred claims as in the base scenario.

Part 1 – illustration of the journal entries with narrative explanation

(a) Initial recognition

As there is no change in the assumptions regarding initial recognition, the same journal entries **JE1** to **JE2** as in the base scenario (Scenario 2.1) are recorded.

(b) Subsequent measurement

Except for the following sets of entries (i.e. **JE5*** and **JE8***) to reflect the change in expenses and claims, all other journal entries are the same as in the base scenario. **JE5*** and **JE8*** are marked with asterisk (*) to differentiate them from the base scenario.

End of February and March, Year 1:

All other journal entries remain the same.

JE5* – Recognition of actual incurred claims and other expenses [HKFRS 17.42(a)]

				HK$	HK$
DR		Insurance service expenses	*(a)*	900	
	CR	LIC – BEL	*(a)*		900

(a) Entity B recognizes the revised actual incurred claims and other expenses as follows:

	HK$
Original estimated actual incurred claims	700
Add: Revised estimates	200
Revised insurance service expense for the month (see JE5*)	**900**

JE8* – Payment of actual claims and other expenses					
				HK$	HK$
DR		LIC – BEL	*(b)*	2,500	
	CR	Cash	*(b)*		2,500

(b) Entity B fully settles the actual incurred claims at the end of March, Year 1. The amount of actual incurred claims paid is the same as the revised estimates.

Part 2 – Movements in insurance contract liabilities

This table serves demonstrates how the accounting entries in ***Part 1*** affect the changes of Entity B's insurance contract liabilities.

Scenario 2.2: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr					LIC (Dr) / Cr					Total insurance contract liabilities
	Premium	***JE***	**IACF**	***JE***	**Total LRC**	**BEL**	***JE***	**RA**	***JE***	**Total LIC**	
	(a)		*(b)*		***(c) = (a) + (b)***	*(d)*		*(e)*		***(f) = (d) + (e)***	***(f) = (d) + (e)***
	HK$		HK$		**HK$**	HK$		HK$		**HK$**	**HK$**
1 January, Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**
Premium received	3,000	*1*	-		**3,000**	-		-		**-**	**3,000**
IACF paid	-		(120)	*2*	**(120)**	-		-		**-**	**(120)**
Amortization of IACF for the month	-		40	*3*	**40**	-					**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	60	*6*	**760**	**760**
End of January, Year 1	***2,000***		***(80)***		***1,920***	***700***		60		***760***	***2,680***
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Changes in RA for actual claims incurred in January, Year 1	-		-		**-**	-		(35)	*7*	**(35)**	**(35)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	900	*5**	25	*6*	**925**	**925**
End of February, Year 1	***1,000***		***(40)***		***960***	***1,600***		***50***		***1,650***	***2,610***
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	900	*5**	-		**900**	**900**
Payment of actual claims and other expenses and changes in RA for non-financial risk	-		-		**-**	(2,500)	*8**	(50)	*7*	**(2,550)**	**(2,550)**
End of Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**

Part 3 – Statement of financial performance

The following is an extract of Entity B's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 2.2: Illustrative statement of financial performance (extract)

	End of January, Year 1	*JE*	End of February, Year 1	*JE*	End of March, Year 1	*JE*	Total
	HK$		HK$		HK$		HK$
Insurance revenue	1,000	*4*	1,000	*4*	1,000	*4*	3,000
Insurance service expenses #	(800)		**(930)**		**(890)**		**(2,620)**
Insurance service result	**200**		**70**		**110**		**380**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***200***		***70***		***110***		***380***

\# *Analysis of insurance service expenses:*

	HK$	*JE*	HK$	*JE*	HK$	*JE*	HK$
• Amortization of IACF	40	*3*	40	*3*	40	*3*	120
• Actual incurred claims and other expenses and related RA for non-financial risk	760	*5, 6*	**925**	*5*, 6*	**900**	*5**	**2,585**
• Changes in RA for non-financial risk	-		(35)	*7*	(50)	*7*	(85)
	800		**930**		**890**		**2,620**

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another Standard.*

Scenario 2.3 – Change in premium

Except for the following, Scenario 2.3 uses the same fact pattern and assumptions as those in the base scenario. Those changes discussed in Scenario 2.2 are not relevant here.

Changes in fact pattern and assumptions	
Future cash flows	Expected cash inflows • On 1 February of Year 1 (i.e. beginning of the 2nd month), Entity B receives an extra premium of HK$400 related to future services[21]

Part 1 – illustration of the journal entries with narrative explanation

(a) Initial recognition

As there is no change in the assumptions relating to initial recognition, the same two sets of the journal entries (**JE1** to **JE2)** as those in the base scenario (Scenario 2.1) are recorded.

(b) Subsequent measurement

Except for the following sets of entries (i.e. **JE1*** and **JE4***) to reflect the extra premium received, all other journal entries are the same as in the base scenario.

Beginning of February, Year 1:

The receipt of extra premium is **JE1*** with asterisk (*) added to differentiate the receipt of premium (**JE1**) recorded at the beginning of the coverage period.

JE1* – Receipt of extra premium at the beginning of February, Year 1					
				HK$	HK$
DR	Cash		*(a)*	400	
CR		LRC – Premium	*(a)*		400

(a) Entity B recognizes the extra premium received.

[21] We assume that the receipt of additional premium in this example does not constitute modification to be accounted for as a derecognition applying HKFRS 17.72.

Readers should note that the example is highly simplified, which is set up solely for illustrating the impact on the journal entries as a result of a change in premium applying HKFRS 17.B126 under the PAA. Accordingly, the fact pattern given may not be consistent with reality, e.g. we assume that the receipt of extra premium on 1 February, Year 1 is not expected at the end of January, Year 1 and hence the extra premium has not been included in the expected premium receipts at the end of January, Year 1. We also assume that there is no increase in expected claims and RA despite there is an increased coverage from receipt of extra premium.

End of February and March, Year 1:

JE4* with asterisk (*) added to differentiate it from **JE4** recorded in the base scenario.

JE4* – Recognition of insurance revenue for February and March [HKFRS 17.55(b)(v), B126]					
				HK$	HK$
DR		LRC – Premium	*(b)*	1,200	
	CR	Insurance revenue	*(b)*		1,200

(b) Entity B recognizes the revised insurance revenue for the month, **i.e. HK$1,000 (base scenario) + HK$400/2 (extra premium)**.

Part 2 **–** Movements in insurance contract liabilities

The following table demonstrates how the accounting entries in ***Part 1*** are reflected in the changes of Entity B's insurance contract liabilities comprising the LRC and LIC.

Scenario 2.3: Insurance contract liabilities recognized in the statement of financial position

	LRC (Dr) / Cr					LIC (Dr) / Cr					Total insurance contract liabilities
	Premium	*JE*	**IACF**	*JE*	**Total LRC**	**BEL**	*JE*	**RA**	*JE*	**Total LIC**	
	(a)		*(b)*		***(c) = (a) + (b)***	*(d)*		*(e)*		***(f) = (d) + (e)***	***(g) = (c) + (f)***
	HK$		HK$		**HK$**	HK$		HK$		**HK$**	**HK$**
1 January, Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**
Premium received	3,000	*1*	-		**3,000**	-		-		**-**	**3,000**
IACF paid	-		(120)	*2*	**(120)**	-		-		**-**	**(120)**
Amortization of IACF for the month	-		40	*3*	**40**	-					**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,000)	*4*	-		**(1,000)**	-		-		**-**	**(1,000)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	60	*6*	**760**	**760**
End of January, Year 1	***2,000***		***(80)***		***1,920***	***700***		60		***760***	***2,680***
Additional premium received	400	*1**	-		**400**	-		-		**-**	**400**
Recognition of expected premium receipts as insurance revenue for the month	(1,200)	*4**	-		**(1,200)**	-		-		**-**	**(1,200)**
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Changes in RA for actual claims incurred in January, Year 1	-		-		**-**	-		(35)	*7*	**(35)**	**(35)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	25	*6*	**725**	**725**
End of February, Year 1	***1,200***		***(40)***		***1,160***	***1,400***		***50***		***1,450***	***2,610***
Amortization of IACF for the month	-		40	*3*	**40**	-		-		**-**	**40**
Recognition of expected premium receipts as insurance revenue for the month	(1,200)	*4**	-		**(1,200)**	-		-		**-**	**(1,200)**
Actual incurred claims and other expenses and related RA for non-financial risk as insurance service expense	-		-		**-**	700	*5*	-		**700**	**700**
Payment of actual claims and other expenses and changes in RA for non-financial risk	-		-		**-**	(2,100)	*8*	(50)	*7*	**(2,150)**	**(2,150)**
End of Year 1	**-**		**-**		**-**	**-**		-		**-**	**-**

Part 3 – Statement of financial performance

The following is an extract of Entity B's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 2.3: Illustrative statement of financial performance (extract)

	End of January, Year 1	*JE*	End of February, Year 1	*JE*	End of March, Year 1	*JE*	Total
	HK$		HK$		HK$		HK$
Insurance revenue **[Note 1]**	1,000	*4*	**1,200**	*4**	**1,200**	*4**	**3,400**
Insurance service expenses #	(800)		(730)		(690)		(2,220)
Insurance service result	**200**		**470**		**510**		**1,180**
Investment income @	-		-		-		-
Insurance finance income or expenses	-		-		-		-
Net finance result	**-**		**-**		**-**		**-**
Profit or loss	***200***		***470***		***510***		***1,180***

\# *Please refer to the 'Illustrative statement of financial performance' in the base scenario (Scenario 2.1) for the analysis of insurance service expenses.*

@ *For the purpose of this scenario, these numbers are not included because they are accounted for applying another HKFRS.*

Note

1 In this example, the total insurance revenue for the contracts equals the total premium received including the extra premium received on 1 February, Year 1:

	HK$
Premium received at the beginning of the coverage period (see **JE1**)	3,000
Extra premium received on 1 February, Year 1 (see **JE1***)	400
Total insurance revenue	**3,400**

3. Comparison between GMM and PAA

The following table provides a high-level comparison of GMM and PAA, focusing on the recognition and measurement of insurance contract liabilities between the two models based on the scenarios discussed in *Sections 1 and 2* above. The comparison also recaps the main basic requirements of the two models in terms of accounting entries. Time value of money and the effect of financial risks are ignored.

<table>
<tr><th></th><th>GMM</th><th>PAA</th></tr>
<tr><td>Nature of insurance contracts</td><td>Mandatorily applies to all insurance contracts except for the following contracts:
• Contracts eligible for and the entity elects to apply PAA
• Contracts with direct participation features for which VFA shall be applied</td><td>Eligible for specified types of contracts (optional)
• Each contract in the group has a coverage period of one year or less, or
• The entity reasonably expects that PAA would produce a measurement of LRC that does not differ materially from the one applying GMM</td></tr>
<tr><td rowspan="4">LRC – initial recognition</td><td>Separately identify and recognize the four building blocks: (1) expected future cash flows, (2) time value of money and other financial risks, (3) RA, (4) CSM. (1) & (2) constitute BEL.</td><td rowspan="2">No need to separately identify the four building blocks but determine a total amount of the LRC (i.e. premium less acquisition cost) on initial recognition. See the journal entries below.

No CSM.</td></tr>
<tr><td><u>Typical journal entries are set out below:</u>

Dr. LRC – BEL #
Cr. LRC – RA #
Cr. LRC – CSM *

FCF = BEL + RA

* CSM, being the unearned profit and can never be negative, is determined on initial recognition of the group of insurance contracts</td></tr>
<tr><td colspan="2">Recognition of premium received</td></tr>
<tr><td>Dr. Cash
Cr. LRC – BEL</td><td>Dr. Cash
Cr. LRC – Premium
<Increase LRC when the premium is received, not when due or expected></td></tr>
</table>

	GMM	PAA
	Accounting for IACF	
	Dr. IACF asset Cr. Cash *<When IACF is paid prior to the initial recognition of the group of insurance contracts. However, when the IACF asset is incurred but not yet paid, then a liability applying another HKFRS (e.g. HKFRS 9) is recognized.>* Dr. LRC – BEL Cr. LRC – RA Cr. IACF asset * Cr. LRC – CSM ** Allocate IACF asset to the group of insurance contracts by Dr. LRC – CSM, Cr. IACF asset.* IACF paid is **not allowed** to be expensed off in P&L on initial recognition of the group of insurance contracts. See also **Part 4** of Scenario 1.4 for information of alternative possible JEs to account for IACF which include the use of two accounts 'LRC – CSM – IACF' and 'LRC – CSM – Recovery of IACF' to control the amortization of IACF to insurance service expense and related recognition of insurance revenue. When IACF is paid at the beginning of the coverage period (Expected cash outflows already included in BEL): Dr. LRC – BEL – IACF Cr. Cash	Dr. IACF asset Cr. Cash *<When IACF is paid prior to the initial recognition of the group of insurance contracts. However, when the IACF asset is incurred but not yet paid, then a liability applying another HKFRS (e.g. HKFRS 9) is recognized.>* When IACF is paid at the beginning of the coverage period Dr. LRC – IACF Cr. Cash Cr. IACF asset * *<Reduce LRC If the insurer chooses not to expense off the IACF when paid. When IACF is incurred but not yet paid, then a liability applying another HKFRS (e.g. HKFRS 9) is recognized.>* ** Allocate IACF asset to the group of insurance contracts by Dr. LRC, Cr. IACF asset.* Dr. Insurance service expense Cr. Cash *<Debit expense in P&L if the insurer chooses to expense off the IACF when paid. When IACF is incurred but not yet paid, then a liability applying another HKFRS (e.g. HKFRS 9) is recognized.>*
LRC – subsequent measurement	***Insurance revenue recognition***	
	Release of components in LRC to insurance revenue as services are provided during the period: Dr. LRC – RA Cr. Insurance revenue *<Release of risk adjustment for risk expired>*	Release of expected premium as services provided during the period: Dr. LRC – Premium Cr. Insurance revenue ^

	GMM	PAA
	Dr. LRC – BEL Cr. Insurance revenue *<Release of expected claims>* Dr. LRC – CSM * Cr. Insurance revenue *<Release of CSM>* ** CSM is recognized as insurance revenue over the coverage period based on coverage units reflecting the expected quantity of benefits and the expected coverage period of each contract in the group. The amount will change if there are subsequent changes related to the provision of future services.*	*^ Insurance contract revenue is the amount of expected premium receipts allocated to the period (excluding investment components and adjusted to reflect the time value of money and the effect of financial risk, if applicable). The allocation to each period of insurance contract services is based on the passage of time; unless the expected pattern of release of risk during the coverage period differs significantly from the passage of time, in which case, it is recognized based on the expected timing of incurred claims and benefits*.
	Amortization of IACF based on allocation of a portion of premium that relates to the recovery of IACF	***Amortization of IACF over the coverage period if the insurer chooses not to expense off the IACF paid***
	Dr. Insurance service expense Cr. Insurance revenue *<Gross up accounting of ISE and insurance revenue>* See also **Part 4** of Scenario 1.4 for information of alternative possible JEs to account for IACF under HKFRS 17.B125 which include the use of two accounts 'LRC – CSM – IACF' and 'LRC – CSM – Recovery of IACF' to control the amortization of IACF to insurance service expense and related recognition of insurance revenue.	Dr. Insurance service expense @ Cr. LRC – IACF *<Amortization of IACF paid>* *@ It is often considered appropriate to recognize the amortization of IACF by applying the same pattern as that is used for recognizing insurance revenue under HKFRS 17.B126.*
LIC – recognition	***Recording the actual incurred claims and related risk adjustment during the period***	
	Dr. Insurance service expense Cr. LIC – BEL Dr. Insurance service expense Cr. LIC – RA	Dr. Insurance service expense Cr. LIC – BEL Dr. Insurance service expense Cr. LIC – RA

	GMM	PAA
LIC – settlement	***Recording the payment of actual incurred claims and release of related risk adjustment***	
	Dr. LIC – BEL Cr. Cash Dr. LIC – RA Cr. Insurance service expense	Dr. LIC – BEL Cr. Cash Dr. LIC – RA Cr. Insurance service expense

The measurement of LIC is the same under the two models. Readers should bear in mind that IFIE and discount rate which are not discussed here should also be considered in the subsequent measurement of LRC and LIC.

4. Variable Fee Approach (VFA)

An insurer shall apply the Variable Fee Approach (VFA) to account for insurance contracts with direct participation features. Insurance contracts with direct participation features are insurance contracts that are **substantially investment-related service contracts** under which an entity **promises an investment return based on underlying items**. Accordingly, HKFRS 17 defines insurance contract with direct participation features as 'An insurance contract for which, at inception:

(a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;

(b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and

(c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items'.

[HKFRS 17.45, B101, Appendix A]

In other words, insurance contracts that meet all the above three eligibility criteria (see ☼) are mandatorily accounted for using VFA. Reinsurance contracts issued or held cannot be insurance contracts with direct participation features for the purposes of HKFRS 17 [HKFRS 17.B109].

Notes for further insights

☼ The following areas are relevant in the assessment of whether the three criteria are met. Such assessment is only performed at inception at the individual contract level, using entity's expectation at inception of the contract and not reassessed subsequently unless the contract is modified applying HKFRS 17.72 [HKFRS 17.B102].

(i) Criterion (a) [HKFRS 17.B105-B106]

- The effect of law and regulation should be considered. This is because HKFRS 17.2 states that an entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulations, when applying HKFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations and such enforceability is a matter of law. Contractual terms include all terms in a contract, explicit or implied but an entity shall disregard terms that have no commercial substance.

- Underlying items may be a portfolio of assets, net assets of the entity or a subset of assets of the entity.

- It is not necessary for an entity to hold the underlying items nor to be held by the entity, provided that the items are clearly defined in the contracts and how returns are shared between the entity and the policyholder.

- This criterion is not met if the entity can change the underlying items with retrospective effect or no underlying items are identified.

(ii) Criteria (b) and (c) [HKFRS 17.B107-B108]

- The assessment should be based on the present value of probability-weighted average of expected scenarios i.e. quantitative assessment with consideration given to the full range of possible outcomes is required [HKFRS 17.B37-B41].

- The insurance contracts may still satisfy these criteria and qualified for using VFA if the underlying items are not measured on a fair value basis (e.g. amortized cost basis) in an entity's financial statements. The assessment depends on the expectation of payments of a substantial share of the fair value returns to the policyholder rather than the accounting measurement of the underlying items[22].

- HKFRS 17 does not provide any specific quantitative threshold for the term 'substantial' in criteria (b) and (c). However, 'substantial' is considered in the context of the objective of insurance contracts with direct participation features being contracts under which the entity provides investment-related services and is compensated for the services for a fee that is determined by reference to the underlying items [HKFRS 17.B107(a)]. Judgement is required in the determination of 'substantial' based on the guidance given in HKFRS 17.B107(b)(i)&(ii).

(iii) All insurance contracts should be separately analyzed based on the three criteria to identify whether any of them needs to be accounted for using VFA [HKFRS 17.BC249D].

(iv) The following contracts are generally expected to require VFA accounting:
- unit-linked contracts, US variable annuities and certain equity index-linked contracts
- continental European 90/10 contracts
- UK with-profits contracts

The accounting for insurance contracts with **direct participation features** under VFA differs from other participating and non-participating contracts for which GMM should instead be applied (see ☼). The VFA modifies the measurement of CSM under the GMM to accommodate the direct participation features of VFA contracts so that the accounting reflects the issuer's obligation to pay the policyholder an amount equal to the fair value of the underlying items, minus a variable fee for services provided by the insurance contract over time [HKFRS 17.B104(a)&(b), BC238-BC249]. This is further illustrated in the journal entries to be discussed later in this section.

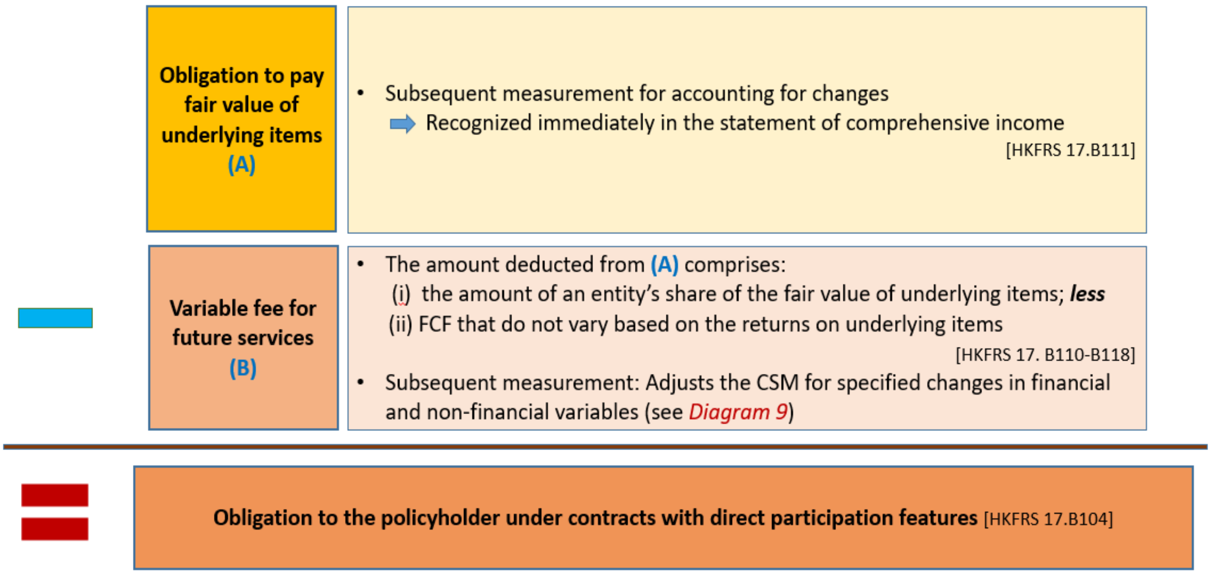
Notes for further insights

☼ Investment contracts with discretionary participating features (DPFs) are investment contracts which do not transfer significant insurance risk and hence they are not insurance contracts. However, they are within the scope of HKFRS 17 if the entity also issues insurance contracts [HKFRS 17.71, BC86, Appendix A].

The definitions of insurance contracts with direct participation features and investment contracts with DPFs have similarities in that both types of contracts participate in a pool of underlying items. When the investment contracts with DPFs are assessed as being within the scope of HKFRS 17, these contracts are measured applying VFA if all three criteria under HKFRS 17.B101 are met. Accordingly, entities should assess the contractual features including those for the investment contracts with DPFs to determine the appropriate accounting model.

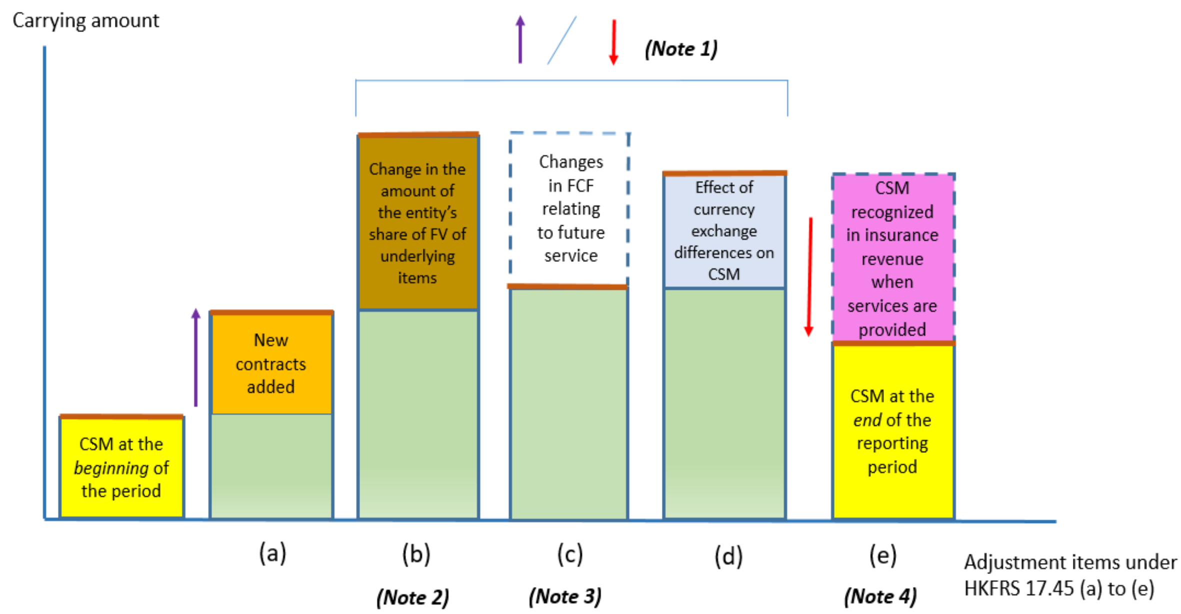
[22] In February 2018 TRG meeting, the TRG members agreed with IASB staff's view that entities' expectation of returns would be assessed over the duration of the contracts and therefore returns measured based on amortized cost might equal returns measured based on the fair value of the underlying items over that duration. Accordingly, the VFA criteria could still be met when the return is measured at amortized cost of the underlying items. See TRG meeting February 2018, Agenda paper no.7, Log#S26.

Diagram 8 Variable Fee Approach – obligation to the policyholder under insurance contracts with direct participation features [HKFRS 17.B104, B110-B118, BC243]



On initial recognition, the accounting for insurance contracts with direct participation features is the same as in GMM for contracts without direct participation features. The differences between GMM and VFA arise from the treatment of CSM which is mostly driven by movements in the fair value of underlying items (see note 2 to *Diagram 9*) subsequently.

Diagram 9 Subsequent measurement of CSM of a group of insurance contracts under VFA



Notes:

1 These adjustment items may lead to increase or decrease in CSM in practice. In this diagram, we hypothetically assume that item (b) and (d) increase CSM whereas item (c) decreases CSM.

2 The adjustment should be made, except to the extent that
(i) HKFRS 17.B115 (on risk mitigation) applies;

(ii) the decrease in the amount of the entity's share of the fair value of the underlying items exceeds the carrying amount of CSM, giving rise to a loss (see HKFRS 17.48); or
(iii) the increase in the amount of the entity's share of the fair value of the underlying items reverses the amount in (ii).

3 The adjustment should be made, except to the extent that
(i) HKFRS 17.B115 (on risk mitigation) applies;
(ii) such increases in FCF exceed the carrying amount of CSM, giving rise to a loss (see HKFRS 17.48); or
(iii) such decreases in FCF are allocated to the loss component of LRC applying HKFRS 17.50(b).

4 The amount of insurance revenue is determined by the allocation of CSM remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period, applying HKFRS 17.B119.

The following scenarios illustrates the journal entries of groups of insurance contracts with direct participation features and hence accounted for under VFA:

- Scenario 4.1: Base scenario
- Scenario 4.2: Change in market interest rate

Scenario 4.1: Base scenario – accounting on initial recognition and subsequent periods

Entity C issues a group of insurance contracts with the following simplified fact pattern and assumptions. The contracts issued are assessed to have met the criteria for insurance contracts with direct participation features applying HKFRS 17.B101.

Fact pattern and assumptions	
Reporting environment	• HKFRS
Insurance coverage	Policyholders will receive either: • HK$1,600, or the account balance if it is higher, if the insured person dies during the coverage period; or • The value of the account balance at the end of the coverage period if the insured person survives until the end of the coverage period (see 'Expected cash outflows' below for the determination of the account balance) For simplicity, no insured person actually dies during the coverage period, which is the same as the insurer's expectation during the period. It is assumed that the account balance represents the NDIC which is repayable to policyholders in all circumstances. The policyholders have the option to surrender, with the surrender value equals the account balance less the surrender charge. The surrender change in this example is assumed to be nil for simplicity.
Coverage period	• Six years • Starts when the insurance contracts are issued • No lapse of contracts during the period
Expected cash flows	1. Expected cash inflows • Premium of HK$1,000 received at inception of the insurance contracts 2. Expected cash outflows • The contract promises the policyholder a return equivalent to an investment in a debt instrument (see 'Underlying items' below for details of the investments) • The amount payable to policyholders on maturity is determined by the fair value of equivalent investments (see 'Underlying items' below for details of the investments) at the end of the sixth year after deducting 5% of those fair values as a service fee for the entity

Fact pattern and assumptions	
Underlying items	• Entity C invests premium received in bond investments on which the promise to the policyholder is based. That means, the underlying items are held by Entity C as assets. The fair value of the bond investments at inception is HK$1,000 • Debt instrument is accounted for by applying HKFRS 9 at fair value through profit or loss and the related fair value change is recognized in P&L • Dispose of the bond investments at end of the sixth year
Bonds	• Market interest rate[23] = 8% at inception • Duration = 6 years, i.e. having the same duration with that of Entity C's insurance contracts with direct participation features in this base scenario • At maturity at the end of Year 6: <u>Proceed of the bonds at the end of Year 6</u> = HK$1,000 X 1.08^6 = HK$1,586.87 <u>Payment to policyholders</u> = HK$1,586.87 X 95% = HK$1,507.53 <u>Amount retained by Entity C</u> = HK$1,586.87 X 5% = HK$79.34
Risk adjustment for non-financial risk, IACF and other expenses	Ignored for simplicity[24]
Service provision	Insurance coverage and investment-related services are evenly provided throughout the coverage period[25].
Market interest rate	8% throughout the coverage period

[23] The debt instrument is similar to a zero coupon bond with an effective interest rate of 8% which is the same as the market interest rate at the date of inception of the insurance contracts. The coupon and principal of the Bonds are paid at the end of the sixth year.

[24] These elements are ignored in the illustration of this highly simplified VFA example. Readers should be aware of the existence of these elements in accounting for VFA contracts and account for them appropriately based on the relevant requirements of HKFRS 17.

[25] In this simplified example, we assume that the services are provided evenly throughout the coverage period. Readers should note that the release of CSM to insurance revenue should be based on coverage units determined under relevant requirements of HKFRS 17. Refer to **note (f)** and ***'Notes for further insights'*** under Scenario 1.1 – **JE5** for more discussions.

(a) Initial recognition

JE1 – Recognition of the group of insurance contracts and the premium received [HKFRS 17.32 & 38][26]

				HK$	HK$
DR		Cash		1,000	
	CR	LRC – BEL	*(a)*		950
	CR	LRC – CSM	*(a), (b)*		50

(a) The amount of LRC – BEL and LRC – CSM on initial recognition is determined as follows:

	Account item	HK$
Inflow of premium received at inception which are used to invest in bonds	***Cash***	1,000
Less: Outflows of the amount to be paid to policyholder discounted at present value HK$1,507.53 / (1 + 8%)[6]	***LRC – BEL***	950
Net unearned profit at present value, i.e. HK$79.34 / (1 + 8%)[6]	***LRC – CSM***	**50**

(b) Same as GMM, on initial recognition, Entity C measures CSM of a group of insurance contracts at an amount that results in no income or expenses.

There is no risk adjustment in this scenario.

JE2 – Purchase of bonds

				HK$	HK$
DR		Investment in bonds	*(c)*	1,000	
	CR	Cash	*(c)*		1,000

(c) Entity C accounts for the purchase of bonds using the premium received from the policyholder.

(b) Subsequent measurement – End of each reporting period from Year 1 to Year 6

JE3 – Recognition of change in fair value in the bond investments under HKFRS 9

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
DR Bond investments	*(d)*	80	86	93	101	109	118
CR Fair value gains	*(d)*	80	86	93	101	109	118

(d) Entity C accounts for the fair value change in the bond investments (represented by accrual of bond in interest). See the table below for the interest income calculation.

[26] The initial recognition of VFA contracts is the same as GMM. As shown in **JE1** and **JE2** of Scenario 1.1, the initial recognition of the VFA contract and premium received for this example can be split into two JEs as follows, i.e. DR. LRC – BEL HK$50, CR CSM HK$50; DR. Cash HK$1,000, CR. LRC – BEL HK$1,000.

	Inception	End of					
	Inception	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
Discount rate	8%	8%	8%	8%	8%	8%	8%
Fair value of the bonds at end of reporting period	HK$1,000	1,080	1,166	1,259	1,360	1,469	1,587
Change in fair value of underlying items (JE3)		**80**	**86**	**93**	**101**	**109**	**118**

JE4 – Recognition of changes in FCF (LRC – BEL) [HKFRS 17.B104(a), B111]

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
DR IFIE	*(e)*	80	86	93	101	109	118
CR LRC – BEL	*(e)*	80	86	93	101	109	118

(e) Entity C applies HKFRS 17.B104(a) to adjust the change in FCF (LRC – BEL, no RA in this example) in order to reflect the change in the obligation to pay an amount equal to the fair value of underlying items (i.e. bond investments in this scenario). Refer to ***(A)*** *of Diagram 8*. (See ☼ also). HKFRS 17.B111 states that changes in the obligation to pay the policyholder an amount equal to the fair value of the underlying items (HKFRS 17.B104(a)) do not relate to future service and do not adjust CSM.

Notes for further insights

☼ The numbers in **JE3** and **JE4** are the same, but they are opposites. **JE3** recognizes increase in fair value of bond investments (assets) with corresponding credit to fair value gains whereas **JE4** recognizes the same amount as expenses and increases LRC – BEL (liability). Accordingly, there is no change in net profit and net assets after putting through **JE3** and **JE4**. It is considered that the benefit of VFA is to eliminate accounting mismatch and reflects the substance of a direct participation feature.

JE5 – Recognition of variable fee for future services adjusting CSM [HKFRS 17.45(b)&(c), B104(b), B112-B113]

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
DR LRC – BEL	*(f)*	4.0	4.3	4.7	5.0	5.4	5.9
CR LRC – CSM	*(g)*	4.0	4.3	4.7	5.0	5.4	5.9

(f) Applying HKFRS 17.45(b) & (c) and B104(b), Entity C deducts a variable fee from LRC – BEL in exchange for future services to be provided under the insurance contracts and adjusts CSM. Refer to ***(B)*** *of Diagram 8*. In this example, the variable fee is calculated as **5% of the numbers in the table of JE4**.

(g) See **JE6** for the table of the movements of CSM over the coverage period.

JE6 – Recognition of insurance revenue [HKFRS 17.45(e), B119]

		Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
DR LRC – CSM	*(h)*	9.0	9.9	11.0	12.7	15.4	21.3
CR Insurance revenue	*(h)*	9.0	9.9	11.0	12.7	15.4	21.3

(h) An entity applies HKFRS 17.45(e) and B119 to recognize insurance revenue which is determined by allocating CSM at the end of reporting period to reflect the insurance contract services provided in the period[27].

The table below shows the movements of CSM over the coverage period. For insurance contracts with direct participation features, CSM is adjusted to reflect the variable nature of the fee. Hence, changes in the amounts set out in HKFRS 17.B104 are treated as set out in HKFRS 17.B111-B114 [HKFRS 17.B110].

Refer to ***(B)*** *of Diagram 8* and *Diagram 9* for the adjustments that give rise to changes in CSM during the period. An entity is not required to identify adjustments to CSM required by HKFRS 17.B112 and B113 separately. Instead, a combined amount may be determined for some or all of the adjustments [HKFRS 17.45, B114].

		End of					
	Inception (JE1)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	HK$	HK$	HK$	HK$	HK$	HK$	HK$
Opening balance **(A)**	50.0	50.0	45.0	39.4	33.1	25.4	15.4
Variable fee for service **(B)** (JE5)	-	4.0	4.3	4.7	5.0	5.4	5.9
CSM release to insurance revenue^^ (JE6)		**(9.0)**	**(9.9)**	**(11.0)**	**(12.7)**	**(15.4)**	**(21.3)**
Closing balance	50.0	45.0	39.4	33.1	25.4	15.4	-

^^ See the calculation in the following table.

Under both GMM and VFA, the release of CSM is reflected in insurance revenue based on coverage units. In this example, we assume that the insurance contract services are provided evenly over the coverage period and there is no discounting applied to coverage units for simplicity. The following table shows the calculation of release of CSM to insurance revenue from Year 1 to Year 6:

		For the year					
	Total for 6 years	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	HK$	HK$	HK$	HK$	HK$	HK$	HK$
(A) + **(B)** = **(C)** **		54.0	49.3	44.1	38.1	30.8	21.3
Number of years for recognizing insurance revenue **(D)**		6	5	4	3	2	1
CSM release to insurance revenue for the period (C) ÷ (D)	**79.3**#	**9.0**	**9.9**	**11.0**	**12.7**	**15.4**	**21.3**

** **(A)** and **(B)** refer to the numbers in the immediate preceding table.

Check point: The present value of HK$79.3 on day 1 = HK$79.3 / 1.08^6 = HK$50 (same as the amount recognized on inception given there is no change in interest rate).

[27] In this simplified example, if there is an expectation of deaths and actual deaths occur, then there would be journal entries to account for the release of the amount relating to expected death benefits for the period to insurance revenue, i.e. DR. LRC – BEL, CR. Insurance revenue (for the amount of expected claims excluding NDIC); and to recognize the incurrence of death benefits, i.e. DR. Insurance service expense, CR. LIC – BEL (for the actual incurred claims excluding NDIC).

(c) Subsequent measurement – End of Year 6

JE7 – Disposal of bond investments and repayment to the policyholders in Year 6						
					HK$	HK$
DR		Cash		*(i)*	1,587	
	CR		Bond investments	*(i)*		1,587
DR		LRC – BEL		*(j)*	1,508	
	CR		LIC – BEL	*(k)*		1,508
DR		LIC – BEL		*(k)*	1,508	
	CR		Cash	*(k)*		1,508

(i) See the table in **JE3(d)** for the fair value of the bond investment at the end of Year 6.

(j) The amount is calculated as **HK$950 (JE1(a)) X 1.08^6 = HK$1,508,** as it is assumed that the account balance represents the NDIC which is repayable to the policyholders in all circumstances.

(k) The amount of cash for repayment to the policyholders
= fair value of the investment minus 5% of those fair value
= HK$1,587 X (1-5%)
= **HK$1,508**

Part 2 **–** Movements in insurance contract liabilities and related investments

This table demonstrates how the accounting entries in ***Part 1*** affect the changes of Entity C's insurance contract liabilities and the carrying amount of the related bond investments (assets).

Scenario 4.1: Insurance contract liabilities and bond investments

	LRC – liability side *(Dr) / Cr*					**LIC – liability side** *(Dr) / Cr*	**Bond investments – asset side** *Dr / (Cr)*	
	BEL	***JE***	**CSM**	***JE***	**Total LRC**	***JE***		***JE***
	(a)		*(b)*		***(c) = (a) + (b)***		*(d)*	
	HK$		HK$		**HK$**	**HK$**	HK$	
Beginning of Year 1	**-**		**-**		**-**		**-**	
New contracts recognized and premium received	950	*1*	50	*1*	**1,000**	-	1,000	*2*
Fair value adjustment	-		-		**-**	-	80	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	80	*4*	-		**80**	-	-	
Recognition of variable fee for future services	(4.0)	*5*	4.0	*5*	**-**	-	-	
Release of CSM to insurance revenue when services provided	-		(9.0)	*6*	**(9.0)**	-	-	
End of Year 1	***1,026***		***45.0***		***1,071***	**-**	***1,080***	
Fair value adjustment	-		-		**-**	-	86	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	86	*4*	-		**86**	-	-	
Recognition of variable fee for future services	(4.3)	*5*	4.3	*5*	**-**	-	-	
Release of CSM to insurance revenue when services provided	-		(9.9)	*6*	**(9.9)**	-	-	
End of Year 2	***1,107.7***		***39.4***		***1,147.1***	**-**	***1,166***	
Fair value adjustment	-		-		**-**	-	93	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	93	*4*	-		**93**	-	-	
Recognition of variable fee for future services	(4.7)	*5*	4.7	*5*	**-**	-	-	
Release of CSM to insurance revenue when services provided	-		(11.0)	*6*	**(11.0)**	-	--	
End of Year 3	***1,196***		***33.1***		***1,229.1***	**-**	***1,259***	
Fair value adjustment	-		-		**-**	-	101	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	101	*4*	-		**101**	-	-	
Recognition of variable fee for future services	(5.0)	*5*	5.0	*5*	**-**	-	-	
Release of CSM to insurance revenue when services provided	-		(12.7)	*6*	**(12.7)**	-	-	
End of Year 4	***1,292***		***25.4***		***1,317.4***	**-**	***1,360***	
Fair value adjustment	-		-		**-**	-	109	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	109	*4*	-		**109**	-	-	
Recognition of variable fee for future services	(5.4)	*5*	5.4	*5*	**-**	-	-	

Scenario 4.1: Insurance contract liabilities and bond investments

	LRC – liability side *(Dr) / Cr*					LIC – liability side *(Dr) / Cr*		Bond investments – asset side *Dr / (Cr)*	
	BEL	***JE***	**CSM**	***JE***	**Total LRC**		***JE***		***JE***
	(a)		*(b)*		***(c) = (a) + (b)***			*(d)*	
	HK$		HK$		**HK$**	**HK$**		HK$	
Release of CSM to insurance revenue when services provided	-		(15.4)	*6*	**(15.4)**	-		-	
End of Year 5	***1,395.6***		***15.4***		***1,411***	**-**		***1,469***	
Fair value adjustment	-		-		**-**	-		118	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	118	*4*	-		**118**	-		-	
Recognition of variable fee for future services	(5.9)	*5*	5.9	*5*	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(21.3)	*6*	**(21.3)**	-		-	
Recognition of LIC for NDIC	(1,507.7)	*7*	-		**(1,507.7)**	1,507.7	*7*	**-**	
Disposal of bond investments and repayment to policyholders	-		-		**-**	(1,507.7)	*7*	(1,587)	*7*
End of Year 6	**-**		**-**		**-**	**-**		**-**	

Part 3 – Statement of financial performance

The following is an extract of Entity C's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 4.1: Illustrative statement of financial performance (extract)

	Year 1	*JE*	Year 2	*JE*	Year 3	*JE*	Year 4	*JE*	Year 5	*JE*	Year 6	*JE*	Total
	HK$		HK$		HK$		HK$		HK$		HK$		HK$
Insurance revenue	9.0	*6*	9.9	*6*	11.0	*6*	12.7	*6*	15.4	*6*	21.3	*6*	79.3
Insurance service expenses	-		-		-		-		-		-		-
Insurance service result	**9.0**		**9.9**		**11.0**		**12.7**		**15.4**		**21.3**		**79.3**
Investment gains and losses **[Note 1]**	80	*3*	86	*3*	93	*3*	101	*3*	109	*3*	118	*3*	587
Insurance finance income or expenses **[Note 2]**	(80)	*4*	(86)	*4*	(93)	*4*	(101)	*4*	(109)	*4*	(118)	*4*	(587)
Net finance result	**-**		**-**		**-**		**-**		**-**		**-**		**-**
Profit or loss	***9.0***		***9.9***		***11.0***		***12.7***		***15.4***		***21.3***		***79.3***

Notes

1 Investment gains and losses relating to the assets (i.e. bond investments) held by Entity C is accounted for applying a different HKFRS (i.e. HKFRS 9).

2 Applying HKFRS 17.B111, changes in the obligation to pay the policyholder an amount equal to the fair value of underlying items do not relate to future service and do not adjust CSM. Applying HKFRS 17.87, Entity C recognizes those changes as IFIE.

Scenario 4.2: Change in market interest rate

Except for the following, Scenario 4.2 uses the same fact pattern and assumptions as those in the base scenario.

Fact pattern and assumptions	
Bonds	• Market interest rate at inception = 7% • Market interest rate at the end of Year 2 = 5% • At maturity at the end of Year 6: Proceeds of the bonds at the end of Year 6[28] = HK$1,000 X 1.07^6 = HK$1,500.73 Payment to policyholders = HK$1,500.73 X 95% = HK$1,425.69 Amount retained by Entity C = HK$1,500.73 X 5% = HK$75.04

Part 1 – illustration of the journal entries with narrative explanation

(a) Initial recognition

The same set of the journal entries is posted as in **JE1** of the base scenario, i.e. same amount of premium (HK$1,000) is received and Entity C retains 5% of fair value of bond investments as unearned service fee.

JE1 – Recognition of the group of insurance contracts and the premium received [HKFRS 17.32 and 38][29]

				HK$	HK$
DR		Cash		1,000	
	CR	LRC – BEL	*(a)*		950
	CR	LRC – CSM	*(a)*		50

(a) Although the same amount of LRC – BEL and LRC – CSM is determined as in the base scenario on initial recognition, they are calculated differently as follows:

	Account item	HK$
Inflow of premium received at inception which are directly used to invest in bonds	***Cash***	1,000
Less: Outflows of the amount to be paid to policyholder discounted at present value HK$1,425.69 / $(1 + 7\%)^6$	***LRC – BEL***	950
Net unearned profit at present value, i.e. HK$75.04 / $(1 + 7\%)^6$	***LRC – CSM***	**50**

[28] The debt instrument is similar to a zero coupon bond with an effective interest rate of 7% which is the same as the market interest rate at the date of inception of the insurance contracts. The coupon and principal of the Bonds are paid at the end of the sixth year.

[29] As mentioned in Scenario 4.1 for VFA contracts, the initial recognition of the VFA contract and premium received for this example can be split into two JEs as follows, i.e. DR. LRC – BEL HK$50, CR. CSM HK$50; DR. Cash HK$1,000, CR. LRC – BEL HK$1,000.

JE2 – Purchase of bonds				
			HK$	HK$
DR	Investment in bonds	*(b)*	1,000	
CR	Cash	*(b)*		1,000

(b) The same set of the journal entries as in the base scenario is recorded.

(b) Subsequent measurement – End of each reporting period from Year 1 to Year 6

JE3 – Recognition of change in fair value in the bond investments under HKFRS 9								
			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
			HK$	HK$	HK$	HK$	HK$	HK$
DR	Bond investments	*(c)*	70	**165**	62	65	68	71
CR	Fair value gains	*(c)*	70	**165**	62	65	68	71

(c) Entity C records the increase in fair value in the bond investments. See the table below for the calculation of the change in fair value of the bond investments reflecting the decrease in the market interest rate from 7% to 5% at the end of Year 2.

		End of					
	Inception	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
Discount rate	7%	7%	**5%**	5%	5%	5%	5%
Fair value of the bonds at end of reporting period (see the table below)	HK$1,000	1,070	**1,235**	1,297	1,362	1,430	1,501
Change in fair value of underlying items (JE3)		**70**	**165**	**62**	**65**	**68**	**71**

		End of					
	Inception	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
		HK$	HK$	HK$	HK$	HK$	HK$
Calculation formula	N/A	1,000 X 1.07	1,297 ÷ 1.05	1,362 ÷ 1.05	1,430 ÷ 1.05	1,501 ÷ 1.05	1,000 X 1.07^6
Fair value of the bonds at the end of reporting period		**1,070**	**1,235**	**1,297**	**1,362**	**1,430**	**1,501**#

\# The maturity value of the bond investments (i.e. HK$1,501) and related payment to the policyholders (i.e. HK$1,426) at the end of the insurance contracts remain unchanged as a fixed coupon is paid at the end of the sixth year.

JE4 – Recognition of changes in FCF (LRC – BEL) [HKFRS 17.B104(a), B111]								
			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
			HK$	HK$	HK$	HK$	HK$	HK$
DR	IFIE	*(d)*	70	**165**	62	65	68	71
CR	LRC – BEL	*(d)*	70	**165**	62	65	68	71

(d) As in the base scenario, Entity C adjusts the change in FCF (i.e. LRC – BEL, no RA in this example) to reflect the change in its obligation to pay an amount equal to the fair value of the underlying items and hence the numbers in the entries are the same as those in **JE3** but in opposite directions *(i.e. Fair value gains* versus *IFIE; Bond investments* versus *LRC – BEL)* resulting in no net profit nor net asset effect to Entity C.

JE5 – Recognition of variable fee for future services adjusting CSM [HKFRS 17.45(b)&(c), B104(b), B112-B113]								
			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
			HK$	HK$	HK$	HK$	HK$	HK$
DR	LRC – BEL	*(e)*	3.5	8.2	3.1	3.2	3.4	3.6
CR	LRC – CSM	*(f)*	3.5	8.2	3.1	3.2	3.4	3.6

(e) Entity C deducts a variable fee from LRC – BEL in exchange for future services as set out in insurance contracts thereby adjusting CSM. In this example, the variable fee is calculated as **5% of the numbers in the table of JE4**.

(f) See **JE6** for the table of movements of CSM over the coverage period.

JE6 – Recognition of insurance revenue [HKFRS 17.45(e), B119]								
			Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
			HK$	HK$	HK$	HK$	HK$	HK$
DR	LRC – CSM	*(g)*	8.9	10.6	11.3	12.4	14.1	17.7
CR	Insurance revenue	*(g)*	8.9	10.6	11.3	12.4	14.1	17.7

(g) As with the base scenario, CSM is released to insurance revenue when insurance contract services are provided evenly over the coverage period applying HKFRS 17.45(e) and B119[30].

The table below shows the movements of CSM over the coverage period, which arise from change in variable fee for future services.

		End of					
	Inception (**JE1**)	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	HK$	HK$	HK$	HK$	HK$	HK$	HK$
Opening balance **(A)**	50.0	50.0	44.6	42.2	34.0	24.8	14.1
Variable fee for service **(B)** (**JE5**)	-	3.5	8.2	3.1	3.2	3.4	3.6

[30] In this simplified example, if there is an expectation of deaths and actual deaths occur, then there would be journal entries to account for the release of the amount relating to expected death benefits for the period to insurance revenue, i.e. DR. LRC – BEL, CR. Insurance revenue (for the amount of expected claims excluding NDIC); and to recognize the incurrence of death benefits, i.e. DR. Insurance service expense, CR. LIC – BEL (for the actual incurred claims excluding NDIC).

CSM release to insurance revenue^^ (JE6)	**-**	**(8.9)**	**(10.6)**	**(11.3)**	**(12.4)**	**(14.1)**	**(17.7)**
Closing balance	50.0	44.6	42.2	34.0	24.8	14.1	-

^^ See the calculation in the following table.

Under both GMM and VFA, the release of CSM is reflected in insurance revenue based on coverage units. In this example, we assume the insurance contract services are provided evenly over the coverage period and there is no discounting applied to coverage units for simplicity. The following table shows the calculation of release of CSM to insurance revenue from Year 1 to Year 6:

		For the year					
	Total for 6 years	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
	HK$	HK$	HK$	HK$	HK$	HK$	HK$
(A) + (B) = (C) **		53.5	52.8	45.3	37.2	28.2	17.7
Number of years for recognizing insurance revenue (D)		6	5	4	3	2	1
CSM release to insurance revenue for the period (C) ÷ (D)	**75.0#**	**8.9**	**10.6**	**11.3**	**12.4**	**14.1**	**17.7**

** **(A)** and **(B)** refer to the numbers in the immediate preceding table.

Check point: Present value of HK$75.0 on day 1 = HK$75.0 / 1.07^6 = HK$50 (same as the amount recognized on inception).

(c) Subsequent measurement – End of Year 6

JE7 – Disposal of bond investments and repayment to the policyholders in Year 6

				HK$	HK$
DR		Cash	*(h)*	1,501	
	CR	Bond investments	*(h)*		1,501
DR		LRC – BEL	*(i)*	1,426	
	CR	LIC – BEL	*(j)*		1,426
DR		LIC – BEL	*(j)*	1,426	
	CR	Cash	*(j)*		1,426

(h) See the table in **JE3** for the fair value of the bond investments at the end of Year 6.

(i) The amount is calculated as **HK$950 (JE1(a)) X 1.07^6 = HK$1,426**, as it is assumed that the account balance represents the NDIC which is repayable to the policyholders in all circumstances.

(j) The amount of cash for repayment to the policyholders
= fair value of the investment minus 5% of those fair value
= HK$1,501 X (1-5%)
= **HK$1,426**

Part 2 – Movements in insurance contract liability and related investments

This table demonstrates how the accounting entries in ***Part 1*** affect the changes of Entity C's insurance contract liabilities and the carrying amount of the related bond investments (assets).

Scenario 4.2: Change in market interest rate

	LRC – liability side (Dr) / Cr					LIC – liability side (Dr) / Cr		Bond investments – asset side Dr / (Cr)	
	BEL	*JE*	**CSM**	*JE*	**Total LRC**		*JE*		*JE*
	(a)		*(b)*		***(c) = (a) + (b)***			*(d)*	
	HK$		HK$		**HK$**	**HK$**		HK$	
Beginning of Year 1	**-**		**-**		**-**	**-**		**-**	
New contracts recognized and premium received	950	*1*	50	*1*	**1,000**	-		1,000	*2*
Fair value adjustment	-		-		**-**	-		70	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	70	*4*	-		**70**	-		-	
Recognition of variable fee for future services	(3.5)	*5*	3.5	*5*	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(8.9)	*6*	**(8.9)**	-		-	
End of Year 1	***1,016.5***		***44.6***		***1,061.1***	**-**		***1,070***	
Fair value adjustment	-		-		**-**	-		165	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	165	*4*	-		**165**	-		-	
Recognition of variable fee for future services	(8.2)	*5*	8.2	*5*	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(10.6)	*6*	**(10.6)**	-		-	
End of Year 2	***1,173.3***		***42.2***		***1,215.5***	**-**		***1,235***	
Fair value adjustment	-		-		**-**	-		62	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	62	*4*	-		**62**	-		-	
Recognition of variable fee for future services	(3.1)	*5*	3.1	*5*	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(11.3)	*6*	**(11.3)**	-		-	
End of Year 3	***1,232.2***		***34.0***		***1,266.2***	**-**		***1,297***	
Fair value adjustment	-		-		**-**	-		65	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	65	*4*	-		**65**	-		-	
Recognition of variable fee for future services	(3.2)	*5*	3.2	*5*	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(12.4)	*6*	**(12.4)**				
End of Year 4	***1,294***		***24.8***		***1,318.8***	**-**		***1,362***	
Fair value adjustment	-		-		**-**	-		68	*3*
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	68	*4*	-		**68**	-		-	
Recognition of variable fee for future services	(3.4)	*5*	3.4	*5*	**-**	-		-	

Scenario 4.2: Change in market interest rate

	LRC – liability side *(Dr) / Cr*					LIC – liability side *(Dr) / Cr*		Bond investments – asset side *Dr / (Cr)*	
	BEL	***JE***	**CSM**	***JE***	**Total LRC**		***JE***		***JE***
	(a)		*(b)*		***(c) = (a) + (b)***			*(d)*	
	HK$		HK$		**HK$**	**HK$**		HK$	
Release of CSM to insurance revenue when services provided	-		(14.1)	***6***	**(14.1)**	-		-	
End of Year 5	***1,358.6***		***14.1***		***1,372.7***			***1,430***	
Fair value adjustment	-		-		**-**			71	***3***
Changes in FCF to reflect change in Entity C's obligation due to change in fair value of underlying items	71	***4***	-		**71**	-		-	
Recognition of variable fee for future services	(3.6)	***5***	3.6	***5***	**-**	-		-	
Release of CSM to insurance revenue when services provided	-		(17.7)	***6***	**(17.7)**	-		-	
Recognition of LIC for NDIC	(1,426)	***7***	-		**(1,426)**	1,426	***7***	-	
Disposal of bond investments and repayment to policyholders	-		-		**-**	(1,426)	***7***	(1,501)	***7***
End of Year 6	**-**		**-**		**-**	**-**		**-**	

Part 3 – Statement of financial performance

The following is an extract of Entity C's statement of financial performance as a result of the accounting entries made in ***Part 1***.

Scenario 4.2: Illustrative statement of financial performance (extract)

	Year 1	*JE*	Year 2	*JE*	Year 3	*JE*	Year 4	*JE*	Year 5	*JE*	Year 6	*JE*	Total
	HK$		HK$		HK$		HK$		HK$		HK$		HK$
Insurance revenue	8.9	*6*	10.6	*6*	11.3	*6*	12.4	*6*	14.1	*6*	17.7	*6*	75
Insurance service expenses	-		-		-		-		-		-		-
Insurance service result	**8.9**		**10.6**		**11.3**		**12.4**		**14.1**		**17.7**		**75**
Investment gains and losses **[Note 1]**	70	*3*	165	*3*	62	*3*	65	*3*	68	*3*	71	*3*	501
Insurance finance income or expenses **[Note 2]**	(70)	*4*	(165)	*4*	(62)	*4*	(65)	*4*	(68)	*4*	(71)	*4*	(501)
Net finance result	**-**		**-**		**-**		**-**		**-**		**-**		**-**
Profit or loss	***8.9***		***10.6***		***11.3***		***12.4***		***14.1***		***17.7***		***75***

Notes

1 Investment gains and losses relating to the assets (i.e. bond investments) held by Entity C is accounted for applying a different HKFRS (i.e. HKFRS 9).

2 Applying HKFRS 17.B111, changes in the obligation to pay the policyholder an amount equal to the fair value of underlying items do not relate to future service and do not adjust CSM. Applying HKFRS 17.87, Entity C recognizes those changes as IFIE.

5. Comparison between GMM and VFA

The following table provides a high-level comparison of GMM and VFA[31], focusing on recognition and measurement of LRC between the two models. The measurement of LIC is the same under both approaches and so no comparison is provided.

<table>
<tr><th></th><th>GMM</th><th>VFA</th></tr>
<tr><td>Nature of insurance contracts</td><td>Mandatorily applies to all insurance contracts except for the following contracts:
• Contracts eligible for and the entity elects to apply PAA
• Contracts with direct participation features for which VFA shall be applied</td><td>Contracts with direct participation features, including investment contracts with discretionary participation features in the scope of HKFRS 17 that meet the three criteria under HKFRS 17.B101</td></tr>
<tr><td rowspan="2">LRC – initial recognition</td><td colspan="2">Separately identify and recognize the four building blocks:
• (1) expected future cash flows, (2) time value of money and other financial risks, (3) RA, (4) CSM. (1) & (2) constitute BEL.
• Recognition of premium received</td></tr>
<tr><td>Dr. LRC – BEL
Cr. LRC – RA
Cr. LRC – CSM

Dr. Cash
Cr. LRC – BEL</td><td>Accounting is the same as GMM.

At inception, CSM is the same as under GMM.</td></tr>
<tr><td rowspan="2">LRC – subsequent measurement</td><td colspan="2">Insurance revenue recognition</td></tr>
<tr><td>Release of components in LRC to insurance revenue as services are provided during the period [Note 1]

Dr. LRC – RA
Cr. Insurance revenue
<Release of risk adjustment for risk expired>

Dr. LRC – BEL
Cr. Insurance revenue
<Release of expected claims>

Dr. LRC – CSM
Cr. Insurance revenue
<Release of CSM based on coverage units in the period></td><td>Dr. LRC – RA
Cr. Insurance revenue
<Release of risk adjustment for risk expired>

Dr. LRC – BEL
Cr. Insurance revenue
<Release of expected claims>

Recognition of changes in FCF

Dr. IFIE
Cr. LRC – BEL
<Adjust changes in FCF to reflect the change in the insurer's obligation to pay an amount equal to the fair value of the underlying items>

Dr. LRC – BEL
Cr. LRC – CSM [Note 2]
<Recognition of a variable fee for future services, changes go to CSM>

Dr. LRC – CSM [Notes 2, 3]
Cr. Insurance revenue
<Release of CSM based on coverage units in the period></td></tr>
</table>

[31] The comparison is only based on Scenario 1.1 for GMM and Scenario 4.1 for VFA.

	GMM	VFA
	Disposal of investments and repayments to policyholders where applicable	
	N/A **[Note 4]**	Dr. Cash Cr. Investments **[Note 5]** *<Disposal of the relevant investments>* Dr. LRC – BEL Cr. LIC – BEL *<Recognize the amount to be repaid to the policyholder>* **[Note 6]** Dr. LIC – BEL Cr. Cash *<Repayments to policyholders>*

Notes

1 As discussed in 'Notes for further insights' under **JE7** of Scenario 1.1, after initial recognition, there would be an interest accretion for BEL and CSM to reflect the time value of money and other financial risks. For the RA, the related interest accretion will be presented as IFIE (i.e. Dr. IFIE, Cr. LRC – RA) if the technique to measure it uses the time value of money[32]. The resulting BEL, RA and CSM released to insurance revenue when services are provided would be after having accounted for the accreted interests.

2 At subsequent measurement, CSM measurement under VFA differs from GMM. Please refer to *Diagram 9* and HKFRS 17.45 for guidance.

3 Under both GMM and VFA, the release of CSM is reflected in insurance revenue based on coverage units. Refer to **note (f)** and ***'Notes for further insights'*** under Scenario 1.1 – **JE5** for more discussions. However, a significant portion of CSM under VFA originates from an entity's share of the fair value of the underlying items.

4 This table illustrates that there are disposals of investments and repayments to policyholders under VFA contracts but that does not mean that there are no investments for non-VFA contracts. Generally, there would also be supporting assets for non-VFA contracts. If so, these journal entries (i.e. Dr. Cash, Cr. Investments; Dr. LRC – BEL, Cr, LIC – BEL (see **Note 6** below); Dr. LIC – BEL, Cr. Cash) will also be recorded under GMM.

5 This is a simplified entry. There could be more account line items impacted in real life situations.

6 This entry is made on the assumption that the related amount is considered as NDIC, being repayable to policyholders in all circumstances.

Time value of money and the effect of other financial risks are not discussed in this publication but they have different impacts on accounting under GMM and VFA and briefly set out below.

	GMM	VFA
Changes in BEL arising from time value of money and other financial risks	Treated as unrelated to services and so recognized immediately in the statement of comprehensive income as IFIE	Insurer's share regarded as part of the variability of the fee for future service adjusting CSM
Interest accretion to CSM in each reporting period	Lock-in interest rate determined on initial recognition of the group of insurance contracts	CSM is effectively remeasured when it is adjusted for changes in financial risks. Hence, CSM is not explicitly adjusted for accretion of interest and is determined based on current discount rates except to the extent that HKFRS 17.B115 applies.

[32] According to HKFRS 17.81, an entity is not required to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses. If an entity does not make such a disaggregation, it shall include the entire change in the risk adjustment for non-financial risk as part of the insurance service result.

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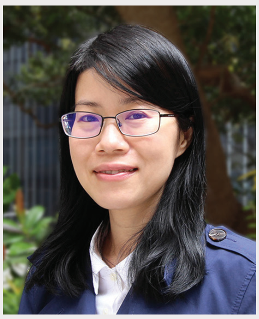

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