



Need to know

IASB amends the transition requirements of IFRS 17

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This *Need to know* outlines the amendment to IFRS 17 *Insurance Contracts* titled *Initial Application of IFRS 9 and IFRS 17—Comparative Information* published by the International Accounting Standards Board (Board) in December 2021.

- The Board published a narrow-scope amendment to the transition requirements in IFRS 17
- For entities that apply IFRS 17 and IFRS 9 at the same time, the amendment relates to financial assets for which comparative information presented on initial application of IFRS 17 and IFRS 9 has not been restated for IFRS 9 (including financial assets that have been derecognised in the comparative period)
- Applying the amendment, an entity is permitted to present comparative information about such financial assets as if the classification and measurement requirements of IFRS 9 had been applied to the financial assets. The option is available on an instrument-by-instrument basis
- In applying the classification overlay to a financial asset, an entity is not required to apply the impairment requirements of IFRS 9
- The amendment is also available for entities that have applied IFRS 9 before they apply IFRS 17. For these entities, the classification overlay applies to financial assets that have been derecognised in the comparative period and permits an entity to apply the redesignation requirements of IFRS 17 based on how the entity expects the asset would have been designated at initial application of IFRS 17
- The amendment is effective at the time an entity first applies IFRS 17

Background

Many insurance entities have elected to apply the temporary exemption that allows them to defer the adoption of IFRS 9 *Financial Instruments* until they apply IFRS 17. However, the two Standards have different requirements with respect of the comparative information presented on initial application. IFRS 17 requires entities to present at least one restated comparative period, while IFRS 9 permits (but does not require) restatement of comparative periods. IFRS 9 prohibits entities from applying IFRS 9 to financial assets derecognised before the date of initial application of IFRS 9.

For more information please see the following websites:

www.ukaccountingplus.co.uk

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Many insurers plan to present restated comparative information for financial assets applying IFRS 9 because they believe that doing so will improve the usefulness of the information presented. However, some of these insurers have raised concerns about the usefulness of the information that would be presented if the comparative period includes a mixture of financial assets classified applying IFRS 9 and others applying IAS 39 *Financial Instruments: Recognition and Measurement*. They noted that this has the potential to create information that may be misleading because it may result in accounting mismatches between insurance contract liabilities and financial assets in the comparative period. These insurers have noted that such information, when compared with the year that includes the full application of IFRS 9 and IFRS 17, would be very difficult to explain.

Further, insurers have raised concerns about the operational complexity of not being able to identify which financial assets will be restated for IFRS 9 until the end of the comparative period.

To address these challenges, insurers asked the Board for the option to present information about financial instruments that reflects the application of the classification requirements of IFRS 9 at the transition date of IFRS 17. The Board has responded to these demands by proposing an amendment to IFRS 17 in Exposure Draft ED/2021/8 *Initial Application of IFRS 9 and IFRS 17—Comparative Information* (the 'ED'), which has now been finalised.

The amendment

An entity that first applies IFRS 17 and IFRS 9 at the same time is permitted to apply a classification overlay for the purpose of presenting comparative information about a financial asset if the comparative information for that financial asset has not been restated for IFRS 9. This may be the case if either the entity chooses not to restate prior periods, or if the entity restates prior periods but the financial asset has been derecognised during those prior periods.

Observation

The Board concluded that the classification overlay should be optional on an instrument-by-instrument basis to allow an entity to assess whether, for a particular financial asset, the benefits of applying the classification overlay outweigh the costs. However, the Board observed that the option to apply the classification overlay on an instrument-by-instrument basis does not prevent an entity from applying it at a higher level of aggregation, for example, by considering the level at which the entity would assess its business model when applying IFRS 9.

The amendment requires that an entity applying the classification overlay to a financial asset presents comparative information as if the classification and measurement requirements of IFRS 9 had been applied to that financial asset. The entity uses reasonable and supportable information available at the transition date to determine how the entity expects the financial asset would be classified and measured on initial application of IFRS 9 (for example, an entity might use preliminary assessments performed to prepare for the initial application of IFRS 9).

Observation

The Basis for Conclusions to the amendment explains that, applying the classification overlay, an entity aligns the classification and measurement of a financial asset in the comparative information with what the entity expects the classification and measurement of that financial asset would be on initial application of IFRS 9. The Board concluded that this expected IFRS 9 classification and measurement should be determined at the transition date to IFRS 17 to enable entities to prepare to apply the classification overlay. In making this determination the entities must use reasonable and supportable information available at the transition date. As an example, an entity could use preliminary assessments of the business model and cash flow characteristics performed to prepare for the initial application of IFRS 9.

In applying the classification overlay to a financial asset, an entity is not required to apply the impairment requirements of IFRS 9. If, based on the classification determined under the amendment, the financial asset would be subject to the IFRS 9 impairment requirements, but the entity does not apply those requirements in applying the classification overlay, the entity continues to present any amount recognised in respect of impairment in the prior period in accordance with IAS 39. Otherwise, any such amounts are reversed and replaced by the restated IFRS 9 impairment amounts.

Any difference between the previous carrying amount of a financial asset and the carrying amount at the transition date that results from applying the classification overlay is recognised in opening retained earnings (or other component of equity, as appropriate) at the transition date.

An entity that applies the classification overlay discloses qualitative information that enables users of financial statements to understand the extent to which the classification overlay has been applied (for example, whether it has been applied to all financial assets derecognised in the comparative period) and whether and to what extent the impairment requirements in IFRS 9 have been applied.

An entity only applies the classification overlay to comparative information for reporting periods between the transition date to IFRS 17 and the date of initial application of IFRS 17.

At the date of initial application of IFRS 9, an entity applies the transition requirements in IFRS 9.

Observation

In the ED, the Board proposed that the classification overlay would not apply to financial assets held in respect of an activity unconnected with contracts within the scope of IFRS 17. However, respondents to the ED informed the Board that permitting an entity that first applies IFRS 17 and IFRS 9 at the same time to apply the classification overlay to financial assets held in respect of non-insurance activities could improve the usefulness of comparative information presented on initial application.

The Board therefore concluded that the benefits of expanding the availability of the classification overlay would outweigh any perceived costs.

The amendment is also available for entities that have applied IFRS 9 before they apply IFRS 17. For these entities, the classification overlay applies to financial assets that have been derecognised in the comparative period and permits an entity to apply the redesignation requirements of IFRS 17 based on how the entity expects the asset would have been designated at initial application of IFRS 17.

Observation

In the ED, the Board proposed that the classification overlay could be applied only by those entities that first apply IFRS 9 at the same time as IFRS 17. However, stakeholders informed the Board that similar, albeit less significant, accounting mismatches could arise for entities that applied IFRS 9 before they first apply IFRS 17. Such mismatches could arise because these entities cannot apply paragraph C29 of IFRS 17 to financial assets derecognised in the comparative period. Therefore, the Board decided to make the classification overlay available to these entities as well, but only for financial assets derecognised in the comparative period.

Effective date

An entity that chooses to apply the classification overlay, applies it on initial application of IFRS 17.

Application in the UK

IFRS 17, including this amendment, is not yet endorsed for use in the UK and can therefore not be applied early by UK IFRS preparers. The UK Endorsement Board is currently consulting on the endorsement and expects to approve the adoption of IFRS 17 in March 2022.

Further information

If you have any questions about the amendment to IFRS 17, please speak to your usual Deloitte contact.

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