

IFRS AT A GLANCE

IFRS 4 *Insurance Contracts*



IFRS 4 Insurance Contracts

Effective Date
Periods beginning on or after 1 January 2005

SCOPE

This Standard applies to:

- Insurance contracts that an entity issues and reinsurance contracts that it holds
- Financial instruments that an entity issues with a discretionary participation feature.

If insurance contracts include a deposit component, unbundling may be required.

The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

- Insurance against theft or damage to property
- Insurance against product liability, professional liability, civil liability or legal expenses
- Life insurance and prepaid funeral expenses
- Life-contingent annuities and pensions
- Disability and medical cover
- Surety bonds, fidelity bonds, performance bonds and bid bonds
- Credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due
- Product warranties (other than those issued directly by a manufacturer, dealer or retailer)
- Title insurance
- Travel assistance
- Catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond
- Insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract
- Reinsurance contracts.

The following are examples of items that are not insurance contracts:

- Investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant risk
- Contracts that pass all significant insurance risk back to the policyholder
- Self-insurance i.e. retaining a risk that could have been covered by insurance
- Gambling contracts
- Derivatives that expose one party to financial risk but not insurance risk
- A credit-related guarantee
- Product warranties issued directly by a manufacturer, dealer or retailer
- Financial guarantee contracts accounted for under IAS 39 *Financial Instruments: Recognition and Measurement*.

- Does not address the accounting for financial assets held by insurers, but:
- Temporary exemption from the requirement to apply IFRS 9 is available; and
 - Overlay approach permitted for designated financial assets.

LIABILITY ADEQUACY TEST

An insurer is required to 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 is not sufficient, the liability is increased and a corresponding expense is recognised in profit or loss.

AREAS OF ADDITIONAL GUIDANCE

Additional guidance is provided in IFRS 4 in relation to:

- Changes in accounting policies
- Prudence
- Insurance contracts acquired in a business combination or portfolio transfer
- Discretionary participation features.

It is highly recommended that insurers gain a full understanding of IFRS 4 as requirements and disclosures are onerous.

Additional guidance is provided in appendices A and B.

DISCLOSURE

An insurer is required to disclose information that identifies and explains the amounts arising from insurance contracts:

- Its accounting policies for insurance contracts and related assets, liabilities, income and expense
- Recognised assets, liabilities, income and expense
- The process used to determine the assumptions that have the greatest effect on measurement
- The effect of any changes in assumptions
- Reconciliations of changes in liabilities and assets.

An insurer is required to disclose information that enables user of its financial statement to evaluate the nature and extent of risks arising from insurance contracts:

- Its objectives, policies and processes for managing risks
- Information about insurance risk
- Information about credit risk, liquidity risk and market risk
- Information about exposures to market risk arising from embedded derivatives.

CONTACT

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

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EUROPE

Anne Catherine Farlay	France	annecatherine.farlay@bdo.fr
Jens Freiberg	Germany	jens.freiberg@bdo.de
Teresa Morahan	Ireland	tmorahan@bdo.ie
Ehud Greenberg	Israel	ehudg@bdo.co.il
David Cabaleiro	Spain	david.cabaleiro@bdo.es
Reidar Jensen	Norway	reidar.jensen@bdo.no
Maria Sukonkina	Russia	m.sukonkina@bdo.ru
René Krügel	Switzerland	rene.kruegel@bdo.ch
Brian Creighton	United Kingdom	brian.creighton@bdo.co.uk

ASIA PACIFIC

Wayne Basford	Australia	wayne.basford@bdo.com.au
Zheng Xian Hong	China	zheng.xianhong@bdo.com.cn
Fanny Hsiang	Hong Kong	fannyhsiang@bdo.com.hk
Khoon Yeow Tan	Malaysia	tanky@bdo.my

LATIN AMERICA

María Eugenia Segura	Argentina	msegura@bdoargentina.com
Luis Pierrend	Peru	lpierrend@bdo.com.pe
Ernesto Bartesaghi	Uruguay	ebartesaghi@bdo.com.uy

NORTH AMERICA & CARIBBEAN

Armand Capisciolto	Canada	acapisciolto@bdo.ca
Wendy Hambleton	USA	whambleton@bdo.com

MIDDLE EAST

Arshad Gadit	Bahrain	arshad.gadit@bdo.bh
Antoine Gholam	Lebanon	agholam@bdo-lb.com

SUB SAHARAN AFRICA

Nigel Griffith	South Africa	ngriffith@bdo.co.za
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