STAFF PAPER

July 2014

REG IASB Meeting

Project	**Insurance contracts**
Paper topic	Changes in accounting policy

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Objective

1. During its March 2014 meeting, the IASB tentatively decided that an entity should choose to present the effect of changes in discount rates in profit and loss or in other comprehensive income as its accounting policy and should apply that accounting policy to all contracts within a portfolio, subject to developing:

   (a) guidance that entities should apply the same accounting policy to groups of similar portfolios, and

   (b) guidance that would provide rigour about when entities could change accounting policies based on the requirements for changing accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

2. In June 2014 the IASB tentatively decided to clarify that, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity should select and apply its accounting policies consistently for similar contracts, considering the portfolio in which the contract is included, the assets that the entity holds and how those assets are accounted for.

3. This paper considers existing requirements for changes in accounting policies and considers if further requirements are needed for insurance contracts. This paper also considers an issue relating to retrospective application of changes in accounting policy that was identified in the March 2014 meeting.

Staff recommendation

4. The staff recommend that an entity should apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to changes in accounting policy relating to the presentation of the effect of changes in discount rate.

Staff analysis

Changes in accounting policy

5. The IASB's tentative decision that an entity should choose as its accounting policy whether to present the effect of changes in discount rate in profit or loss or other comprehensive income means that entities would be able to change from one period to the next where those effects are presented. The IASB acknowledges that there may be instances when an entity may decide that changing its accounting policy is appropriate. However, in order to provide users with meaningful information, financial statements of an entity must be comparable between periods, and frequent changes in accounting policy would reduce comparability.

6. Therefore, the IASB asked the staff to consider whether any additional requirements are needed to address the concerns that an entity could change its accounting policy frequently, or only to achieve a favourable accounting outcome.

7. The requirements relating to a change in accounting policy are set out in IAS 8. That standard addresses the concerns described in paragraph 5 as follows:

   (a) paragraph 14 of IAS 8 restricts the reasons for changes in accounting policy, as follows:

   > An entity shall change an accounting policy only if the change:
   >
   > (a) is required by an IFRS; or
   >
   > (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

   (b) paragraph 19(b) of IAS 8 requires an entity to apply a change in accounting policy retrospectively, and

   (c) paragraph 29 of IAS 8 requires disclosure of:

   > (i) the nature of the change in accounting policy;

(ii) the reasons why applying the new accounting policy provides reliable and more relevant information for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

1. for each financial statement line item affected; and
2. if IAS 33 applies to the entity, for basic and diluted earnings per share;

(iii) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(iv) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when a change in accounting policy would be applied.

8. Thus, the requirements of IAS 8 mean that:

(a) An entity would need to justify a change in accounting policy as providing more reliable and relevant information and the entity's justification for changes in accounting policy would be disclosed.

(b) Comparability is ensured by retrospective application and disclosures of the amount of the adjustment for each period presented.

9. Some question whether the requirements in IAS 8 would be sufficiently restrictive to prevent entities from making changes in accounting policies to achieve a particular accounting outcome. For example, although IAS 8 restricts the circumstances in which there can be a voluntary change in accounting policy, this relies on the entity applying judgment to determine whether a change in accounting policy would result in information that is more reliable and relevant. However, in the staff's view, it would be difficult to justify that frequent changes in accounting policy result in relevant and reliable information, and the staff expect that users of financial statements would be likely to scrutinise changes in accounting policy and the reasons for, and impact of, the change. Furthermore, the staff observe that the restrictions for changes in accounting policy in IAS 8 are well-established and few issues have been reported in practice. Accordingly, the staff believe that the IASB should not add requirements for when an entity can change accounting policy for presenting the effect of changes in discount rates.

10. The staff also note that the costs associated with retrospective application of an accounting policy to present the effect of changes in discount rates in other comprehensive income are likely to encourage careful examination whether that change in accounting policy is necessary.

Retrospective application of changes in accounting policy

11. During the meeting in March 2014 some of the IASB members questioned whether retrospective changes in accounting policy for insurance contract liabilities would be appropriate when any changes in the accounting for financial assets would be prospective in accordance with IFRS 9 *Financial Instruments*.

12. IFRS 9 specifies in paragraph 5.6.1 that:

> If an entity reclassifies financial assets […] it shall apply the reclassification prospectively from the reclassification date.[1]

13. The different treatments reflect the different reasons for possible changes in where gains and losses are presented, as follows:

    (a) For insurance contract liabilities, an entity *chooses* whether to present the effect of changes in discount rate in profit or loss or other comprehensive income. The underlying economic transaction has not changed, however the entity can choose one of two approaches for presenting that transaction.

    (b) Financial assets accounted for using IFRS 9 are reclassified only if the entity changes its business model for managing those financial assets. The business model is a matter of fact, rather than choice. Even if the business model has changed in the current year, the business model in the comparative year did not change.

14. As a result, some are concerned that if the business model for managing financial assets would change and an entity would change its accounting policy for the liability to avoid a consequential mismatch, the comparative information presented would not be meaningful or useful. The mismatches would come from the fact that the liability would be restated and the assets would not be restated.

15. However, this scenario is expected to be very infrequent, because IFRS 9 states that changes in business model for managing financial assets are expected to be very infrequent and determined as a result of external or internal changes that are significant to the entity's operations and demonstrable to external parties.

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[1] The reclassification date is defined as the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets.

Accordingly, a change in an entity's business model for managing financial assets will occur only when an entity either begins or ceases to perform an activity that is significant to its operations; for example, when the entity has acquired, disposed of or terminated a business line.

16. A more likely reason for an entity changing its accounting policy for insurance liabilities would be the changes in the assets that it uses to back the insurance contracts. This was the main reason that the IASB decided to allow an accounting policy choice: the IASB noted that an entity might have a significant change in asset strategies over time, such that accounting mismatches under existing policies eventually occur. When this is the case, the staff believe that the concern that restating the comparatives for the insurance contract and not restating the comparatives for the assets might result in accounting mismatches is unfounded. This is because the financial statements for the current and comparative period would be likely to include accounting mismatches as a result of the gradual change in asset mix. Because a change in accounting policy is permitted when it results in more relevant and reliable information, but it is not required, it is not always the case that restatement of the comparatives when the entity eventually changes its accounting policy for insurance contracts might result in more accounting mismatches.

17. The staff also note that another reason for permitting an accounting policy choice, rather than requiring an entity to present the effect of changes in discount rate in profit or loss or other comprehensive income on the basis of reduction of mismatch, was to allow entities to make their own assessment of the balance of (i) the provision of information that separates underwriting and investing performance, and changes that reverse from other changes, against (ii) the situations in which accounting mismatches obscure the benefits of providing information that separates changes in discount rate. That assessment may vary according to product type, backing assets, reporting history, local regulations and local practice. Thus, accounting mismatches are not necessarily the main reason for choosing a particular accounting policy, but in practice entities may consider accounting mismatches when deciding what their accounting policy should be. Accordingly, the staff believe that the fact that different mismatches might arise in the comparative periods compared to the current periods do not justify a departure from the general requirements of IAS 8 for retrospective application of changes in accounting policy.

Question: Changes in accounting policy

Does the IASB agree that an entity should apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to changes in accounting policy relating to the presentation of the effect of changes in discount rate?