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FRED 82
Insurance Intermediaries – Revenue Recognition

How FRED 82 impacts the revenue recognition of insurance intermediaries

What insurance intermediaries need to know about FRED 82

Financial Reporting Exposure Draft (FRED) 82 amendments represent an important milestone in introducing:

- a new revenue recognition model which is similar to the International Financial Reporting Standard 15 (IFRS 15), five-step model; and
- a new, on-balance sheet, model for leases based on IFRS 16

Both include appropriate simplifications. This guide focuses on the new revenue recognition model under the proposed amendments to Financial Reporting Standard 102 (FRS 102).

FRED 82

is more complex and prescriptive than the current Section 23 of FRS 102

includes options for IFRS groups to streamline accounting policies

could accelerate revenue recognition for insurance intermediaries in the case of some contingent commissions

FRED 82 draft amendments were issued on 15 December 2022 following the second periodic reviews of FRS 102 and the comment period ended in April 2023. The Financial Reporting Council (FRC) has undertaken significant engagement with stakeholders and is currently taking into account the helpful responses and feedback received across all aspects of the proposals. The FRC expects to issue the final amendments to FRS 102 in the first half of 2024, with an effective date not before 1 January 2026. Early adoption is expected to be permitted.

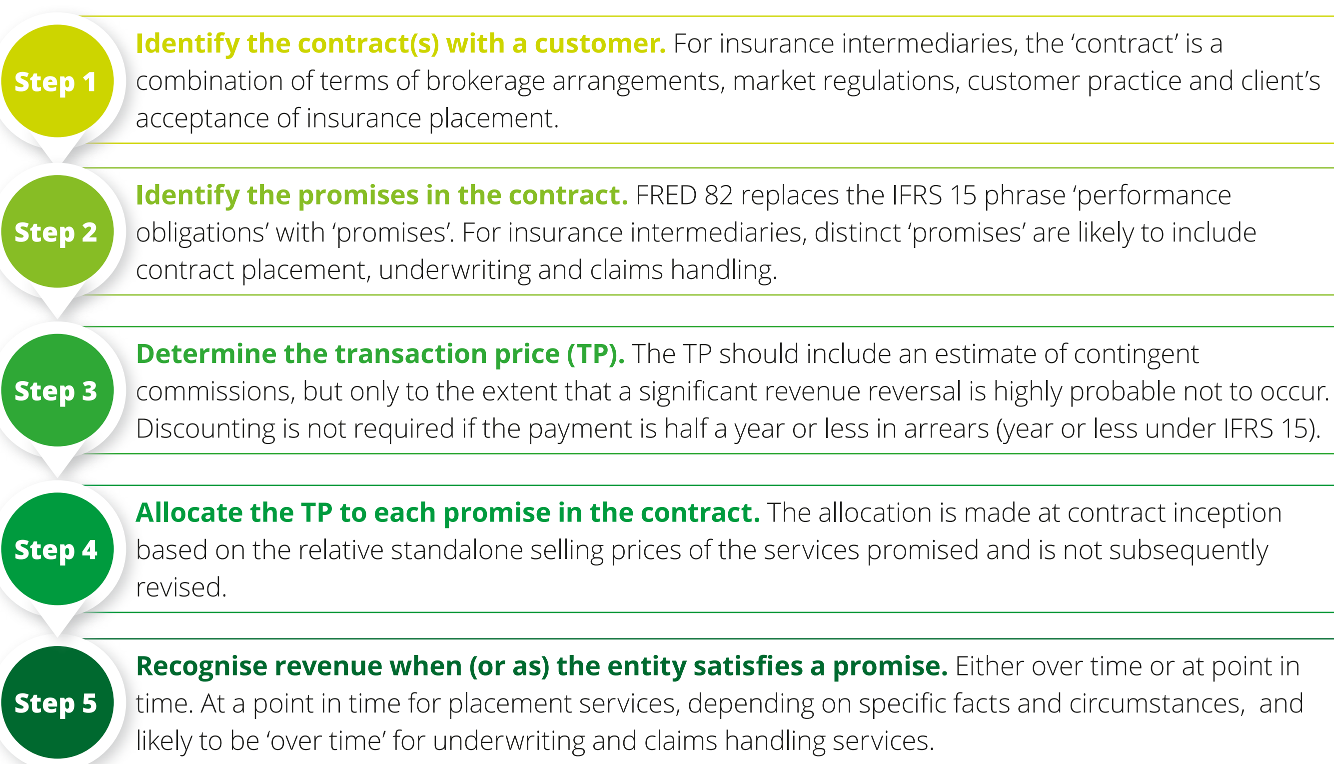
Current reporting

Extant section 23 of FRS 102 includes revenue recognition requirements based on IAS 18 Revenue that was superseded by IFRS 15 for IFRS reporters. Currently, under FRS 102, insurance intermediaries (brokers and agents) recognise revenue from transactions based on the stage of completion when the amount can be reliably estimated and it is probable that the economic benefit will flow to the entity. Although different insurance intermediaries have different fact patterns, and it will be important to assess whether the customer is the policyholder or the insurer, revenue recognition was often interpreted by many insurance intermediaries to be for:

- placement services on the effective commencement date of the related insurance policy or later where the insurer bills the policyholder directly;
- underwriting services performed upon receipt of cash or on the date the commission becomes due in the case of commissions contingent on the profitability or volume of insurance policies underwritten that cannot be reliably estimated earlier; and
- claims handling services over time based on the period over which the intermediary expects to process claims.

Five-step model

The amended section 23 of FRS 102 establishes a five-step model for accounting for revenue from contracts with customers that better depicts the transfer of promised goods or services to the customers in exchange for the consideration to which the entity expects to be entitled:



The new guidance could lead to an acceleration of recognition of revenue – for example, in circumstances when an intermediary is entitled to contingent or renewal commissions and there are no further implied or contractual services to be performed in the renewal periods.

Our Deloitte guide to IFRS 15 contains a comprehensive analysis of these steps. The purpose of the rest of this industry supplement is to highlight relevant differences among current reporting, FRED 82 and IFRS 15.

Comparison of current reporting to FRED 82 to IFRS 15

The following are some of the key differences among (a) current section 23 of FRS 102, (b) amended section 23 of FRED 82 and (c) IFRS 15. Comparison between (a) and (b) is more relevant to insurance intermediaries that report under UK GAAP in their solo and group accounts (if applicable). Comparison (b) and (c) is more pertinent to entities that report under UK GAAP in their solo accounts and under IFRS in their group ones.

<table>
<tr><th>Focus area</th><th>(a) Current</th><th>(b) FRED 82</th><th>(c) IFRS 15</th><th>Potential impact</th></tr>
<tr><td>Identify the contract</td><td colspan="3">A contract is an agreement between two or more parties that creates enforceable rights and obligations. In the context of an insurance intermediary, the contractual terms may need to be drawn from several different sources, including the TOBA, the policy slip and market practice.</td><td>It will be very important in many instances to identify the point at which a contract comes into existence for accounting purposes, as this may affect the timing of revenue recognition.</td></tr>
<tr><td>Identify the promises in the contract</td><td>Revenue recognition criteria are applied to separately identifiable components of a single transaction to reflect the substance of the transaction.

No revenue may be currently allocated to promises arising from customer business practices that were not contractual in nature.</td><td colspan="2">At contract inception each promise to transfer a distinct good or service is identified. The transaction price is then allocated to those distinct 'promises', including promises arising from customer business practices.</td><td>Consideration of the promises that are implicit in the contract or separate. Services, other than placement, such as underwriting and claims handling, should be identified, documented and revenue should be allocated to the separate services identified.</td></tr>
<tr><td>Determining the TP – profit and volume-based commissions</td><td>Revenue is recognised net of the provision for expected cancellations, based on the stage of completion, when the amount can be reliably estimated and it is probable that the economic benefit will flow to the entity. It was sometimes interpreted that certain contingent commissions such as profit and volume-based could not be reliably estimated before they become due.</td><td colspan="2">The TP should also consider expected cancellations by portfolio (e.g. type of insurance policies). The variable consideration is included in the TP to the extent that it is highly probable that there will not be a significant revenue reversal.

In practice, it will often be necessary to consider the possibility of revenue reversals at the level of a portfolio, rather than an individual contract.</td><td>Under certain broking arrangements such as marine, reinsurance excess of loss and quote-share treaties, the best estimate of profit and volume-based commissions should be determined often at a portfolio of similar policies level.

There could be potential challenges in estimating proportional treaty reinsurance revenues. This includes lack of historic data available and the extent of reliability of estimated premium income information received from insurers.</td></tr>
</table>

Comparison of current reporting to FRED 82 to IFRS 15 (continued)

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<tr><td>Revenue recognition – trail commissions</td><td>Refer to the 'Current reporting' section on page 2.

Under current FRS 102, renewal or trail commissions that do not require the intermediary to render further services are only recognised at the time of the initial contract if they can be reliably measured. They are often excluded, because reliable measurement is not possible, and are instead recognised when they arise.</td><td colspan="2">The revenue amount for placement services shall include trail commissions contingent on future renewals that do not require the intermediary to render further services to the extent that it is probable there will not be a significant reversal of revenue.

Claims handling services are 'promises' satisfied over time, as the customer concurrently receives the services as the entity performs.</td><td>Important considerations include identifying contracts that have trail commission and/or are multi-annual policies and assessing whether the promise has been fully delivered at inception of the contract (i.e. trail commission) or whether additional services are provided for subsequent renewals (i.e. they are separate promises).

For trail commissions, the level of future commissions that can be considered highly probable not to reverse will typically need to be estimated on a portfolio basis, and is likely to be an area of significant judgement.</td></tr>
<tr><td>Incremental costs to obtain a contract</td><td rowspan="2">An entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered.</td><td>Accounting policy choice to expense or capitalise such costs.</td><td>They are capitalised if they are expected to be recovered. There is a practical expedient to expense such costs if their amortisation period is a year or less.</td><td>Identification of 'incremental costs to obtain a contract' is likely to be an area of judgement if an entity elects to capitalise those costs under FRS 102.

An entity that reports under IFRS 15 for the group accounts and FRS 102 for the solo accounts may elect to capitalise such costs to avoid creating any new sources of dual accounting.</td></tr>
<tr><td>Costs to fulfil a contract</td><td colspan="2">If the costs incurred in fulfilling a contract are not within the scope of another Standard / FRS 102 section, an entity shall recognise those costs as an asset if:
(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify;
(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) promises in the future; and
(c) the costs are expected to be recovered.</td><td>Identification of capitalised costs to 'fulfil a contract' is likely to be an area of judgement, particularly in relation to anticipated contracts.</td></tr>
</table>

Contacts

Feel free to contact us and send us questions directly if you would like to discuss FRED 82 impact assessment, implementation including contract reviews and data considerations.

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