**MODULE 6: MEASUREMENT ON INITIAL RECOGNITION**

**Introduction**

This module provides an in-depth overview of the initial recognition measurement requirements for insurance contracts under **IFRS 17.**

**Recognition Criteria**

Insurance contracts must be recognized at the earliest of:

1. The beginning of the coverage period;
2. The date when the first premium is due; or
3. The date when the group of contracts becomes onerous.

**Components of Measurement at Initial Recognition**

Under the General Measurement Model (GMM), the initial measurement of a group of insurance contracts is the sum of:

1. **Fulfilment Cash Flows (FCF):**
2. **Future Cash Flows:** Best estimates of expected premiums, claims, benefits, and expenses.
3. **Discounting:** Adjustment to reflect the time value of money and financial risks.
4. **Risk Adjustment:** Compensation for being uncertainty in non-financial risks (e.g. mortality, lapse)
5. **Unallocated Loss Adjustment Expenses (ULAE)**: Expected internal claims handling costs that are not directly linked to individual claims. ULAE should be estimated at inception and included in fulfilment cash flows for future claims.
6. **Contractual Service Margin (CSM):**
7. Represents unearned profit.

The Premium Allocation Approach (PAA) is a simplified method permitted for short-duration contracts or when it provides measurements that are not materially different from those produced under the General Measurement Model (GMM)

At initial recognition:

1. The liability is measured as: premiums received (or due) – insurance acquisition cash flows
2. Acquisition costs may be expensed immediately or deferred, depending on the entity’s policy

**Measurement Approaches Overview**

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| --- | --- | --- |
| **Measurement Model** | **Applicability** | **Key Features** |
| **General Measurement Model (GMM)** | Default model for long-duration contracts | Includes FCF, Discounting, Risk Adjustment, CSM |
| **Premium Allocation Approach (PAA)** | Optional for short-duration contracts | Simplified method, no explicit CSM |
| **Variable Fee Approach (VFA)** | For contracts with direct participation features | CSM adjusts based on underlying asset returns |

**Contractual Service Margin (CSM)**

The CSM is the key component that defers recognition of profits until insurance services are provided. At initial recognition:

1. CSM=Fulfilment cash inflows -outflows-risk adjustment.
2. If the result is negative; the contract is **onerous,** and a loss is recognized immediately in profit or loss.

**Scenario:**

* Expected premiums: KES 1,200
* Expected claims & expenses: KES 900
* Risk Adjustment: KES 50
* Discounting impact: KES 100

**Calculation:**

* Fulfilment Cash Flows = KES 1,200-KES 900-KES 100-KES 50= KES 150
* **CSM= KES 150**  which is to be released over the coverage period.

**Treatment of Onerous Contracts**

If the total of expected outflows + risk adjustment exceeds the inflows, the contract is **onerous.**

1. No CSM is recognized.
2. The difference is recorded as a loss in profit or loss

**Summary of Measurement at Initial Recognition**

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**KEY TAKEWAYS**

1. Contracts are recognized when the earliest recognition condition is met.
2. Measurement includes **future cash flows, discounting, risk adjustment, ULAE, and CSM (under GMM)**.
3. The CSM ensures no upfront profit. and is adjusted only for changes in future service
4. Onerous contracts result in immediate loss recognition.
5. Choosing between the GMM and PAA depends on contract duration and materiality of results.
6. Acquisition costs are handled differently under GMM (included in FCFs) and PAA (either deferred or expensed).