STAFF PAPER

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Project	**Amendments to IFRS 17 *Insurance Contracts***		
Paper topic	Transition—Optionality and comparative information		
CONTACT(S)	Chalani Mohotti	cmohotti@ifrs.org	+44 (0)20 7246 6436
	Laura Kennedy	lkennedy@ifrs.org	+44 (0)20 7246 6437
	Hagit Keren	hkeren@ifrs.org	+44 (0)20 7246 6410

Purpose

1. This paper discusses the transition requirements in IFRS 17 *Insurance Contracts*. Agenda Paper 2C *Transition—Risk mitigation option and amounts accumulated in other comprehensive income on transition* and Agenda Paper 2D *Transition—Modified retrospective approach* are also about the transition requirements in IFRS 17.

2. This paper discusses the following topics:

   (a) optionality included in the transition requirements (paragraphs 5–16 of this paper); and

   (b) the requirement to present comparative information for prior reporting periods (paragraphs 17−29 of this paper).

Summary of staff recommendations

3. The staff recommend the International Accounting Standards Board (Board):

   (a) retain the IFRS 17 transition requirements, without amendments that would reduce optionality included in those requirements; and

   (b) retain the IFRS 17 requirement to present restated comparative information for the annual reporting period immediately preceding the date of initial application of IFRS 17.

Structure of the paper

4. For each topic, this paper provides:

   (a) an overview of the requirements in IFRS 17;

   (b) a summary of the Board's rationale for setting those requirements, including an overview of the Board's previous discussions;

   (c) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued; and

   (d) the staff analysis, recommendation and question for Board members.

Optionality included in the transition requirements

IFRS 17 requirements

5. An entity is required to apply IFRS 17 retrospectively, unless impracticable.[1] If a full retrospective application is impracticable, an entity can choose—on a group-by-group basis—between:

   (a) the modified retrospective approach, that aims to approximate the outcome of a retrospective application of IFRS 17; and

   (b) the fair value approach.

[1] The risk mitigation exception in paragraph B115 of IFRS 17 cannot be applied for periods before the date of initial application of IFRS 17. Agenda paper 2C discusses this topic.

6. Applying the fair value approach, an entity is permitted to make choices regarding specified aspects of the requirements.

Board's rationale

7. The Board concluded that entities should apply IFRS 17 retrospectively and should be allowed to use alternative methods only when retrospective application of IFRS 17 is impracticable. This conclusion is consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Applying IAS 8, when an entity changes an accounting policy upon initial application of an IFRS Standard that does not include specific transitional provisions applying to that change, it shall apply the change retrospectively except to the extent that it is impracticable.[2]

8. In developing alternative transition approaches, the Board had to balance the usefulness of the information provided to users of financial statements, the request of some preparers to develop approaches to transition that approximate the outcome of full retrospective application and the practical concerns related to retrospective application. The Board considered the following:

   (a) feedback on the 2010 Exposure Draft *Insurance Contracts*—some stakeholders recommended that the Board develop approaches to estimate a residual margin (term used for the predecessor to the contractual service margin) on transition, even though such approaches would likely be costly.

   (b) feedback on the 2013 Exposure Draft *Insurance Contracts*—some insurers suggested that the Board provide further simplifications to the alternative transition approaches that would be applied to contracts for which a full retrospective application would be impracticable.

   (c) feedback during the external testing of a draft of IFRS 17 conducted in the second half of 2016—as a result of this feedback, the Board decided to provide additional cost relief to insurers, in particular, by permitting an entity to choose between a modified retrospective approach and a fair value approach when it is impracticable to apply a full retrospective approach.

[2] IAS 8 defines applying a requirement as impracticable when the entity cannot apply it after making every reasonable effort to do so.

9. As explained in paragraph BC373 of the Basis for Conclusions on IFRS 17, the Board acknowledged a choice of transition methods results in a lack of comparability of transition amounts but concluded it was appropriate because of the variety of situations that could arise. Particularly:

(a) the similarity between a modified retrospective approach and a full retrospective application would depend on the amount of reasonable and supportable information[3] available to an entity; and

(b) if an entity has relatively little reasonable and supportable information available, and therefore would need to use many of the permitted modifications, the cost of the modified retrospective approach might exceed the benefits.

10. The Board expected that there would be differences in the measurement of insurance contracts when applying the different transition approaches permitted in IFRS 17. Accordingly, the Board decided to require an entity to provide disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the contractual service margin and revenue in subsequent periods. Furthermore, the Board decided that entities should explain how they determined the measurement of insurance contracts that existed at the transition date for all periods in which these disclosures are required. This information will assist users of financial statements to understand the nature and significance of the methods used and judgements applied.

Concerns and implementation challenges expressed since IFRS 17 was issued

11. Some stakeholders are concerned that the optionality and availability of different transition approaches could reduce comparability of entities' performance after the date of transition, potentially for a number of years.

[3] The use of 'reasonable and supportable information' is further discussed in Agenda Paper 2D.

12. Most investors and analysts we spoke to agreed with the Board's conclusion that retrospective application of IFRS 17 provides the most useful information by allowing comparison between contracts written before and after the date of transition. Those investors and analysts were therefore concerned that the use of alternative transition methods could result in a loss of trend information for some groups of insurance contracts. Many were pleased to learn that entities will be required to separately disclose the 'transition contractual service margin' in subsequent periods and agreed that this disclosure requirement could be a mitigating factor that is helpful in their future analysis.

Staff analysis and recommendation

13. The Board developed the transition requirements considering the feedback during the development of IFRS 17. The concerns expressed by stakeholders in paragraphs 11−12 of this paper are similar to the concerns that the Board heard during the development of IFRS 17.

14. The staff think that the following possible amendments to IFRS 17 would reduce optionality relating to the transition requirements, could increase comparability between entities and would therefore address the concerns about optionality raised by stakeholders:

    (a) removing the choice between the modified retrospective approach and the fair value approach when retrospective application is impracticable;

    (b) requiring the application of the fair value approach when retrospective application is impracticable; or

    (c) removing the choices available to an entity when applying the fair value approach.

15. However, the staff do not think that amending the transition requirements of IFRS 17 as discussed in paragraph 14 of this paper would meet the criteria for amending IFRS 17 set by the Board at its October 2018 meeting because:

    (a) limiting the availability of any approach or removing the choices available to an entity applying the fair value approach may unduly disrupt implementation already under way; and

(b) the Board already exposed a version of the approaches described in paragraphs 14(a)−(b) of this paper for comments and developed the transition requirements based on feedback.

16. The staff recommend the Board retain the IFRS 17 transition requirements, without amendments that would reduce the optionality included in those requirements.

Question for Board members
Do you agree the Board should retain the IFRS 17 transition requirements, without amendment that would reduce the optionality included in those requirements?

Comparative information

IFRS 17 requirements

17. On initial application of IFRS 17, an entity is required to restate comparative information about insurance contracts for the annual reporting period immediately preceding the date of initial application. IFRS 17 permits, but does not require, an entity to present adjusted comparative information applying IFRS 17 for any earlier periods presented.

Board's rationale

18. The Board concluded that the restatement of comparative information about insurance contracts on initial application of IFRS 17 is necessary to allow users of financial statements to assess the effects of applying IFRS 17 for the first time because:

(a) IFRS 17 introduces fundamental changes to the accounting for insurance contracts, which are currently subject to the wide range of accounting practices entities apply under IFRS 4 *Insurance Contracts*; and

(b) the effects are so pervasive on the financial statements of insurers.

19. Paragraph BC389 of the Basis for Conclusions on IFRS17 explains that the requirement in IFRS 17 for the restatement of comparative information for one reporting period differs from the IFRS 9 *Financial Instruments* transition requirements. IFRS 9 did not:

    (a) require restatement of comparative amounts at transition; or

    (b) allow restatement if doing so required the use of hindsight.

20. The Board noted that different circumstances applied when it developed the transition requirements for IFRS 9:

    (a) the requirements in IFRS 9 were developed with the intention of minimising obstacles to voluntary application of IFRS 9 before its effective date. In addition, entities applying the IFRS 9 transition requirements had all previously applied the same requirements (ie the requirements in IAS 39 *Financial Instruments: Recognition and Measurement*).

    (b) in contrast, the Board expects that most entities will apply IFRS 17 no earlier than the effective date and views the restatement of comparative amounts on transition to IFRS 17 as particularly important. The Board therefore decided not to provide relief from the restatement of comparative information to facilitate early application of IFRS 17.

21. The Board considered the disadvantages that would result if entities restated comparative information for insurance contracts, but not for financial assets. However, the Board concluded that an entity can avoid accounting mismatches because it is permitted, but not required, to restate comparative information applying IFRS 9 if it is possible without hindsight.

Concerns and implementation challenges expressed since IFRS 17 was issued

22. Some stakeholders expressed the view that there is insufficient time to implement IFRS 17 before its effective date of 1 January 2021 and suggested that the Board could address the concerns expressed about the effective date of IFRS 17 by permitting entities not to present adjusted comparative information when applying IFRS 17.

23. Some stakeholders are concerned that financial statements that restate comparative information about insurance contracts, but not about financial assets, could distort users' understanding of those entities' economic circumstances and transactions, both in prior periods and the current period. This is because the comparative period might show accounting mismatches between insurance contracts and related financial assets, and the net financial position and profit reported by entities in the comparative period would not be comparable to that reported in the current reporting period.

24. Some stakeholders also note the different approach to restating comparative information applying the transition requirements of IFRS 9.

Staff analysis and recommendation

25. The staff note that the Board has already tentatively decided to defer the effective date of IFRS 17 by one year.[4] This gives entities a further year to prepare comparative information.

26. The staff think that the reasons for which the Board decided to require entities to restate comparative information for insurance contracts, but not for financial assets discussed in paragraphs 19–21 of this paper are still valid. The staff note that an entity can:

    (a) avoid accounting mismatches because it is permitted, but not required, to restate comparative information applying IFRS 9 if it is possible without hindsight; and

    (b) start collecting the necessary information now to apply IFRS 9 without hindsight.

27. The staff think that permitting entities not to present adjusted comparative information when first applying IFRS 17 would increase the complexity for users of financial statements and, therefore, would cause significant loss of useful information relative to that which would be provided by IFRS 17 which requires the presentation of comparative information.

[4] November 2018 Board meeting.

28. Investors and analysts we spoke to since the issuance of the Standard have already noted how difficult it will be to understand the transition to IFRS 17 in the light of the options available on transition (see discussion in paragraphs 5−16 of this paper). Permitting entities not to present adjusted comparative information when first applying IFRS 17 would add to this issue.

29. The staff recommend the Board retain the IFRS 17 requirement to present restated comparative information for the annual reporting period immediately preceding the date of initial application of IFRS 17.

Question for Board members

Do you agree the Board should retain the IFRS 17 requirement to present restated comparative information for the annual reporting period immediately preceding the date of initial application of IFRS 17?