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Overview of accounting implications for non-insurers of IFRS 17 Insurance Contracts

Irrespective of whether an entity has previously applied IFRS 4 *Insurance Contracts*, the transition to IFRS 17 *Insurance Contracts* is likely to have significant impacts on the systems an entity uses to monitor and manage the insurance contracts it issues, as well as its reported operating results and financial position. Over the coming months we will focus on the recognition, measurement, presentation and disclosure implications for non-insurers transitioning to IFRS 17. Notwithstanding we will be focusing on non-insurers, many of the implications we discuss will be equally relevant to registered insurers. However, before we dive headlong into the accounting implications, let us have a brief recap of what we have covered to date.

When does IFRS 17 apply

As discussed in our April and May editions of *Accounting Alert*, if an arrangement meets the definition of an insurance contract for annual reporting periods beginning on or after 1 January 2023, the contract is required to be accounted for as an insurance contract under IFRS 17 , unless either:

- The type of contract is specifically scoped out of IFRS 17 *Insurance Contracts*, or
- An accounting policy choice is available in respect to the type of contract that permits an entity to account for the contract under another standard, the entity meets any specified criteria in respect to the accounting policy choice, and the entity chooses to apply an Accounting Standard other than IFRS 17.

Credit card and similar contracts providing credit or payment arrangements scoped out of IFRS 17

As discussed in the May edition of *Accounting Alert*, the International Accounting Standards Board (IASB) subsequently amended IFRS 17 to mandatorily scope out credit card contracts (or similar contracts that provide credit or payment arrangements) which meet the definition of an insurance contract, provided that the issuer does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with the customer.

Irrevocable choice to apply IFRS 17 or IFRS 9 in certain circumstances

We also discussed in the May edition of *Accounting Alert* the IASB's decision to subsequently amend the scope of IFRS 17 to permit issuers with an irrevocable choice to apply (on a portfolio-by-portfolio basis) either IFRS 17 or IFRS 9 *Financial Instruments* to contracts that limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract, such as loans with death waivers.

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It is also rele that had utilised the policy choice available under IFRS 4 *Insurance Contracts* (and accounted for financial guarantee contracts under IFRS 9) could choose to utilise the corresponding accounting choice available under IFRS 17. That is, they can make an irrevocable policy choice, on a contract-by-contract basis, to account for financial guarantee contracts under IFRS 9, IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures*.

For an entity that had previously asserted explicitly that it regarded its financial guarantee contracts as insurance contracts, the choice between IFRS 17 and IFRS 9, IAS 32 and IFRS 7 is not available; it is required to account for its financial guarantee contracts under IFRS 17.

Insurance liabilities under IFRS 4 and IFRS 17 could be different

The IASB consider IFRS 4 as 'Phase 1' of a two-Phase project to transition the accounting for insurance contracts to a more robust reporting framework. In an attempt to strike a balance between setting a minimum standard of reporting in respect to insurance contracts, and accommodating the diversity in insurance accounting practices in 2005, IFRS 4 did not specify a comprehensive insurance liability measurement model. It only required that an entity with insurance contracts apply, at a minimum, a **liability adequacy test** to recognised insurance contracts. The purpose of the liability adequacy test was to determine whether provisioning, based on current estimates of future cash flows, is adequate.

For those entities transitioning from IFRS 4 to IFRS 17 (as well as those entities adopting IFRS 17 for the first time), **the most apparent differences between the two Standards are the insurance liability measurement models**. The following table provides a summary of the potential differences in practices for measuring insurance liabilities under IFRS 4 and IFRS 17.

IFRS 4	IFRS 17

No specific requirements regarding the **unit of account** for measurement purposes, except in relation to some embedded derivatives and deposit components.	Insurance contracts are required to be **initially identified at the portfolio level**, comprising contracts that are: • subject to similar risks, and • managed together. For measurement purposes, **portfolios** of insurance contracts are required to be **further subdivided** into (if applicable): • groups of contracts that are onerous at initial recognition • groups of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, and • a group of the remaining contracts in the portfolio. In addition, contracts issued more than one year apart are **not permitted** to be included in the same group.
No specific requirements regarding when a liability for an insurance contract should be initially recognised.	A group of insurance contracts will be recognised from the **earliest of**: • the beginning of the coverage period of the group of contracts • the date when the first payment from a policyholder in the group becomes due, and • for a group of onerous contracts, when the group becomes onerous.

No comprehensive measurement model specified, except in relation to some embedded derivatives and deposit components.	On initial recognition of a group of insurance contracts, apply the General Measurement Approach (GMA) unless: • the group of insurance contracts meet the necessary criteria for application of the Premium Allocation Approach (PAA) and the entity chooses to apply the PAA to that group, or • the group of insurance contracts contain a discretionary participation feature, in which case the entity applies the Variable Fee Approach (VFA). At the end of each reporting period, the carrying amount of a group of insurance contracts is measured at the sum of: • the liability for remaining coverage, comprising the remaining fulfilment cash flows allocated to the group of contracts and the remeasured amount of the contract service margin*, and • the liability for incurred claims, comprising the fulfilment cash flows related to past service allocated to the group of contracts.
** The contractual service margin represents the unearned profit the issuer of an insurance contract will recognise as it provides insurance contract services in the future over the term of the insurance contract.*	
No definitive guidance in relation to the recognition of any contractual service margin incorporated within insurance contracts.	Except in relation to onerous contracts and some types of assets or liabilities recognised prior to associated insurance contracts, the contractual service margin on initial recognition is measured at an amount that results in no income or expenses at initial recognition of the associated insurance contracts.
Insurance contracts could be measured using dated assumptions.	Insurance contracts must be measured at their current value using assumptions and information that reflects economic conditions at the measurement date.

No definitive guidance in respect to discount rates. Accordingly, cash flows need not be discounted.	All insurance contract balances are to be measured on a present value basis (subject to materiality) using a discount rate that reflects: • the time value of money • the characteristics of the future cash flows • liquidity characteristics of the insurance contracts, and • a risk adjustment for uncertainty about the amount and timing of the cash flows arising from non-financial risk. In addition, discount rates must: • be consistent with observable current market prices for comparable financial instruments, and • exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

As is evident from the table above, subject to the approach previously adopted, the transition to IFRS 17 may have significant impacts on the reported results of entities transitioning to IFRS 17, as well as those entities adopting IFRS 17 for the first time. For instance, entities transitioning from IFRS 4 to IFRS 17 may experience a change in the carrying amount of its insurance liabilities as a consequence of having to adjust the discount rate used to:

- Incorporate the impact of:
  - Time value of money
  - Liquidity risk
  - Non-financial risk, and
- Exclude the impact (if any) of expected returns on assets held.

Over the coming months we will look at each of the components of the liability measurement model under IFRS 17 outlined above, and the potential implications for those entities transitioning from IFRS 4 to IFRS 17, as well as those entities adopting IFRS 17 for the first time.

For more on the above, please contact your local BDO representative.