Ihre Ansprechpartner

Sehr geehrte Damen und Herren,

für Rückfragen zur beigefügten Ergänzung „Insurance entity industry supplement“ zu unserer Publikation „In depth“ zur Thematik „Revenue from contracts with customers” stehen Ihnen folgende Ansprechpartner gerne zur Verfügung:

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In depth
A look at current financial reporting issues

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What's inside:

Revenue from contracts with customers

A comprehensive look at the new revenue model

Insurance entity industry supplement

At a glance

In May 2014, the IASB and FASB issued their converged standard on revenue recognition. The standard presents a number of challenges to preparers, evidenced by the deferral of the effective date and the level of activity at the Transition Resource Group.

Insurance contracts are outside the scope of the new standard, but insurance entities that render other services will be affected. Insurance entities will need to consider changes that might be necessary to information technology systems, processes and internal controls, to capture new data and to address changes in financial reporting.

In depth 2014-02 is a comprehensive analysis of the revenue standard. This supplement discusses some of the more significant changes for insurance entities.

Overview

Insurance entities issue insurance contracts, and contracts creating financial assets or financial liabilities, and they enter into contracts to deliver other services. The new standard on revenue from contracts with customers (IFRS 15 and ASC 606, hereafter, the 'new revenue standard') excludes insurance contracts within the scope of IFRS 4, 'Insurance Contracts' ("IFRS 4"), and, under US GAAP, those within the scope of ASC Topic 944 – 'Financial Services – Insurance'. The new revenue standard also excludes financial instruments and other contractual rights or obligations within the scope of IFRS 9, 'Financial Instruments' ("IFRS 9"), and, under US GAAP, those within the scope of various financial instrument topics. However, insurance entities will have to consider the new revenue standard for other aspects of their business. For example, insurance entities might provide asset management and claims handling services.

This document focuses on the accounting for transactions that are not insurance contracts or financial instruments. This includes any service components required to be separated (or optionally separated under IFRS 4) from those contracts and accounted for under the new revenue standard.

Insurance entities currently recognise revenue from transactions other than insurance contracts, based on the transfer of risks and rewards or based on the stage of completion, when the consideration can be reasonably and reliably estimated and it is probable that the economic benefit will flow to the entity (IFRS), or when it is earned and realised or realisable (US GAAP). The new revenue standard requires an insurance entity to recognise revenue as services are transferred to the customer, using the amount that it expects to be entitled to in exchange for the services provided. The new guidance could lead to a change in the recognition of revenue and costs from services other than insurance contracts – for example, upfront fees and costs from asset management activities of insurance entities.

This supplement provides an initial analysis of some of the questions and issues facing the insurance industry. These will continue to evolve as insurance entities address the challenges of implementation and as the FASB Transition Resources Group for Revenue Recognition addresses various issues. The examples and related discussions are intended to highlight areas of focus to assist insurance entities in evaluating the implications of the new revenue standard. The new revenue standard is principles-based, requiring the application of judgement.

Recent developments

The Transition Resource Group for Revenue Recognition ('TRG') was formed by the FASB and IASB to advise the Boards on implementation challenges. The last meeting of the joint TRG was held in November 2015. The IASB does not plan to schedule further meetings, but the TRG will be available for consultation by the IASB, and the IASB will monitor any discussions that the FASB might have. The FASB TRG members met in April and the FASB has scheduled additional TRG meetings for 2016.

The IASB and FASB have both issued amendments to the revenue standard in 2016. The FASB has proposed further technical corrections to the revenue standard that it expects to finalise later in 2016.

This supplement is based on the standard issued in May 2014 and subsequently issued amendments. Preparers should monitor developments in FASB and TRG discussions, and consider the impact on accounting. A summary of the discussions is available on our Revenue recognition page on CFOdirect.com.

Five-step approach

Insurance entities will need to assess their contracts (or a component separated from an insurance contract or unit-linked investment contract) to determine the timing and amount of revenue to recognise under the new revenue standard. The model has a five-step approach:

1. Identify the contract with the customer.
2. Identify the performance obligations in the contract.
3. Determine the total transaction price.
4. Allocate the total transaction price to each performance obligation in the contract.
5. Recognise as revenue when (or as) each performance obligation is satisfied.

In depth 2014-02 contains a comprehensive analysis of these steps. The purpose of this industry supplement is to highlight the relevant areas for insurance entities, which means that some steps might not be discussed in detail.

Scope of the new revenue standard

Insurance entities offer a wide range of products to their customers, many of which are insurance contracts for which the accounting requirements are described in IFRS 4 or ASC Topic 944 (US GAAP). US GAAP currently has comprehensive guidance for insurance contracts, but IFRS 4 only provides limited improvements to varying existing accounting practices and disclosure requirements to identify and explain the amounts recognised. Some insurance contracts and financial instruments issued by insurance entities might have non-insurance elements, such as asset management services and claims handling services.

The new revenue standard applies to all contracts with customers other than specific contracts excluded from its scope. A customer is defined as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. A number of specific scope exclusions apply, for which other standards provide the appropriate guidance, including lease contracts, financial instruments and insurance contracts. The new revenue standard states that a contract can be partially within the scope of the new revenue standard and partially within the scope of the other guidance.

An insurance entity will apply the separation and/or measurement guidance in other applicable standards to determine whether all or part of a contract is within the scope of another standard, and then apply the guidance in the new revenue standard to any remaining components. An insurance entity will apply the separation and/or measurement guidance in the new revenue standard if the other standard does not include separation and/or measurement guidance.

Investment contracts partially within the scope of the new revenue standard

An example of 'an arrangement partly in the scope of the new revenue standard' under IFRS is an investment contract that has a service component (see 'Asset management services provided by insurance entities' below).

There is no guidance in ASC 944 describing how to account for explicit fees associated with investment contracts. Current practice is to account for them on a basis consistent with the accounting for fees under the universal life insurance model in ASC 944 (deferred and recognised as earned for front-end fees). The accounting for elements of investment contracts other than fee revenue (such as DAC capitalisation and amortisation and the measurement of additional liabilities) is explicitly governed by other guidance within the ASC 944 universal life insurance model. ACS 606 currently excludes ASC 944 from its scope, but is silent on whether the exclusion applies to fees associated with investment contracts.

PwC observation: investment contracts accounted for under US GAAP

The FASB has discussed its intent to propose a technical correction to the new revenue standard that would broaden the current exclusion for 'insurance contracts within the scope of ASC 944' to 'contracts within the scope of ASC 944'. Some believe that this scope exclusion change will clarify that *fees* for the service component of investment contracts are outside the scope of the new revenue standard and are governed either by financial instrument guidance or by ASC 944, consistent with current practice and with the accounting for other elements of investment contracts.

Insurance contracts partially within the scope of the new revenue standard

In phase I of the insurance contracts project the IASB limited the requirement for insurers to change their existing accounting policies to avoid unnecessary disruption for both users and preparers. As a result, IFRS 4 does not require insurers to unbundle non-insurance components from insurance contracts, except for embedded derivatives and deposit components in certain circumstances. The new insurance contracts standard is expected to explicitly address the unbundling of non-insurance goods and services. IFRS 15 looks first to the unbundling guidance in other standards and therefore does not change the current guidance for unbundling goods and services within insurance contracts under IFRS 4. However, under IFRS 4 insurers may voluntarily change their accounting policies to unbundle contracts with customers and recognise and measure them in accordance with the new revenue standard if this change makes the financial statements more relevant and no less reliable, or more reliable and no less relevant. We would not expect that integrated service components, such as claims handling within a property/casualty contract or asset management services within a life insurance contract, would be separated.

PwC observation: insurance contracts with potential service components under IFRS

Where a contract as a whole qualifies as an insurance contract and, in accordance with IFRS 4, unbundling is not required, an insurance entity will not be required to change its accounting. Therefore, under the new revenue standard, similar to current practice, we do not expect many related goods or services to be separated from insurance contracts.

The IASB is working on its project on the accounting for insurance contracts. Our most recent publication on the proposed IFRS requirements of the revised exposure draft on insurance contracts is Practical Guide 42: 'Revised exposure draft will significantly change accounting for insurance contracts'. The final IFRS on insurance contracts will include scope guidance to determine which insurance arrangements (or parts thereof) are excluded from the insurance contracts standards and are therefore within the scope of another standard, such as the new revenue standard. Exposure Draft 2013/7 (Insurance Contracts) and subsequent deliberations of the IASB suggest that, for IFRS reporters, the scope of current IFRS 4 is not expected to change significantly under the proposed insurance contracts standard.

US GAAP guidance for insurance contracts for the most part does not provide separation or measurement guidance for a contract that might be partially within the scope of the new revenue standard.

PwC observation: insurance contracts with potential service components under US GAAP

Current US GAAP guidance for insurance contracts includes specific guidance on the accounting for various service fees relating to universal life insurance contracts and variable annuity contracts with significant insurance risk that are accounted for under the universal life insurance model. We therefore believe that the fees received for the various components of service relating to these contracts are subject to the insurance guidance rather than the new revenue standard.

However, ASC 944 does not explicitly specify whether or how to separate and/or initially measure service components of other insurance contracts. For example, claims adjudication and settlement services might be performed by an insurance entity relating to claims that fall below the deductible amount for a commercial general liability high-deductible insurance policy. Under current practice, if the activity is part of fulfilling the insurance obligation or mitigating the insurance entity's insurance risk, regardless of whether it might also provide a service to the policyholder, the contract is typically accounted for in its entirety as an insurance contract under ASC Topic 944. We believe the FASB's intent was that this practice would not change upon adoption of ASC 606, which is expected to be clarified in the Basis for Conclusion of an upcoming FASB Technical Correction document.

Distinct performance obligations

A performance obligation is a promise (whether explicit, implicit or implied by an entity's customary business practice) in a contract with a customer to transfer a distinct good or service to the customer. Identifying the separate performance obligations in a contract is essential to applying the revenue recognition model. Distinct performance obligations are the units of account to which the transaction price is allocated, and satisfaction of those separate performance obligations determines the timing of revenue recognition. Satisfaction of the performance obligation can occur either at a point in time or continuously over time, depending on the nature of the obligation.

A good or service is distinct only if:

- the customer can benefit from the good or service, either on its own or together with other readily available resources (that is, the goods or services are capable of being distinct); and

- the good or service is separately identifiable from other promises in the contract (that is, the good or service is distinct within the context of the contract).

Insurance entities provide other services under contracts separate from insurance and asset management contracts. The fees from these services are subject to the revenue recognition standard. These services include, for example, claims administration, complex claims management, risk mitigation, financial planning, asset reviews and valuations, financial analysis, and health and safety management.

These services could be provided on a stand-alone basis to customers rather than as an integrated component of insurance coverage. For example, a property/casualty insurance entity might provide claims management services for a large manufacturing company that self-insures a large component of various types of risk, including general and product liability.

A contract for services might contain more than one performance obligation. For example, a contract might provide risk mitigation services for a one-year period, with claims handling services for complex workers' compensation claims (for which the performance period is estimated to be 15 years) and with claims handling services for commercial motor physical damage (for which the performance period is estimated to be 18 months). The different performance obligations (and term associated with each) require an insurance entity to determine the allocation of consideration and revenue recognition patterns for each performance obligation identified.

New revenue standard	Current US GAAP	Current IFRS
Insurance entities evaluate the terms of the contract and their customary business practices to identify each performance obligation. The transaction price for the contract is allocated to each performance obligation and recognised when those obligations are satisfied. Performance obligations include promises that are explicit or implied by customer business practices, published policies or specific statement. Insurance entities that previously did not allocate revenue to services, because they did not arise from an explicit contractual arrangement, will need to allocate the transaction price to all promises in the arrangement under the new standard. Multiple elements of any services will need to be documented, performance obligations identified and revenue allocated where material**.** If the entire contract qualifies as an insurance contract, the insurance contracts guidance should be applied.	Insurance entities identify all deliverables in an arrangement, whether explicit or implicit, and allocate the arrangement consideration to each deliverable. Revenue is then recognised in relation to services performed. If the entire contract qualifies as an insurance contract (that is, if there are no distinct non-insurance services provided), the insurance contracts guidance should be applied. Some insurance contracts that include significant services, such as high-deductible property/casualty insurance policies with claims handling services provided by the insurance entity, are typically treated entirely as an insurance contract. Other transactions, such as a stop loss health insurance coverage offered with an administrative claims servicing contract, are accounted for separately as an insurance contract and a service contract, respectively.	IAS 18 requires insurance entities to apply the revenue recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. If the entire contract qualifies as an insurance contract, the insurance contracts guidance should be applied.

PwC observation: multiple performance obligations

The new revenue standard is similar to current IFRS and US GAAP and requires separate promises to the customer to be identified, and the transaction price for each component and the performance period and pattern determined. The new standard includes specific criteria for determining whether a promised good or service is distinct and should be accounted for separately. These criteria should be reviewed to determine whether a service is distinct. The new revenue standard also provides guidance for determining and allocating the transaction price.

Recent developments

In April 2016, the IASB and the FASB each issued amendments to the new standard that clarify the principle for determining whether a good or service is distinct and therefore should be accounted for separately. The revised principle states that an entity should determine whether its promise is to transfer individual goods or services to the customer or to transfer a combined item (or items) to which the individual goods or services are inputs. The FASB's amendment also clarifies that an entity is not required to identify goods or services promised to the customer that are immaterial in the context of the contract, The IASB decided not to incorporate similar guidance into IFRS 15 but agreed with the concept. An entity applying IFRS should assess whether performance obligations are immaterial to its financial statements, as described in IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

Variable consideration

The transaction price might include an element of consideration that is variable or contingent on the outcome of future events. Variable consideration should be estimated using the method which best predicts the amount of consideration to which the entity will be entitled (that is, the expected value or the most likely amount).

Variable consideration included in the transaction price is subject to a constraint. An entity should include variable consideration in the transaction price only if it is highly probable (IFRS) or probable (US GAAP) that a change in the estimate of the variable consideration would not result in a significant reversal of the cumulative revenue recognised when the uncertainty is resolved. Factors to be considered in the assessment include whether the variability is significantly influenced by factors outside the entity's influence (such as market factors or the actions of third parties), the length of time the uncertainty is likely to exist, the entity's experience with similar transactions, and the number and range of outcomes.

The accounting for variable consideration is different from the current revenue recognition requirements under IFRS and US GAAP. Insurance entities should review the new guidance to determine whether there will be a change from their current practices.

For example, the highly probable (IFRS) and the probable (US GAAP) constraint for recognition for variable consideration does not exist today. An example of variable consideration is a performance guarantee in a claims administration contract. An insurance entity might have contracted to receive a fee for providing claims administrative services, but that fee could be adjusted upwards or downwards depending on the achievement of certain service standards. For example, consideration might vary based on the speed of resolving customer enquiries, ultimate claim processing time, cost reduction metrics, or certain other financial metrics.

Management will need to determine if there is a portion of the variable consideration (that is, a 'minimum amount') that is highly probable (IFRS) or probable (US GAAP) of not resulting in a significant revenue reversal if included in the transaction price. Any minimum amount that is highly probable (IFRS) or probable (US GAAP) of not reversing is included in the transaction price. Management's estimate of the transaction price will need to be reassessed each reporting period, including any estimated minimum amount of variable consideration that it expects to receive.

New revenue standard	Current US GAAP	Current IFRS
The transaction price is estimated using either the expected value method or the most likely outcome and is then subject to a constraint. Variable consideration is included in the transaction price (and revenue is recognised) only to the extent that it is highly probable (IFRS) or probable (US GAAP) that it will not be subject to significant reversal when the uncertainty is resolved. Factors considered in the assessment might include whether the variability is significantly influenced by factors outside the insurance entity's influence (such as market factors or the actions of third parties), the length of time the uncertainty is likely to exist, the insurance entity's experience with similar transactions, and the number and range of outcomes.	In general, revenue is recognised when earned and realised or realisable, including consideration of when it is fixed or determinable. However, there is no specific guidance for recognition of variable consideration. Certain performance-based incentive fees that are not finalised until the end of a period of time specified in the contract could be recognised using one of two methods. Under one method, performance fees are recognised in the period in which the related services are performed and all the contingencies have been resolved, which is typically at the end of the contract. Alternatively, performance-based fees are recognised as revenue at the amount that would be due under the contract at any point in time as if the contract had terminated at that date.	IAS 18 requires revenue to be recognised when the amount can be reliably estimated and it is probable that the economic benefit will flow to the insurance entity. The judgement involved in making these determinations means that insurance entities have recognised contingent consideration in different ways. Some recognise revenue only when the uncertainty is resolved or on cash receipt, because only then are they able to reliably estimate the contingent consideration. However, some insurance entities recognise revenue earlier, where they believe that they can make a reliable estimate.

PwC observation: variable consideration

Life insurance entities might receive fees for asset management services related to investment contracts. These fees are often a fixed percentage of the fund's net assets and paid daily or monthly and are recognised as determined. The recognition of these fees is not expected to change under the new revenue standard, as the services have been provided and the uncertainty (that is, the quantum of funds under management) related to the variable consideration is resolved at the end of each reporting period (in other words, at the end of each reporting period it is highly probable (IFRS) or probable (US GAAP) that a significant reversal in the amount of cumulative revenue recognised will not occur) and usually the fee is not subject to clawback.

Insurance entities might provide other services that have variable consideration, such as performance fees for claim management services. The recognition of revenue for these services might need to change, depending on an insurance entity's current practice compared to the new requirement to determine whether the revenue is subject to significant reversal.

Asset management services provided by insurance entities

A significant part of the business of many life insurance entities is selling unit-linked investment contracts and other investment-type contracts that are not accounted for as insurance contracts. The amounts owed to customers are determined by reference to the price of units in an internal or external investment fund (that is, a designated pool of assets held by the insurance entity or by a third party and operated in a manner similar to a mutual fund). The assets within the unit-linked funds and the related obligations to customers are included in the insurance entity's financial statements.

The customer is paying for separate components when it purchases a unit-linked investment contract: a financial instrument issued by the insurance entity; and an asset management service. Insurance entities might charge introduction and other upfront fees on investment contracts. These fees are often subtracted from the initial policyholder deposit. An insurance entity also typically charges ongoing fees, which are often a specified percentage of the fund's net assets and subtracted daily or monthly from the account balance.

There are often additional charges that apply when a unit-linked investment contract is surrendered, also known as surrender penalties. An alternative to surrender penalties in some unit-linked investment contracts are 'capital units'. These units have higher annual management charges than the normal 'accumulation' units. The purpose of the capital units is to allow the insurance entity to recover the initial acquisition costs of the product in the earlier years, without having to make significant upfront charges. The insurance entity differentiates between funded and unfunded units. The funded value of the units will converge with the unfunded value over the life of the contract, becoming equal at the end of the contract, if the unit-linked investment contract is not surrendered. If the policyholder surrenders before the end of the term, a surrender penalty is applied, so the holder would be paid the lower funded value of the units.

Asset management services that are an integral part of an insurance contract, participating insurance contract or participating investment contract are not within the scope of the new revenue standard, for the reasons discussed above, and are therefore not discussed in this document.

Insurance groups might also provide asset management services as part of a separate operation (for example, where an asset manager subsidiary of an insurance entity manages mutual funds or other unit trust structures), in which case the assets under management are not assets of the insurance entity. In depth INT2014-02 (supplement) for the asset management industry explains the implications of the new revenue standard in these situations. Additional considerations might arise for insurance groups where the mutual funds or unit trust structures are consolidated into the insurance group financial statements in accordance with IFRS 10.

New revenue standard	Current US GAAP	Current IFRS
Bifurcation of asset management services A consequential amendment to IAS 39[1] has been made (which will be carried forward in IFRS 9) that requires entities to distinguish fees and costs that are an integral part of the effective interest rate for the financial liability from fees and transaction costs relating to the obligation to provide asset management services. This will replace the illustrative examples in the appendix to IAS 18. The new revenue	Deposits received by an insurance entity relating to investment contracts are required to be reported as liabilities and accounted for in a manner consistent with accounting for interest-bearing or other financial instruments. There is no guidance in ASC 944 describing how to account for explicit fees associated with investment contracts. Current practice is to account for them on a basis that is consistent with the	Many IFRS insurance entities account for the asset management services on investment contracts under revenue guidance (currently IAS 18) and account for the financial liability under financial instrument guidance (IAS 39 or IFRS 9). The bifurcation of services from the investment contract is often made based on the illustrative examples in the appendix to IAS 18.

[1] The consequential amendment states: *"An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services"*.

New revenue standard	Current US GAAP	Current IFRS
standard, however, provides no guidance on separating fees receivable. See 'Investment contracts partially within the scope of the new revenue standard' above for developing thoughts on whether, under US GAAP, explicit fees for investment contract services would be outside the scope of the new revenue standard.	accounting for fees under the universal life insurance model in ASC 944. This applies to both periodic fees deducted from the account balance as well as any upfront or surrender fees.	
Upfront fees An upfront fee is typically an advance payment for future services and is therefore recognised as revenue over time as the related services are performed. The new revenue standard provides more guidance on the pattern of transfer of services. Insurance entities will need to assess whether the current amortisation pattern applied for deferred upfront fees is consistent with the transfer to the customer of the services. Similar to current accounting, an insurance entity will need to consider its individual facts and circumstances to make judgements about the amortisation pattern for upfront fees for asset management services. A straight-line pattern of amortisation is likely to be the most common basis used to amortise deferred upfront fees, but there might be other methods that could be acceptable if they meet the requirements of the new revenue standard. It is unlikely that a pattern based on profits or fund management charges will meet the requirements of the new standard, because it does not reflect the services provided to the customer. An amortisation pattern based on funds invested might be appropriate if it reflects the transfer to the customer of the services and is not dependent on the changes in market variables. See 'Investment contracts partially within the scope of the new revenue standard' above for developing thoughts on whether, under US GAAP,	Upfront fees are deferred and amortised on a basis that is consistent with the accounting for such fees under the universal life insurance model in ASC 944 (typically based on estimated gross profits).	The amortisation of deferred upfront fees for asset management services is largely based on one of several bases: straight-line, fund management charges, assets under management, or on an actuarial basis using expected profits.

New revenue standard	Current US GAAP	Current IFRS
explicit fees for investment contract services would be outside the scope of the new revenue standard.		
Ongoing fees Asset management services are satisfied over time. The new revenue standard requires insurance entities to determine the transaction price at contract inception and at each reporting date. The insurance entity will recognise revenue as the performance obligation is satisfied. The transaction price (and revenue) is limited to the amount that is highly probable (IFRS) or probable (US GAAP) of not resulting in a significant revenue reversal in the future. An entity that previously recognised performance fees revenue based on an estimate will need to apply the constraint and recognise only to the extent that it is highly probable (IFRS) or probable (US GAAP) that a significant reversal in the amount of cumulative revenue recognised will not occur. Where contingent performance fees revenue was recognised only when the fee became reliably measurable, an entity will need to consider whether any of that revenue should be recognised earlier because it is highly probable (IFRS) or probable (US GAAP) that a significant reversal in the amount of cumulative revenue recognised will not occur. See 'Investment contracts partially within the scope of the new revenue standard' above for developing thoughts on whether, under US GAAP, explicit fees for investment contract services would be outside the scope of the new revenue standard.	 Current practice is to account for explicit fees assessed on separate account products and general account products consistent with the universal life insurance model under ASC 944 (typically, as assessed, for ongoing fees).	 A fixed percentage asset-based *management fee* is earned periodically for providing asset management services. These fees are generally recognised as revenue each period in accordance with the terms of the asset management contract. *Performance fees* that are tied to returns subject to performance targets (for example, high watermark) could be recognised using one of two methods. Under the first approach, the asset manager recognises revenue based on the performance up to the measurement date, including an estimate of fees ultimately to be received. The asset manager's estimates are reassessed at each measurement date. Under the second approach, non-contingent and contingent fees are analysed separately. Performance fees, being contingent amounts of revenue, are recognised as the services are performed, but only when the fee becomes reliably measurable, which is often at the end of the performance period, once the outcome is known.
Surrender penalties There is no specific guidance on surrender penalties on investment contracts. Surrender penalties will only be charged if a customer cancels in a year where the penalties apply.	 Current practice is to account for explicit surrender fees assessed on separate account products and general account products consistent with the universal life insurance model under ASC 944 (typically,	 Insurance entities might consider surrender penalties in different ways. Some believe that they are fully attributable to the investment management service component, because the penalty is payable when a

New revenue standard	Current US GAAP	Current IFRS
The possibility of the customer paying a surrender penalty might be included in determining the fair value of the liability on initial recognition in accordance with the financial instruments standards. The surrender penalty in this case will be an input to the valuation technique using a probability-weighted average impact of future surrenders, which is likely to reduce the fair value of the financial instrument below the consideration received. The balance of the consideration received over the resulting value of the financial instrument will then be deferred and recognised as the investment management service is provided in accordance with the new revenue standard. Any adjustments to the probability of receiving a surrender penalty are adjusted against the measurement of the liability. Surrender penalties could also be accounted for separately from the financial instrument, in which case they should be accounted for in accordance with the revenue standard and recognised when they are paid. See 'Investment contracts partially within the scope of the new revenue standard' above for developing thoughts on whether, under US GAAP, explicit fees for investment contract services would be outside the scope of the new revenue standard.	upon surrender for surrender charges).	policyholder cancels the contractual obligation to pay for future investment management services, so the surrender penalty income will be recognised as income only on surrender of the contract. However, others believe that the surrender penalty is attributable to the financial instrument, so the surrender penalty will be an input to the valuation technique of the financial instrument using a probability-weighted average impact of future surrenders. The balance of the consideration received over the resulting value of the financial instrument will then be deferred and recognised as the investment management service is supplied in accordance with IAS 18.

PwC observation: amortisation of deferred upfront fees

Deferred upfront costs that are recognised as an asset are amortised on a systematic basis that is consistent with the transfer to the customer of the services to which the asset relates, which is the same basis used for any deferred upfront fees. However, the pattern of amortisation of deferred fees might be different from that applied to deferred costs if revenue includes variable consideration (for example, an upfront fee with a clawback provision). The guidance on variable consideration might result in revenue recognition later than the date when the service is transferred to the customer and thus later than the amortisation of deferred upfront costs.

Significant financing component

The new revenue standard requires the transaction price to be adjusted for the effects of the time value of money if the timing of payments agreed to by the parties to the contract provides the customer or the insurance entity with a significant benefit of financing the transfer of services to the customer.

Recent developments

The TRG discussed the matters related to significant financing components in March 2015. TRG members agreed that there is no presumption in the standard that a significant financing component exists or does not exist where there is a difference in timing between when services are transferred and when the promised consideration is paid. An entity applies judgement to determine whether the payment terms are providing financing or are for another reason.

PwC observation: finance component of upfront fee

If there is a significant financing component (for example, an upfront fee received from the customer), it is accounted for as a loan, and interest is accrued over the period in which services are provided as interest expense. Revenue will be greater than the cash received, due to the accretion of interest on the unearned revenue liability. The new revenue standard requires an entity to recognise as an asset and amortise the incremental costs of obtaining a contract if the entity expects to recover those costs. However, the deferred cost is not adjusted for the time value of money.

Contract costs

Often, insurance entities pay fees to third parties, such as insurance intermediaries, to distribute their investment contracts. Various types of fees are paid, and the timing of payment can also vary (that is, the fees could be paid upfront or on an ongoing basis). The third party generally does not provide substantive ongoing services beyond the initial introduction of the investor to the product.

The new revenue standard will require insurance entities to clearly distinguish between costs to fulfil a contract and incremental costs to obtain a contract. Costs that are an integral part of an insurance contract or participating investment contract are not within the scope of the new revenue standard and are therefore not discussed in this document. In addition, under US GAAP, guidance on costs relating to investment contract liabilities issued by insurance entities are subject to existing insurance guidance (ASC 944) and not the new revenue standard (ASC 606).

New revenue standard	Current US GAAP	Current IFRS
An insurance entity applying IFRS will recognise as an asset the incremental costs of obtaining a contract if it expects to recover those costs. The incremental costs of obtaining a contract are those costs that the insurance entity would not have incurred if the contract had not been obtained (for example, a sales commission). An asset recognised in accordance with the above is amortised on a systematic basis consistent with the pattern of transfer of the services to which the asset relates. A practical expedient is available allowing incremental costs to be expensed when incurred if the amortisation period would be one year or less. An impairment loss is recognised to the extent that the carrying amount of the capitalised asset exceeds the net amount of consideration to which the insurance entity expects to be entitled in exchange for the services to which the asset relates, less the remaining costs that relate directly to providing those services.		Fixed costs paid that are incremental and directly attributable to securing an investment contract (for example, sales commissions or placement fees) are capitalised if they can be identified separately, measured reliably, and it is probable that they will be recovered. An incremental cost is one that would not have been incurred if the insurance entity had not secured the investment management contract. The asset is amortised as the insurance entity recognises the related revenue. Amortisation bases include straight-line, fund management charges, assets under management, or an actuarial basis using expected profits. An impairment loss is recognised if the carrying value of the capitalised asset exceeds the recoverable amount.
Under US GAAP, for insurance and investment contracts issued by an insurance entity, ASC 944 insurance guidance remains the appropriate guidance for acquisition costs with significant surrender charges; those without significant surrender charges follow financial instrument guidance.	For insurance and investment contracts issued by an insurance entity, ASC 944 insurance guidance is the appropriate guidance for acquisition costs with significant surrender charges; those without significant surrender charges follow financial instrument guidance.	

PwC observation: amortisation method for incremental costs

The new revenue standard provides guidance on the subsequent accounting for contract cost assets, including their amortisation. The asset recognised from capitalising the costs to obtain a contract is amortised on a systematic basis, consistent with the pattern of the transfer of the goods or services to which the asset relates. A straight-line pattern of amortisation is likely to be the most common basis used to amortise deferred upfront costs, but there might be other methods that could be acceptable if they meet the requirements of the new revenue standard.

PwC observation: trail commission payable

Some insurance entities pay commission to intermediaries on an annual or periodic basis as long as the underlying contract continues in existence (known as trail commissions). There is currently diversity in practice in accounting for trail commission payable by insurance entities and asset managers.

The new revenue standard does not provide guidance on this topic. Thus, the accounting for trail commissions payable is not expected to change under the new revenue standard.

Final thoughts

This *In depth* does not address all aspects of the new standard. Entities should continue to evaluate how the new standard might change current business activities, including contract negotiations, key metrics, taxes, budgeting, controls and processes, information technology requirements, and accounting.

The effective date of the new revenue standard has been deferred by one year, such that it is effective for the first interim period within annual periods beginning on or after 1 January 2018 for calendar year-end entities (2019 for non-public companies following US GAAP). Entities will have the option to apply the new revenue standard retrospectively or to use a simplified transition method. An entity will not restate prior periods if it uses the simplified method.

About PwC's insurance practice

The insurance industry faces challenging markets, new regulatory reform measures, and competition for clients and talent – all against a backdrop of heightened expectations from investors, regulators, industry partners and other stakeholders. Our insurance partners and staff can assist in meeting these key industry challenges.

PwC helps organisations and individuals to create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in assurance, tax and advisory services.