

Interim reporting eased under IFRS 17 but M&A accounting remains a puzzle

The IASB approves its second round of amendments to IFRS 17

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Agenda

- Highlights of the IASB meeting on 30 January 2020
- Detailed analysis of the IASB discussion and its decisions
- Next steps

Highlights of the IASB meeting on 30 January 2020

- The IASB announced that their **discussion and vote on the IFRS 17 effective date** will be at their meeting **during the week of Monday 16 March 2020** after completing all of its decisions on the IFRS 17 amendments.
- With a **majority of 13 against 1**, the IASB decided to amend the requirement of IFRS 17:B137 relating to **interim financial statements**, permitting entities to apply the requirement as an accounting policy choice at the reporting entity level;
- The IASB discussed and **approved unanimously** to:
 - Retain unchanged the requirement for the acquirer of **liabilities for incurred claims (e.g. acquired through a business combination/M&A) to account for them as liabilities for remaining coverage**. **Confirm** the amendment to keep the same classification as in the vendors' financial statements only when full restatement is impracticable.
 - Amend the **transition provisions** to include requirements for accounting **for insurance acquisition cash flows**.
 - Confirm the **scope exclusion** from IFRS 17 of **some credit card contracts** that meet the definition of insurance contracts and agreed to extend the scope exclusion to other contracts that provide **credit or payment arrangements**. Introduce a **"reverse unbundling"** for the associated insurance component in a scoped out credit card.
- For the requirement to **prohibit** entities from applying the **risk mitigation option retrospectively on transition**, the IASB voted **13 in favour** of **confirming** the current approach in the ED and one member abstained.

Interim Financial Statements

Overview

- IFRS 17:B137 requires that an entity **does not change the treatment of accounting estimates** made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period. This is a different accounting treatment compared to that for accounting estimates when entities apply IAS 34, *Interim Financial Reporting*. IAS 34 requires that the frequency of an entity's reporting should not affect the measurement of its annual results.
- The following is an illustrative example in Agenda Paper 2D applying IFRS 17:B137 and a Deloitte interpretation of IAS 34 without B137.
 - At the beginning of year 1, Entity A and Entity B issue the same two-year insurance contract with a premium of CU100, expected claims of CU50, and a contractual service margin (CSM) of CU50 which is allocated based on coverage units on a straight-line basis.
 - In Q4 of Year 1, Entity A and Entity B change their expectations and now expect an additional amount of claims of CU30 to be incurred in Year 2.
 - Below table illustrates the CSM recognised in profit or loss by each Entity applying IFRS 17:B137 on a period-to-period basis:

Contractual service margin (CSM) recognised in profit or loss	Q1	Q2	Q3	Q4	Year 1	Remaining CSM end of Year 1
Entity A (quarterly reporting as defined in B137)	6.25	6.25	6.25	0.25	19.00	1.00
Entity B (annual reporting)					10.00	10.00
Alternative without B137 – Deloitte's view	6.25	6.25	6.25	(8.75)	10.00	10.00

Interim Financial Statements

Overview

- The Board **agreed with a majority of 13 against 1** to the Staff recommendation to amend the requirement relating to interim financial statements as set out in IFRS 17:B137 to **require** an entity to:
 - a) Make **an accounting policy choice** as to whether to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period; and
 - b) Apply its choice of accounting policy at the **reporting entity level**, i.e. to all insurance contracts issued and reinsurance contracts held

Interim Financial Statements

Staff analysis and recommendations

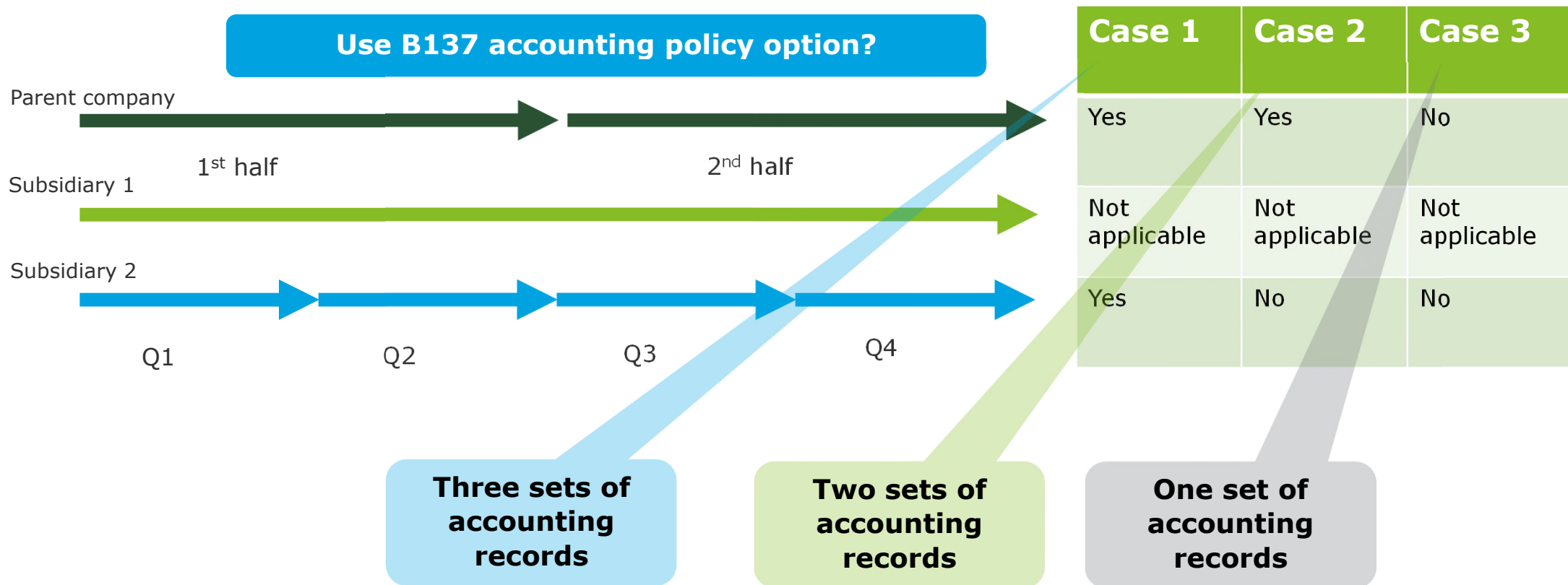
Staff analysis and recommendations

- Most of the respondents who provided feedback on the requirement of IFRS 17:B137 expressed concerns about the application of the requirement. These respondents noted that the requirement of IFRS 17:B137:
 - **Does not currently ensure comparability** between entities with different reporting frequency;
 - Results in a **more significant practical burden**, especially for entities in a consolidated group with different frequency of reporting;
 - Results in a **fundamental change** to existing insurance accounting practices for entities that currently use a year-to-date basis in interim financial statements, therefore presenting a major implementation challenge;
 - Does **not result in useful information** given that many entities currently do not fully update actuarial assumptions at interim periods for the purpose of applying IAS 34.
- At the November 2019 IASB meeting, the Staff have identified from the feedback from outreach activities and from comment letters additional information about the balance between the cost and benefits of applying the requirement of IFRS 17:B137. The Staff noted that the main sources of costs for the implementation and application of IFRS 17:B137 are the need for entities to:
 - Maintain two sets of accounting estimates; and
 - Change existing insurance accounting practices for interim financial statements, i.e. from a year-to-date basis to a period-to-period basis.

Interim Financial Statements

An accounting policy choice for accounting estimates

- Parent reports half year interim financials, one subsidiary reports annually and another subsidiary reports quarterly (due to a local regulator demanding IAS 34 financial reports to be published by all insurers in that market)



Interim Financial Statements

Other approaches considered

- The Staff considered other approaches suggested by stakeholders relating to the requirements of IFRS 17:B137:

a) **Deleting IFRS 17:B137**

However, deleting the requirement may result in unduly disrupting implementation for entities that might need to revisit the work already done to develop systems and processes to comply with the requirement.

b) Permitting a subsidiary to account for its insurance contracts **on the basis of the frequency of reporting at the consolidated level**

However, the Staff concluded that this approach would add complexity for both preparers and users of financial statements and would reduce comparability between entities.

Contracts acquired in their settlement period

Overview

- Under IFRS 17, an entity is **required** to account for the liability for settlement of claims incurred before the contracts were acquired/transferred in a business combination or a portfolio transfer as a **liability for remaining coverage**, leading to the recognition of insurance revenue in the acquiring entity in future periods.
- The Exposure Draft *Amendments to IFRS 17* (ED) proposed to **amend** the transition requirements such that:
 - For entities applying the **modified retrospective approach** (MRA), the entity is **required** to classify the liability for settlement of claims incurred before the contracts were acquired/transferred as a liability for incurred claims if the entity does not have reasonable and supportable information to apply the retrospective approach.
 - For entities applying the **fair value approach** (FVA), the entities are provided an **optional relief** to classify such liability as a liability for incurred claims.
- The Board **unanimously approved** to retain, **unchanged** the requirements of IFRS 17 for insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3, *Business Combinations*.

Contracts acquired in their settlement period

Staff analysis and recommendations

- The following is an illustrative example in Agenda Paper 2C with Deloitte additional analysis:

An entity acquires an insurance contract in its settlement period. At acquisition date:

- o Expected claims CU300
- o plus Risk adjustment CU50
- o less Consideration received CU370
- o equals CSM CU20

Assuming events occurred as expected, the following amounts are recognised in profit or loss, applying IFRS 17.

Profit or loss	Parent/acquirer FS	Contracts acquired via BC Subsidiary FS	Contracts acquired via portfolio transfer Vendor FS
Insurance revenue	370	Nil	Nil
Insurance service expenses	(300)	Nil	(20)
Insurance service results	70	50	(20)

The insurance revenue recognised from insurance contracts acquired in their settlement period would equal the consideration the entity receives on the acquisition.

Contracts acquired in their settlement period

Deloitte's Comments

Deloitte Comment Letter:

- Our **position:** "We support the proposal in the ED, however we note that this exemption is applicable only on transition and only to the extent the entity does not have reasonable and supportable information for the full retrospective approach..."
- Our **proposal:** "To address this concern, we recommend that the IASB requires the presentation of the earning of the liability for remaining coverage that relates to the settlement of uncertain claims on contracts acquired in a business combination in a claim settlement phase as a gain in the insurance service expense line, and not as insurance revenue. In our view, this would still reflect the principle of measurement of such liability and related CSM over the period of discovery of the ultimate cost of claims, but it would better reflect the economic nature of the consideration allocated to such contracts in a business combination and would improve comparability both over time and across entities."
- Applying Deloitte's proposed accounting treatment, the following amounts will be recognised in profit or loss:

Profit or loss	CU
Insurance revenue	0
Insurance service expenses	70 ^A
Insurance service results	70

A Actual claims
Gain from insurance contracts
in settlement period

CU300

CU370
CU 70

Of which CU50 from
RA and CU20 from
CSM

This accounting treatment will result in contracts acquired in their settlement period being **treated in the same way** whether the contract is acquired before or after the transition date.

Contracts acquired in their settlement period Deloitte's Comments (cont.)

- On their first IFRS 17, FS insurers will have to disclose up to three types of liabilities in their settlement period:

Liability for incurred claims (LIC) from issued contracts (no CSM, no future insurance revenue)

LIC acquired in prior periods before the point when full restatement is impracticable (no CSM, no future insurance revenue) – MRA balances

LIC acquired in prior periods before the point when full restatement is impracticable (no CSM, no future insurance revenue) – FVA balances

LIC acquired in prior periods¹ when the full restatement is practicable (with CSM and with future insurance revenue) – This will apply also to all future acquisitions

1 – the acquirer will have to classify this as a LRC

- It may be difficult to argue that these insurance contracts are in the same group of contracts
- With this decision, insurance revenue could grow year on year when an entity completes an acquisition of LIC even if no insurance revenue is recognised in the acquired/underlying subsidiaries and insurance revenue from contracts issued by the acquirer may decline in the same period.
- No disclosure to split the different types or insurance revenue was proposed in the Staff paper except for insurance revenue arising from different restatement approaches.
- LIC with CSM could also become onerous – a Loss Component for these LIC will only appear in the parent company FS
- Reinsurance purchased will have different treatment. Let's consider a stop loss on the LIC purchased in the subsidiary after acquisition date with a net cost for the cedant:
 - The subsidiary FS will charge the net cost to P&L because the protection is for past insured events;
 - The parent FS will defer and amortise the net cost to P&L because the protection is for a future coverage period

Assets for insurance acquisition cash flows – Transition and Business Combinations

Recognition of an IACF asset at transition

- In response to the feedback received from respondents on the ED that the proposed amendments relating to insurance acquisition cash flows (IACF) did not specify how to recognize and measure an IACF asset at transition, the Board **agreed** during this meeting with the Staff recommendations to amend IFRS 17 to provide guidance relating to:
 - Recognition of an IACF asset at transition
 - Recognition of an IACF asset for acquired contracts at transition
 - Impairment test considerations on transition

Recognition of an IACF asset at transition

Full retrospective approach

- The Board agreed to **amend** IFRS 17 to **require** an entity **to identify, recognise and measure an asset for IACF** at the transition date as if IFRS 17 has always applied.
- If and only if, it is impracticable for the entity to apply IFRS 17 retrospectively, an entity is required to measure an asset for IACF at the transition date applying either the modified retrospective approach (MRA) or the fair value approach (FVA).

Assets for insurance acquisition cash flows – Transition and Business Combinations

Recognition of an IACF asset at transition (cont.)

Modified retrospective approach

- The Board **agreed to amend IFRS 17** to require an entity to:
 - a) Permit** an entity to use the modifications in items (b) and (d) below only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.
 - b) Measure an asset for IACF using information available at the transition date by:
 - i. Identifying the amount of IACF paid before the transition date, excluding the amount relating to the contracts that ceased to exist before the transition date; and
 - ii. Allocating the amount determined in item (b)(i) above using the same systematic and rational allocation method that the entity will apply going forward to:
 - (a) Groups of insurance contracts that are recognised at the transition date; and
 - (b) Groups of insurance contracts that are expected to be recognised after the transition date.
 - c) Adjust the measurement of the CSM of the groups of insurance contracts that are recognised at the transition date by deducting the amount of IACF determined applying item (b)(ii)(a) above. This accounting treatment will be consistent with that for measuring CSM of group of insurance contracts at initial recognition.

Assets for insurance acquisition cash flows – Transition and Business Combinations

Recognition of an IACF asset at transition (cont.)

Modified retrospective approach (cont.)

- d) Recognise an asset for IACF for the groups of insurance contracts that are expected to be recognised after the transition date at the amount determined applying item (b)(ii)(b). The IACF asset will be included in the measurement of the CSM when the entity recognises the group of insurance contracts to which it is allocated.
- e) When there is no reasonable and supportable information necessary to apply the modifications described in item b-d above, apply the MRA as follows:
 - i. Make the adjustment to the CSM of the groups of insurance contracts that are recognised at the transition date equal to nil; and
 - ii. Make the asset for IACF for the group of insurance contracts that are expected to be recognised after the transition date equal to nil.

Fair value approach

- The Board **agreed to amend IFRS 17** to require an entity to recognise an asset for IACF measured as the amount of IACF that the entity would incur at the transition date if the entity had not already paid those IACF to obtain the rights to:
 - a) Recover IACF from premiums of insurance contracts originated before the transition date but not yet recognised at the transition date; or
 - b) Obtain future contracts, including the expected renewals, after the transition date without paying again IACF the entity has already paid.

Assets for insurance acquisition cash flows – Transition and Business Combinations

Additional amendments

Transfer of insurance contracts and business combinations

- The Staff noted that at acquisition date, an asset for IACF would represent the right of the acquirer to obtain future contracts after the transition date without paying again IACF that have already been paid, and therefore the acquirer should recognise an IACF asset separately from intangible assets recognised applying IFRS 3, *Business Combinations*.
- The Board **agreed to amend IFRS 3 and IFRS 17** to require an entity to recognise a separate asset for IACF measured at **fair value at the acquisition date** for acquired contracts.

Impairment test

- The Board clarified that on transition to IFRS 17, an entity is **not required** to apply the recoverability assessment requirement retrospectively for IACF asset recognised at the transition date.

Transition – Risk Mitigation Option

Prospective application from transition date

- The Board did consider the 'all or nothing' approach suggested by stakeholders that would permit an entity to apply the risk mitigation option retrospectively if and only if the entity applies the option for all risk mitigation relationships that would meet the requirements of IFRS 17:B116.
- However, as the Staff indicated in the paper, **the 'all or nothing' approach would be impracticable in almost all cases** as meeting the conditions to apply such approach would be a high hurdle.
- The Board **voted 13 in favour** to retain, unchanged the prohibition from applying the risk mitigation option retrospectively, with **1 abstention**.

Scope exclusion from IFRS 17 for some credit card contracts

A reverse unbundling regime applies to all credit cards scoped out of IFRS 17

- The Staff proposed to add the requirement that if the entity provides the insurance coverage to the customer as part of the contractual terms of such a credit card contract, the entity is required to:
 - 1) **Separate** that insurance coverage component and apply IFRS 17 to it; and
 - 2) Apply other applicable IFRS Standard, such as IFRS 9 to the other components of the credit card contract.
- This is a form of “reverse unbundling” as it applies to transactions scoped out of IFRS 17 but for which their insurance component is unbundled on a mandatory basis and brought back into IFRS 17 in all cases
- This solution allows also the SPPI test in IFRS 9 to be passed ordinarily given that the more volatile insurance cash flows are unbundled from the credit card that is accounted under IFRS 9
- The Board agreed with the Staff’s recommendations and voted **unanimously in favour** of the scope exclusion from IFRS 17 of some credit card contracts that meet the criteria for scope exclusion, including the proposed changes to separate insurance coverage in certain credit cards (i.e. those for which the scope exclusion test from the ED applies) and apply IFRS 17 to it.
- In addition, the Board agreed to **extend the scope exclusion to other contracts that provide credit or payment arrangements that are similar to the credit cards** meeting the IFRS 17 scope exclusion criteria.

Scope exclusion from IFRS 17 for some credit card contracts

Deloitte's Comments

Deloitte Comment Letter:

- Our **position**: “We support the proposal in the ED that credit card contracts that provide insurance coverage would be excluded from the scope of IFRS 17 for the reasons noted in the ED...”
- Our **proposal**: “...We recommend that the amendment merely scopes out the arrangement from IFRS 17 and remains silent on which IFRS Standard applies. This would ensure that **obligations bundled with the insurance component and the financial instrument component** that form the credit card contract **are accounted for under the most appropriate IFRS Standard...**”

We propose the scope **refers to 'credit cards and similar payment cards'** and the Basis for Conclusions explains that the scope is intended to provide relief for the insurance risk relating to the goods and services purchased under a credit relationship created by the financial institution or credit relationship created by the purchaser (in the case where the purchaser pre-funds the purchase).”

Next steps

- The IASB will vote on the remaining topics on February 2020 IASB meeting (w/c 24 February). The remaining topics should include:
 1. [Non-ED item] Level of aggregation – annual cohorts for some specific insurance contracts (contracts with mutualisation features);
 2. CSM attributable to investment services—coverage units for insurance contracts without direct participating features, disclosures and terminology;
 3. Applicability of the risk mitigation option to non-derivative financial instruments at FVTPL
- The Staff announced that a paper to the IASB regarding the proposed effective date of IFRS 17 and the proposed extension of the IFRS 9 Financial Instruments temporary exemption in IFRS 4 will be tabled on the March 2020 IASB meeting (w/c 16 March).
- The Staff noted that the progress of the deliberations remains in line with the IASB's plan and on track for the expected publication of the final amendments by mid-2020.





Contact details

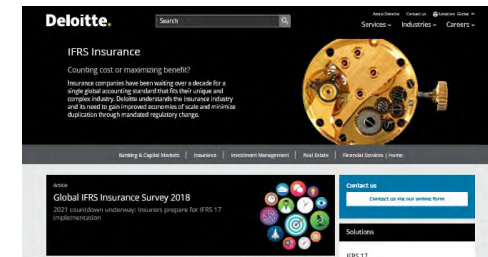
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