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STAFF PAPER

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Project	**Insurance Contracts**		
Paper topic	An option for presenting the effect of changes in discount rates		
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Purpose of paper

1. In agenda paper 2D *Use of OCI to present the effect of changes in discount rates*, the staff recommended that the Board confirm the proposals in the ED that an entity should present in other comprehensive income ('OCI') the effect of changes in discount rate, subject to developing an option that would permit entities to present that amount in profit or loss ('P&L') and disclosures that would provide information about the effect of changes in discount rate in the period. This paper discusses such an option. Agenda paper 2F discusses disclosures.

2. The paper does not discuss:

   (a) The use of OCI for insurance contracts that provide policyholders with returns from underlying items (e.g., unit linked, universal life, variable annuity, etc.);

   (b) The reference date for determining locked-in discount rates for contracts measured using the premium allocation approach; or

   (c) The interaction between any optional use of OCI and unlocking the contractual service margin.

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Staff recommendation

3. The staff recommends that an entity should choose to present the effect of changes in discount rates in P&L or in OCI as its accounting policy and should apply that accounting policy to all contracts within a portfolio.

4. After the IASB has considered the treatment of the contractual service margin for participating contracts, staff will consider the tentative decisions together to see if the tentative decisions reached for non-participating contracts should be revisited, or vice versa

Structure of paper

5. This paper provides:

   (a) Background on the context for an option and a review of existing measurement options in IFRS (paragraphs 7 -13)

   (b) Staff analysis and recommendations (paragraphs 14 to 29).

6. Appendix A sets out relevant extracts from the Basis for Conclusions to the 2013 ED *Insurance Contracts* ('the ED') as background information. Appendix B sets out relevant extracts from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Background

Context for this paper

7. In developing the 2013 ED, the Board concluded that permitting an option for entities to recognise all gains and losses from insurance contracts in P&L would introduce additional complexity for preparers to operate the option and for users of financial statements to understand the result. Taken together with the lack of comparability that results when different measurement and presentation bases are used for similar transactions, the Board previously concluded that the cost of that complexity overall

would not be justified by the benefits of reduced mismatches for some entities. However, the overall feedback to the ED, as described in agenda paper 2D, indicates that most constituents believe that in making this assessment, the Board:

(a) Underestimated the costs that would be imposed by the lack of understandability that results from extensive accounting mismatches for some entities; and

(b) Underestimated the benefits of reduced accounting mismatches that could result from an option.

8. Accordingly, agenda paper 2D recommends that the Board confirms the use of OCI as proposed in the ED, subject to developing an option that would permit entities to present the effect of changes in discount rates in OCI or P&L and developing disclosures that provide information about the effect of changes in discount rate during the period (see agenda paper 2F). That recommendation is intended to balance the competing demands of understandability and comparability by adopting an approach that:

(a) Continues to acknowledge that, when measurement inconsistencies do not result in a lack of faithful representation, it could be appropriate to measure financial assets at fair value through other comprehensive income ('FVOCI') or amortised cost ('AC') and present the effect of changes in discount rates on the measurement of insurance contracts in OCI.

(b) Allows entities to avoid accounting mismatches when they would result in financial statements that do not faithfully represent the reporting entity's financial position and performance. In many cases, an entity could avoid accounting mismatches by presenting the effect of changes in discount rate on the measurement of insurance contracts and financial assets in P&L or OCI.

(c) Ensures that the information sought by users of financial statements is provided in disclosures in a way that allows comparison, regardless of whether the effect of changes in discount rate is provided in P&L or in OCI (see agenda paper 2F).

9. The staff observes that the way in which individual entities would assess the relative importance of these demands will vary according to entity-specific factors such as product type, backing assets, reporting history, local regulations and local practice.

10. Assuming that the Board agrees that there should be an option that would permit entities to present the effect of changes in discount rates in OCI or in P&L, the following questions arise:

    (a) Should the same approach be used by a single entity for all insurance contracts that it issues, or should an entity be permitted to present the effect of changes in discount rates for some contracts in OCI, and for other contracts in P&L? In other words, what should be the unit of account for an option?

    (b) Should the Board specify restrictions on the use of an option, and if so, what would those restrictions be?

A review of existing measurement options in IFRS

11. In some cases, IFRS provides entities with the option of applying different measurement bases, subject to various different types of restrictions. For example:

    (a) IFRS 9 includes the following options:

        (i) an entity may, at initial recognition, irrevocably designate a **financial asset** as measured at fair value through profit or loss (‘FVPL’) if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases

        (ii) an entity may, at initial recognition, irrevocably designate some types of **financial liabilities** as measured at FVPL if:

            1. doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or

recognising the gains and losses on them on different bases; or

2. a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

(iii) An entity may, at initial recognition, make an irrevocable election to present in OCI subsequent changes in the fair value of an **investment in an equity instrument** that is not held for trading. If an entity makes such an election, amounts presented in OCI shall not be subsequently transferred to P&L. However, an entity may transfer the cumulative gain or loss within equity. An entity shall recognise in P&L dividends from that investment when the entity's right to receive payment of the dividend is established in accordance with IAS 18.

(b) IAS 16 *Property, Plant and Equipment* states that "an entity shall choose either the cost model ... or the revaluation model… as its accounting policy and shall apply that policy to an entire class of property, plant and equipment."

(c) IAS 38 *Intangible Assets* states "an entity shall choose either the cost model… or the revaluation model…as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets."

(d) IAS 40 *Investment Property* states that "an entity shall choose as its accounting policy either the fair value model …or the cost model… and shall apply that policy to all of its investment property". IAS 40 notes that IAS 8 would permit a voluntary change in accounting policy only if the change results in the financial statements providing reliable and more

relevant information about the effect of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. IAS 40 also notes that "It is highly unlikely that a change from the fair value model to the cost model will result in a more relevant presentation."

12. Thus, measurement options in IFRS differ as follows:

    (a) in whether they are restricted to being applied when criteria are met (as for financial assets and financial liabilities in IFRS 9), or at the discretion of the entity (as for equity instruments in IFRS 9, or under IASs 16, 38 and 40)

    (b) in whether the decision to apply the option is an irrevocable election at initial recognition (as for financial assets, financial liabilities and equity instruments in IFRS 9), or an accounting policy choice (as under IASs 16, 38 and 40).

    (c) in whether they are restricted to being applied on an item by item basis (as for financial assets, financial liabilities and equity instruments in IFRS 9), or to a class of items (as under IASs 16, 38 and 40).

13. The Basis for Conclusions to these standards explains the reasons for the restrictions on the options as follows:

    (a) the Board decided to restrict application of the option to designate a financial asset or financial liability at FVPL in IFRS 9 because of concerns about how the option would be used. In particular, the Basis for Conclusions to IFRS 9 notes:

        (i) financial instruments cannot be designated, or previous designations revoked, after initial recognition, to impose discipline on the use of the option.

        (ii) The requirement to designate irrevocably on initial recognition the financial instruments for which the fair value option ('FVO') is to be applied would prevent an entity 'cherry picking' by recognising changes in fair value selectively in profit or loss

(iii) There should be restrictions for the use of the FVO to situations in which permitting designation at FVPL either results in more relevant information or is justified on the grounds of reducing complexity or increasing measurement reliability. This would address concerns that the FVO might be used inappropriately, eg when:

1. Fair value is not verifiable and subjective valuation of financial assets and financial liabilities inappropriately affects profit or loss
2. Volatility in P&L is increased, rather than decreased, for example if an entity applied the option to only one part of a matched position
3. Gains and losses would be recognised in P&L associated with changes in an entity's own creditworthiness.

(b) The Board decided to restrict application of the option in IFRS 9 to present some gains and losses on equity instruments in OCI to address concerns that such an exception to the overall classification and measurement approach adds complexity. In particular, the Basis for Conclusions to IFRS 9 notes that the Board decided that the option must be irrevocable to provide discipline to its application, and noted that the option to designate a financial asset as measured at fair value is also irrevocable.

(c) In IAS 40, there are no restrictions on the use of the option although paragraph 31 of that Standard notes that it is highly unlikely that a change from the fair value model to the cost model will result in a more relevant presentation and hence meet the IAS 8 requirements for a change in accounting policy. As explained in the Basis for Conclusions this approach was taken because "the Board believes that it is impracticable, at this stage, to require a fair value model for all investment property. At the same time, the Board believes that it is desirable to permit a fair value model. This evolutionary step forward will allow preparers and users to gain greater

experience working with a fair value model and will allow time for certain property markets to achieve greater maturity."

(d) IAS 16 and IAS 38 do not impose restrictions for the use of an option, and the Basis for Conclusions did not discuss the reasons for an option.

Staff analysis and recommendations

14. The paragraphs that follow discuss our considerations in determining our recommendations about an option for presenting changes in discount rates.

Unit of account

Entity level

15. If an entity were to apply the same presentation for the effect of changes in discount rates to all contracts, there would be consistency in the treatment for all of an entity's insurance contract liabilities. This could make it easier for users of financial statements to understand how an entity presents the effect of changes in discount rates and could enhance comparability between entities because it would be straightforward to determine the effect of an option. Such an approach would also be consistent with the view expressed in some comment letters that an option is needed to reduce operational complexity for some cases where preparers believed that the information provided by determining an amount to present in OCI does not warrant the cost of the complexity that is inherent in doing so.

16. However, requiring that an entity use a single approach for all insurance contracts it issues could result in an entity continuing to report significant accounting mismatches if, as is often the case, there is variation in measurement attributes of assets backing insurance contract liabilities (see appendix A of agenda paper 2D). Because the need to reduce accounting mismatch is a significant factor in our recommendation for an option, we believe that an option needs to be at a lower unit of account than the entity level.

Contract level

17. As noted in paragraph BC144(a) of the ED, applying an option to an individual insurance contract is the best way to fully eliminate accounting mismatches, and would be consistent with the application of the fair value option for financial assets. However, the Board previously concluded that such an approach would be operationally complex and would not provide useful information because insurance contracts and associated assets are typically managed at a more aggregated level. The comment letters did not contradict that conclusion. Furthermore, the rationale for the proposal for an option relates to balancing the competing demands of separating underwriting from investing performance, and reducing accounting mismatch. An entity would not typically consider performance nor determine asset strategies at an individual contract level. Accordingly, the staff believes that an option needs to be at a more aggregated level of aggregation than the contract level.

Portfolio level

18. Many aspects of the accounting for insurance contracts proposed in the ED are implemented at a portfolio level. A portfolio of insurance contracts is defined as "a group of insurance contracts that (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and (b) are managed together as a single pool".

19. In the staff's view, applying an option at a portfolio level would be consistent with the Board's approach of acknowledging that it could be appropriate to present the effect of changes in discount rates on the measurement of insurance contracts in OCI, while allowing entities to avoid accounting mismatches when they would result in financial statements that do not faithfully represent the reporting entity's financial position and performance. Feedback on the 2013 ED indicates that many entities regard the different asset strategies for assets backing insurance contracts to be driven by the differences between portfolios of insurance contracts, and hence a single entity might back one portfolio predominantly with FVOCI assets, and another portfolio predominantly with FVPL assets. Accordingly, an option applied to portfolios of insurance contracts would allow reduction in accounting mismatches. It also means

that there is likely to be some comparability between entities, as entities within the same jurisdiction are likely to issue similar products and adopt similar assets strategies for those products.

20. Most constituents that expressed a preference for the unit of account proposed that an option should operate at the level of portfolios of insurance contracts.

21. The staff notes that the options in IASs 16, 38 and 40, which apply to groups of items (rather than an item by item basis as in IFRS 9) would apply to classes of items. A class is a "group of assets of a similar nature and use in an entity's operations." In the staff's view, portfolios of insurance contracts are a lower level grouping than classes, and there could be several portfolios that have a similar nature and use in an entity's operations. Applying an accounting policy to a class avoids selective application to particular items and more consistent reporting in financial statements for similar items. In the staff's view, a similar outcome is achieved by applying an accounting policy to a portfolio of insurance contracts, which is defined as "a group of insurance contracts that (a) provide coverage for similar risks and that are priced similarly relative to the risk taken on; and (b) are managed together as a single pool". The staff therefore propose that the option be applied to portfolios of insurance contracts.

Accounting policy choice vs criteria with default approach

22. When an option is a matter of accounting policy choice, there is no default approach: in other words, entities are free to select the approach they consider to be the most appropriate (eg IASs 16, 38 and 40). Such an approach permits two different views of the most approach to accounting to co-exist.

23. In other cases, a Standard suggests that one approach is the most appropriate in most circumstances, but allows an option for another approach (eg IFRS 9). In such cases, the Standard specifies a default approach, and also specifies criteria to constrain the circumstances in which the option can be used. Examples of such criteria are the requirement that the exercise of the option must significantly eliminate or reduce an accounting mismatch, or that the option may only be exercised at initial recognition.

24. In assessing which approach should apply to the presentation of the effect of changes in discount rates, the staff considered the following:

    (a) Some believe that an approach that would present all changes in P&L is the most appropriate in most circumstances. Those with this view note that it reduces accounting mismatches in more circumstances, provides the most transparent information about economic mismatches, and is the simplest to apply. However, others believe that an approach that presents the effect of changes in discount rate in OCI is the most appropriate in most circumstances, because they believe such an approach reflects the long-term nature of the insurance business better, because short-term fluctuations in value are not reported in P&L. Still others believe that different approaches are most appropriate in different circumstances. If the option is a matter of accounting policy choice, each view could be accommodated.

    (b) Some believe that specifying criteria with a default approach is likely to result in less variation in the approach taken by reporting entities. However, the staff does not agree. Feedback on the 2013 ED indicates that most entities have firm views as to what is the most appropriate accounting for their different portfolios of insurance contracts. In practice, unless the criteria are very strict, entities are likely to exercise any option to achieve their preferred accounting approach. The staff notes that, although challenged, constituents have failed to come to a consensus about criteria that would define in a disciplined way when different approaches should apply.

    (c) Because the staff propose an option to address situations in which accounting mismatches obscure useful information, the Board could specify that the option should be applied only when doing so would significantly reduce accounting mismatches. However, the staff's proposal is not driven only by the reduction of accounting mismatch (because in that case, presenting all changes through P&L would be a more effective way of eliminating accounting mismatches). Instead, the staff believe that there is a need to balance (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 the effect of changes in discount rate. That assessment may vary according to product type, backing assets, reporting history, local regulations and local practice. Thus, in the staff's view, accounting mismatches do not necessarily drive the option, but in practice entities may consider accounting mismatches when deciding what their accounting policy should be. Permitting entities to choose whether to apply an option as an accounting policy choice for each portfolio would acknowledge that entities need to consider the factors contributing to their own cost-benefit analysis for the different types of portfolio. In this context, the portfolio is analogous to the class of asset in IASs 16, 38 and 40.

Ability to eliminate accounting mismatches

25. In many cases, an entity will back a single portfolio with assets that are measured using a mix of measurement attributes. The staff believes that in such cases, an accounting policy choice (ie no default) or a default P&L approach could enable entities to achieve a reduction in accounting mismatches more simply than a default OCI approach, as illustrated in the table below.

Asset mix [backing a portfolio]	**No default approach (accounting policy choice)**	**OCI default for liabilities, entity exercises option to reduce accounting mismatch**	**P&L default for liabilities, entity exercises option to reduce accounting mismatch**
100% FVOCI [1]assets	✓ If assets at FVOCI, entity likely to choose to measure liabilities through OCI to reduce accounting mismatch.	✓ Default position – No accounting mismatch as assets FVOCI and liabilities through OCI	X Default position – Accounting mismatch due to 100% FVOCI assets v P&L liabilities ✓ If entity exercises FVOCI option on liabilities then there will be no accounting mismatch as assets FVOCI and liabilities through OCI OR ✓ If entity exercises FVO on FVOCI assets then there will be no accounting mismatch as assets FVPL and liabilities through P&L
100% FVPL assets	✓ If assets at FVPL, entity likely to choose liabilities through P&L to reduce accounting mismatch.	X Default position – Accounting mismatch arises due to 100% FVPL assets v OCI liabilities ✓ If entity exercise P&L option on liabilities, then there will be no accounting mismatch as assets FVPL and liabilities through P&L	✓ Default position – No accounting mismatch as assets FVPL and liabilities through P&L

[1] For the purpose of this illustration we have considered FVOCI and FVPL assets only, as assets held at amortised cost would always result in an accounting mismatch in equity. However, in P&L, the assessment of accounting mismatch would be the same as for FVOCI assets.

Asset mix [backing a portfolio]	No default approach (accounting policy choice)	OCI default for liabilities, entity exercises option to reduce accounting mismatch	P&L default for liabilities, entity exercises option to reduce accounting mismatch
50:50 FVOCI v FVPL	✓ If entity chooses liabilities through P&L, then there would be an accounting mismatch with 50% assets at FVOCI. The entity would then exercise a FVO on the FVOCI assets to reduce the accounting mismatch. X If entity chooses liabilities through FVOCI, then there would be an accounting mismatch with 50% assets at FVPL. The entity would be unable to eliminate this accounting mismatch through use of options.	X Default position – Accounting mismatch arises due to 50% FVPL assets v OCI liabilities X Exercising a FVO on the assets would not reduce the accounting mismatch as there would then be 100% FVPL assets vs OCI liabilities. X Exercising a P&L option on the liabilities would not reduce accounting mismatch as there would be 50% FVOCI assets vs P&L liabilities. ? However, exercising FVO on the assets and a P&L option on the liabilities at the same time would avoid accounting mismatch. This would rely on mutual dependence between asset and liability options.	X Default position - Accounting mismatch due to 50% FVOCI assets v P&L liabilities ✓ If entity exercises FVO on FVOCI assets there will be no accounting mismatch as assets FVPL and liabilities through P&L

26. Thus, if there is a mix of FVOCI and FVPL assets backing liabilities, then:

    (a) An accounting policy choice could allow entities to eliminate accounting mismatches whether assets are held at FVPL, FVOCI or a mixture.

    (b) A P&L default for the insurance liabilities could allow entities to eliminate accounting mismatches by exercising either the existing FVO in IFRS 9, or by exercising an option to present the effect of changes in discount rates on insurance contracts in OCI in the cases when the assets are predominantly at FVOCI.

    (c) An OCI default for the insurance liabilities would not allow entities to fully reduce accounting mismatches, unless the entity exercised options for both assets and liabilities at the same time. The FVO in IFRS 9 may be exercised only when if doing so eliminates or significantly reduces a measurement or recognition inconsistency. Thus, when there is a mix of assets measured at FVOCI and FVPL, the entity might not be able to exercise the FVO in IFRS 9 on the FVOCI assets, if doing so would increase, rather than decrease, the accounting mismatch between the assets at FVPL and insurance contracts through OCI.

        As a result, in order to avoid accounting mismatch, an entity would need to first exercise a P&L option for insurance liabilities. That would then create an accounting mismatch between the assets at FVOCI and the insurance contracts through P&L, which the entity could then reduce through subsequent exercise of the FVO for assets in IFRS 9. The staff notes that if the P&L option for insurance liabilities were to be condition of reducing accounting mismatch in the same way as for IFRS 9, then there might be situations in which neither the option for assets nor the option for liabilities could be exercised because of their mutual dependence (logical circularity).

27. The staff notes that when assets are held at amortised cost, accounting mismatch could only be eliminated to the extent that entities elect to apply the FVO in IFRS 9 to such assets.

Ability to invoke or revoke an option

28. When Standards permit an option, the Board has historically been concerned about an entity's ability to invoke or revoke an option to recognise gains or losses selectively in P&L ('cherry picking'). That concern can be mitigated as follows:

    (a) When the exercise of an option is an accounting policy choice, the ability to invoke or revoke the option is governed by the restrictions in IAS 8. IAS 8 allows changes to the accounting policy for a class of assets only when it 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 statements[2]. Because the accounting policy applies to a whole class of items, and voluntary changes in accounting policy are expected to be rare, the ability to 'cherry pick' is limited. The staff notes that when entities change accounting policy from recognising the effect of changes in discount rates in OCI to recognising such effects in P&L, it would be significantly easier to meet the requirements in IAS 8 to disclose the amount of adjustment for current and prior periods than changing accounting policy the other way around.

    (b) When the exercise of an option is not an accounting policy choice, but applied to an individual item, the Board has generally made the exercise of the option irrevocable on initial recognition. The advantages of an option that is irrevocable at initial recognition are that it would be simple to apply and understand, and would avoid changes in presentation only to achieve a desired accounting outcome.

Staff recommendation

29. The staff propose that the option to present the effect of changes in discount rates should be an accounting policy choice applied to all contracts within a portfolio, for the following reasons:

[2] Appendix B reproduces the relevant requirements of IAS 8.

(a) The reasons for providing an option are only partly to deal with accounting mismatches. They also reflect that different constituents have different views about the most appropriate approaches for their circumstances. This reflects their different assessments of cost and benefit. As a result, the reasons for providing an option are more consistent with allowing entities to consider the factors contributing to their own cost-benefit analysis for the different types of portfolio.

(b) An accounting policy choice would mean that entities would be able to change accounting policy when it 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 statements. In contrast, an option applied to a portfolio of insurance contracts that is irrevocable at initial recognition may not provide relevant information about insurance contracts. This might happen if there is significant change in asset strategies over time, such that extensive accounting mismatches occur, for example, if liabilities are measured using an OCI approach and the level of assets mandatorily measured as FVPL that backs the liabilities becomes significant. A portfolio of insurance contracts could have a long life span (if the nature of the contract and its pricing do not change significantly over time). Although risk management and the choice of assets backing portfolios of insurance contracts are unlikely to change in the short term, asset matching can change in the longer term if, for example, bonds eligible for measurement at FVOCI or amortised cost became less available at a reasonable price, or if entities seek protection from market risk through acquiring derivatives.

(c) Although there may be concerns about opportunities for earnings management, IAS 8 restricts the circumstances in which an entity can change accounting policy, and provides disclosures when an accounting policy is changed. In the staff's view, this would limit such opportunities and reduce the risk of confusion for users of financial statements.

(d) Applying an option at a portfolio level would be consistent with the Board's approach of acknowledging that it could be appropriate to present the effect of changes in discount rates on the measurement of insurance contracts in OCI, while allowing entities to avoid accounting mismatches when they would result in financial statements that do not faithfully represent the reporting entity's financial position and performance.

Question for Board members
Does the Board agree that entities should choose to present the effect of changes in discount rates in profit or loss or in other comprehensive income as its accounting policy and apply that accounting policy to all contracts within a portfolio?

Appendix A: Relevant extract from the Basis for Conclusions to the 2013 ED

An option to recognise all gains and losses in profit or loss

BC142 The IASB considered whether it should make the presentation of changes in the insurance contract liability in other comprehensive income an option rather than a requirement. An option could either be unrestricted, or restricted to circumstances in which the exercise of the option would significantly eliminate accounting mismatches. Such options would ensure that preparers would not have to suffer the complexity that is inherent in the IASB's revised decisions if they believed that the information provided in their circumstances does not warrant the cost of the complexity.

BC143 However, the IASB concluded that an unrestricted option would result in a lack of comparability and could reduce transparency across entities that issue insurance contracts. The IASB's objective in requiring the presentation of the effects of changes in discount rates on the insurance contract liability in other comprehensive income is to separate underwriting and investing performance from the effects of the changes in those discount rates that unwind over time. That objective would not be achieved if entities were permitted an unrestricted option to recognise those changes in profit or loss.

BC144 Some suggested an approach similar to the existing option in IFRS 9 that permits an entity to measure a financial asset at fair value through profit or loss (the 'fair value option') if it reduces or eliminates accounting mismatches. However, the IASB observed that a similar option for insurance contract liabilities would be problematic because:

(a) applying such an option to an individual insurance contract is the best way to fully eliminate accounting mismatches. It is also consistent with the application of the fair value option for financial assets. However, applying such an option at an individual insurance contract level may be operationally complex and may not provide useful information. This is because insurance contracts and associated assets are typically managed at a more aggregated level. Nonetheless, it would be difficult to achieve the objective of reducing or

eliminating accounting mismatches through the use of a fair value option for insurance contracts because accounting mismatches would not be eliminated overall if an entity applied an option to recognise in profit or loss all changes in the value of insurance contracts at:

(i) an entity level, because an entity may have different portfolios that it manages in different ways.

(ii) a portfolio level, because an entity may hold assets that are measured using a mix of measurement attributes (for example, at fair value through profit or loss, amortised cost or fair value through other comprehensive income) and the mix of measurement attributes in the portfolio may change over time. Accounting mismatches would be reduced only if the entity exercises the option to measure all the assets at fair value through profit or loss.

(b) it would be necessary to specify whether an entity should be permitted or required to invoke or revoke any such option, and in what circumstances. For financial assets, the application of the fair value option in IFRS 9 is available only at initial recognition and is irrevocable. This ensures that entities do not invoke or revoke the fair value option in a particular period to achieve a particular accounting result for that period. However, an irrevocable option would not necessarily reduce or eliminate accounting mismatches if the duration of insurance contracts and the assets backing the insurance contracts differed. An entity would only be able to assess whether the accounting mismatches would be reduced or eliminated when the duration of either the insurance contract or the backing assets ended. While the exercise of the option might reduce accounting mismatches in the short term, it could exacerbate those accounting mismatches in later periods. This would be especially of concern because of the extent of the duration mismatches that might arise between assets and liabilities.

BC145 Consequently, the IASB concluded that permitting an option for entities to recognise all gains and losses from insurance contracts in profit or loss would introduce additional complexity for preparers to operate the option and for users of financial

statements to understand the result. Taken together with the lack of comparability that would result from an option, the Board concluded that the cost of that complexity is not justified by the benefits of reduced mismatches for some entities. This would be the case regardless of whether the option was unrestricted, or restricted to circumstances in which the exercise of the option would significantly eliminate accounting mismatches.

Appendix B: IAS 8 requirements relating to accounting policies

Consistency of accounting policies

13 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different accounting policies may be appropriate. If an IFRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

14 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 users of financial position, financial performance or cash flows.

15 Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria in paragraph 14.

16 The following are not changes in accounting policies:

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.

29 When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is

impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 applies to the entity, for basic and diluted earnings per share;

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

(e) 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 the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.