

**International Financial Reporting Standard 4****Insurance Contracts**

*This version includes amendments resulting from IFRSs issued up to 31 December 2008.*

IFRS 4 *Insurance Contracts* was issued by the International Accounting Standards Board (IASB) in March 2004.

IFRS 4 and its accompanying documents have been amended by the following IFRSs:

- IFRS 7 *Financial Instruments: Disclosures* (issued August 2005)
- *Financial Guarantee Contracts (Amendments to IAS 39 and IFRS 4)* (issued August 2005)
- IFRS 8 *Operating Segments* (issued November 2006)\*
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007)\*
- IFRS 3 *Business Combinations* (as revised in January 2008)†
- IAS 27 *Consolidated and Separate Financial Statements* (as amended in January 2008).†

In December 2005 the IASB published revised Guidance on implementing IFRS 4.

The following Interpretation refers to IFRS 4:

- SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease* (as amended in 2004).

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\* effective date 1 January 2009

† effective date 1 July 2009

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International Financial Reporting Standard 4 *Insurance Contracts* (IFRS 4) is set out in paragraphs 1–45 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. IFRS 4 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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## Introduction

### Reasons for issuing the IFRS

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- IN1 This is the first IFRS to deal with insurance contracts. Accounting practices for insurance contracts have been diverse, and have often differed from practices in other sectors. Because many entities will adopt IFRSs in 2005, the International Accounting Standards Board has issued this IFRS:
- (a) to make limited improvements to accounting for insurance contracts until the Board completes the second phase of its project on insurance contracts.
  - (b) to require any entity issuing insurance contracts (an insurer) to disclose information about those contracts.
- IN2 This IFRS is a stepping stone to phase II of this project. The Board is committed to completing phase II without delay once it has investigated all relevant conceptual and practical questions and completed its full due process.

### Main features of the IFRS

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- IN3 The IFRS applies to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. It does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. Furthermore, it does not address accounting by policyholders.
- IN4 The IFRS exempts an insurer temporarily (ie during phase I of this project) from some requirements of other IFRSs, including the requirement to consider the *Framework* in selecting accounting policies for insurance contracts. However, the IFRS:
- (a) prohibits provisions for possible claims under contracts that are not in existence at the end of the reporting period (such as catastrophe and equalisation provisions).
  - (b) requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets.
  - (c) requires an insurer to keep insurance liabilities in its statement of financial position until they are discharged or cancelled, or expire, and to present insurance liabilities without offsetting them against related reinsurance assets.
- IN5 The IFRS permits an insurer to change its accounting policies for insurance contracts only if, as a result, its financial statements present information that is more relevant and no less reliable, or more reliable and no less relevant. In particular, an insurer cannot introduce any of the following practices, although it may continue using accounting policies that involve them:
- (a) measuring insurance liabilities on an undiscounted basis.

- (b) measuring contractual rights to future investment management fees at an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services.
  - (c) using non-uniform accounting policies for the insurance liabilities of subsidiaries.
- IN6 The IFRS permits the introduction of an accounting policy that involves remeasuring designated insurance liabilities consistently in each period to reflect current market interest rates (and, if the insurer so elects, other current estimates and assumptions). Without this permission, an insurer would have been required to apply the change in accounting policies consistently to all similar liabilities.
- IN7 An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it should not introduce additional prudence.
- IN8 There is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts.
- IN9 When an insurer changes its accounting policies for insurance liabilities, it may reclassify some or all financial assets as 'at fair value through profit or loss'.
- IN10 The IFRS:
- (a) clarifies that an insurer need not account for an embedded derivative separately at fair value if the embedded derivative meets the definition of an insurance contract.
  - (b) requires an insurer to unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its statement of financial position.
  - (c) clarifies the applicability of the practice sometimes known as 'shadow accounting'.
  - (d) permits an expanded presentation for insurance contracts acquired in a business combination or portfolio transfer.
  - (e) addresses limited aspects of discretionary participation features contained in insurance contracts or financial instruments.
- IN11 The IFRS requires disclosure to help users understand:
- (a) the amounts in the insurer's financial statements that arise from insurance contracts.
  - (b) the nature and extent of risks arising from insurance contracts.
- IN12 [Deleted]

### **Potential impact of future proposals**

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IN13 [Deleted]

## International Financial Reporting Standard 4 *Insurance Contracts*

### Objective

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- 1 The objective of this IFRS is to specify the financial reporting for *insurance contracts* by any entity that issues such contracts (described in this IFRS as an *insurer*) until the Board completes the second phase of its project on insurance contracts. In particular, this IFRS requires:
  - (a) limited improvements to accounting by insurers for insurance contracts.
  - (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

### Scope

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- 2 An entity shall apply this IFRS to:
  - (a) insurance contracts (including *reinsurance contracts*) that it issues and reinsurance contracts that it holds.
  - (b) financial instruments that it issues with a *discretionary participation feature* (see paragraph 35). IFRS 7 *Financial Instruments: Disclosures* requires disclosure about financial instruments, including financial instruments that contain such features.
- 3 This IFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7), except in the transitional provisions in paragraph 45.
- 4 An entity shall not apply this IFRS to:
  - (a) product warranties issued directly by a manufacturer, dealer or retailer (see IAS 18 *Revenue* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).
  - (b) employers' assets and liabilities under employee benefit plans (see IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment*) and retirement benefit obligations reported by defined benefit retirement plans (see IAS 26 *Accounting and Reporting by Retirement Benefit Plans*).
  - (c) contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see IAS 17 *Leases*, IAS 18 *Revenue* and IAS 38 *Intangible Assets*).
  - (d) financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used

accounting applicable to insurance contracts, in which case the issuer may elect to apply either IAS 39, IAS 32 and IFRS 7 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

- (e) contingent consideration payable or receivable in a business combination (see IFRS 3 *Business Combinations*).
- (f) *direct insurance contracts* that the entity holds (ie direct insurance contracts in which the entity is the *policyholder*). However, a *cedant* shall apply this IFRS to reinsurance contracts that it holds.

- 5 For ease of reference, this IFRS describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.
- 6 A reinsurance contract is a type of insurance contract. Accordingly, all references in this IFRS to insurance contracts also apply to reinsurance contracts.

### Embedded derivatives

- 7 IAS 39 requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in profit or loss. IAS 39 applies to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.
- 8 As an exception to the requirement in IAS 39, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirement in IAS 39 does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).
- 9 Paragraph 8 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

### Unbundling of deposit components

- 10 Some insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is required or permitted to *unbundle* those components:
  - (a) unbundling is required if both the following conditions are met:
    - (i) the insurer can measure the deposit component (including any embedded surrender options) separately (ie without considering the insurance component).

- (ii) the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.
  - (b) unbundling is permitted, but not required, if the insurer can measure the deposit component separately as in (a)(i) but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.
  - (c) unbundling is prohibited if an insurer cannot measure the deposit component separately as in (a)(i).
- 11 The following is an example of a case when an insurer's accounting policies do not require it to recognise all obligations arising from a deposit component. A cedant receives compensation for losses from a *reinsurer*, but the contract obliges the cedant to repay the compensation in future years. That obligation arises from a deposit component. If the cedant's accounting policies would otherwise permit it to recognise the compensation as income without recognising the resulting obligation, unbundling is required.
- 12 To unbundle a contract, an insurer shall:
- (a) apply this IFRS to the insurance component.
  - (b) apply IAS 39 to the deposit component.

## Recognition and measurement

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### Temporary exemption from some other IFRSs

- 13 Paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy if no IFRS applies specifically to an item. However, this IFRS exempts an insurer from applying those criteria to its accounting policies for:
- (a) insurance contracts that it issues (including related acquisition costs and related intangible assets, such as those described in paragraphs 31 and 32); and
  - (b) reinsurance contracts that it holds.
- 14 Nevertheless, this IFRS does not exempt an insurer from some implications of the criteria in paragraphs 10–12 of IAS 8. Specifically, an insurer:
- (a) shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions).
  - (b) shall carry out the *liability adequacy test* described in paragraphs 15–19.
  - (c) shall remove an insurance liability (or a part of an insurance liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.



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

### **Liability adequacy test**

- 15 **An insurer shall assess at the end of each reporting period whether its recognised insurance liabilities are adequate, using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities (less related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32) is inadequate in the light of the estimated future cash flows, the entire deficiency shall be recognised in profit or loss.**
- 16 If an insurer applies a liability adequacy test that meets specified minimum requirements, this IFRS imposes no further requirements. The minimum requirements are the following:
- (a) The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.
  - (b) If the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss.
- 17 If an insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16, the insurer shall:
- (a) determine the carrying amount of the relevant insurance liabilities\* less the carrying amount of:
    - (i) any related deferred acquisition costs; and
    - (ii) any related intangible assets, such as those acquired in a business combination or portfolio transfer (see paragraphs 31 and 32). However, related reinsurance assets are not considered because an insurer accounts for them separately (see paragraph 20).
  - (b) determine whether the amount described in (a) is less than the carrying amount that would be required if the relevant insurance liabilities were within the scope of IAS 37. If it is less, the insurer shall recognise the entire difference in profit or loss and decrease the carrying amount of the related deferred acquisition costs or related intangible assets or increase the carrying amount of the relevant insurance liabilities.

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\* The relevant insurance liabilities are those insurance liabilities (and related deferred acquisition costs and related intangible assets) for which the insurer's accounting policies do not require a liability adequacy test that meets the minimum requirements of paragraph 16.

- 18 If an insurer's liability adequacy test meets the minimum requirements of paragraph 16, the test is applied at the level of aggregation specified in that test. If its liability adequacy test does not meet those minimum requirements, the comparison described in paragraph 17 shall be made at the level of a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio.
- 19 The amount described in paragraph 17(b) (ie the result of applying IAS 37) shall reflect future investment margins (see paragraphs 27–29) if, and only if, the amount described in paragraph 17(a) also reflects those margins.

#### **Impairment of reinsurance assets**

- 20 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment loss in profit or loss. A reinsurance asset is impaired if, and only if:
- (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive all amounts due to it under the terms of the contract; and
  - (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

#### **Changes in accounting policies**

- 21 Paragraphs 22–30 apply both to changes made by an insurer that already applies IFRSs and to changes made by an insurer adopting IFRSs for the first time.
- 22 **An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An insurer shall judge relevance and reliability by the criteria in IAS 8.**
- 23 To justify changing its accounting policies for insurance contracts, an insurer shall show that the change brings its financial statements closer to meeting the criteria in IAS 8, but the change need not achieve full compliance with those criteria. The following specific issues are discussed below:
- (a) current interest rates (paragraph 24);
  - (b) continuation of existing practices (paragraph 25);
  - (c) prudence (paragraph 26);
  - (d) future investment margins (paragraphs 27–29); and
  - (e) shadow accounting (paragraph 30).

#### **Current market interest rates**

- 24 An insurer is permitted, but not required, to change its accounting policies so that it remeasures designated insurance liabilities\* to reflect current market interest rates and recognises changes in those liabilities in profit or loss. At that

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\* In this paragraph, insurance liabilities include related deferred acquisition costs and related intangible assets, such as those discussed in paragraphs 31 and 32.