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Hindsight is 20/23: How insurers navigate their IFRS 17 2024 reporting with improved vision

In March 2024, many insurers with December year-ends published their first set of the highly anticipated *IFRS 17 Insurance Contracts* (IFRS 17) compliant financial statements. This marked the culmination of a multi-year investment worthy of celebration. Yet, despite what appeared to be celebratory photo finishes, in many cases, the 2023 reporting deadline was still crossed with 'blurred IFRS 17 financial reporting vision', as insurers grappled with operational and reporting complexities in producing financial statements.

Post the most recent reporting period, insurers have analysed their 2023 financial statements against those of other insurers, both locally and globally. With this analysis, insurers’ 'IFRS 17 financial reporting vision' improved. As a result, many insurers are identifying refinements and changes they may want or need to make post implementation in order to pursue optimal financial reporting in the next reporting period.

Insurers that are considering making changes or corrections to their 2023 financial results in the 2024 financial statements will be required to assess the accounting treatment and disclosure thereof under *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8).

Unfortunately, peering back through the corrective lens to the 2023 financial reporting period brings additional complexities that insurers will need to navigate under IAS 8; the application of which may not be easy.

Improved ‘IFRS 17 financial reporting vision’ may lead to changes and corrections after transition

As IFRS 17 is more deeply embedded and understood moving into the second year of implementation, insurers may identify IFRS 17-related operational and reporting shortfalls with an impact on the 2023 financial statements.

Insurers may want or have to address these shortfalls in the 2024 reporting period to ensure compliance, enhance reporting quality and improve benchmarking against peers. Refinements to valuation models and methodologies, re-calibration of systems and process enhancements to better accommodate sophisticated models are but some of the expected improvements.

Accounting for IFRS 17-related changes and corrections under IAS 8

Changes and corrections made in subsequent years to the recognition and measurement of groups of insurance contracts or the related presentation and disclosures previously reported in the 2023 financial statements are required to be accounted for and disclosed in accordance with the requirements of IAS 8. In addition, IFRS 17 contains specific disclosure requirements when changes are made to accounting policies and accounting estimates that need careful consideration.

Under IAS 8, companies need to determine whether a change amounts to a change in its initial accounting policy or a change in accounting estimate and account for the change accordingly. In both cases, companies should assess if such a change may indicate the correction of a prior period error. To be able to effectively perform this assessment, it is important to go back to the basics; the definitions and requirements of IAS 8.

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Key distinctions between changes in accounting policies, changes in accounting estimates and the correction of prior period errors

The summary noted below provides an overview of the IAS 8 requirements that companies need to consider when making changes and corrections in the next financial reporting period:

Accounting policy

Specific **principles, bases, conventions, rules and practices** applied by an entity in preparing and presenting financial statements.

Change in accounting policy

If the change is required by IFRS
or
results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions.

Retrospective application*

Restate the opening balance of equity for the earliest prior period presented as if the new accounting policy had always been applied.

Accounting estimate

Monetary amounts in financial statements that are subject to **measurement uncertainty.**

Change in accounting estimate

If changes occur in the circumstances on which the accounting estimate was based
or
as a result of new information, new developments or more experience.

Prospective application*

Include adjustment in profit or loss in current and future periods, where applicable – "catch-up adjustment".

Where applicable, adjust the carrying amount of the related asset, liability or equity item in the period of the change.

Prior period error

Omissions from, and **misstatements** in, the entity's financial statements for one or more **prior periods** arising from a **failure to use, or misuse of, reliable information.**

Retrospective restatement*

If material, restate comparative amounts for the prior period(s); and

if the error occurred before the earliest prior period presented, restate the opening balances of assets, liabilities and equity for the earliest prior period presented.

***Unless retrospective application or retrospective restatement is impracticable.**

If a company believes it is impracticable to retrospectively apply a change in accounting policy or restate a prior period error, IAS 8 provides that the new accounting policy or the impact of the prior period error may be applied as at the beginning of the earliest period for which retrospective application or restatement is practicable.

Key considerations when assessing IFRS 17 changes under IAS 8

The considerations listed below are aimed at assisting insurers in identifying the correct starting point for a change or correction, i.e. accounting policy, accounting estimate or error, and to assess whether the requirements to change an accounting policy or accounting estimate are met. This will determine the accounting treatment and disclosure requirements for a change or correction.

When assessing changes or corrections under IAS 8:

Identify **what** the change or correction is.
Understand whether the change or correction is made to:

- specific principles, bases, conventions, rules and practices applied in preparing and presenting financial statements; or
- an estimation technique or inputs to an estimation technique that determines monetary amounts in financial statements that are subject to measurement uncertainty.

Understand **why** the change or correction is being considered.
Identify whether the change or correction:

- will result in reporting more relevant and reliable information; or
- results from changes in circumstances or new information, new developments or more experience derived after year-end.

Critically think about the information reported in the first year of IFRS 17 implementation. Did management **fail to use information** that was available at that point in time? Could the information reasonably have been expected to have been obtained and taken into account in the prior year?

Review the recognition, measurement and disclosure requirements of IFRS 17 when changes or corrections are made and determine if and how, this will impact the IAS 8 assessment.

Assessing changes to IFRS 17 financial reporting requires careful consideration and determining how to account for these adjustments under IAS 8 is complex.

Common changes to IFRS 17 financial reporting

Included below are common areas of change to the measurement and presentation of insurance contracts that insurers are currently considering:

Measurement model	No.	Change
General Measurement Model (GMM) applied to groups of contracts	**1**	Change in the method of allocating directly attributable overhead expenses
	2	Change in the reference portfolio when determining the discount rate under the top-down approach
	3	Change in the election to discount coverage units or not
Premium Allocation Approach (PAA) applied to groups of contracts	**4**	Change in the election to apply the PAA to qualifying contracts
Variable Fee Approach (VFA) applied to groups of contracts	**5**	Change in the quantitative threshold to determine VFA eligibility
Other considerations	**6**	Changes in presentation of the financial statements

Analysing the accounting treatment for these changes under IAS 8 has sparked insightful deliberations and some changes still require further assessment. Considerations to date are summarised below:

1. Change in the method of allocating directly attributable overhead expenses

Insurers apply judgement to determine which cash flows, that are within the boundary of insurance contracts, relate directly to the fulfilment of such contracts; particularly the extent to which fixed and variable overheads are directly attributable to fulfilling insurance contracts. IFRS 17 does not specify a methodology for attributing directly attributable overhead expenses to groups of insurance contracts. The standard only requires that the methods used be systematic and rational.

An insurer may decide to further refine the method it applies to allocate directly attributable fixed and variable overhead expenses subsequent to its first year of IFRS 17 reporting, for example, due to more experience. It could be argued that this change should be treated as a **change in accounting estimate** as the refinement will change the inputs to the estimation technique applied to allocate such cash flows. Its effect will impact amounts in the financial statements that are subject to measurement uncertainty. Such a refinement is not expected to change the insurer's accounting policy; which in principle is to allocate fixed and variable overheads that are directly attributable to the fulfilment of insurance contracts.

A change in measurement technique to reflect changes in circumstances or new information and developments, unless it is a prior period error, will generally be treated as a change in estimate under IAS 8.

This will require prospective application in the financial statements issued in the next reporting period, unless impracticable. Disclosure under IAS 8 will be required to inform users of the nature of the change to the method applied to allocate directly attributable overhead expenses and the amount of the change that has an effect in the current period or is expected to have an effect in future periods, to the extent practicable. Companies should also provide additional disclosure for users to assess the effects of changes in the judgements applied under IFRS 17.

2. Change in the reference portfolio when determining the discount rate under the top-down approach

In developing the estimated discount rate under the top-down approach, the insurer may change the reference portfolio from the target reference portfolio, that reflects assets that the insurer intends to acquire over time, to the actual reference portfolio once a desired portfolio has been acquired. This change should be accounted for under IAS 8.

Changing the composition of the reference portfolio does not change the measurement basis of the groups of insurance contracts (groups are still measured based on the present value of future cash flows). It could therefore be argued that this is not a change in accounting policy.

Instead, this change relates to an input to the estimation technique that is used to determine the value of a group of insurance contracts and should be treated as a **change in accounting estimate**.

We believe that subsequent changes in the actual assets that represent the reference portfolio will also constitute a change in accounting estimate.

IAS 8 requires that such a change be applied prospectively unless it is deemed impracticable. Disclosure under both IAS 8 and IFRS 17 will be required regarding the change in estimate in the financial statements issued in the next reporting period, similar to what has been noted above in respect of a change in the method of allocating directly attributable overhead expenses.

3. Change in the election to discount coverage units or not

IFRS 17 does not specify whether an insurer should consider the time value of money for coverage units.

A potential view is that the election to discount coverage units qualifies as a specific practice that insurers apply in preparing financial statements, constituting an accounting policy choice. Subsequent changes to the election to discount coverage units or not is viewed as a **change in accounting policy** if the change is not due to a prior period error.

This will require retrospective application in the financial statements issued in the next reporting period, unless impracticable. Disclosure regarding the nature of the change, the amount of the adjustment for each affected period and the reasons for applying the new accounting policy provides reliable and more relevant information as required by IAS 8.

4. Change in the election to apply the PAA to qualifying contracts

Insurers may choose to apply the PAA to groups of insurance contracts provided that certain criteria are met at inception. One criterion is that the insurer reasonably expects that the PAA would produce a measurement of the liability for remaining coverage (LRC) for a group of insurance contracts that would not differ materially from the measurement that would be achieved by applying the requirements of the GMM.

The question is whether an insurer may change this election subsequently and instead account for such groups of insurance contracts applying the requirements of the GMM.

Although the election to measure qualifying insurance contracts under the PAA is an accounting policy choice, the standard does not require or permit reassessment of the eligibility criteria or the election to apply the PAA measurement model.

Unless there is a modification of the contract, an insurer cannot revoke its election to apply the PAA and change its accounting policy retrospectively. In this case, the requirements of IFRS 17 prohibits such a change to be accounted for per the requirements of IAS 8 and the change in accounting policy can only be applied to new qualifying groups of insurance contracts that are issued.

IFRS 17 contains elections and limitations that may directly impact how insurers account for IFRS 17 changes or corrections under IAS 8. Consider if and how the requirements of IFRS 17 will impact the assessment made under IAS 8.

5. Change in the quantitative threshold to determine VFA eligibility

When a contract meets the definition of a direct participating contract, the VFA is applied to the group of contracts of which it forms part. Although such contracts are substantially investment-related service contracts, they are defined as insurance contracts for which an insurer expects to pay the policyholder an amount equal to a substantial share of the fair value returns from the underlying items; and expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in the fair value of the underlying items. Determining a quantitative threshold for a 'substantial' share or 'substantial' proportion to assess whether this criterion is met, requires judgement.

If, for example, a subsidiary decides to change its quantitative threshold of 'substantial' to align with its holding company's threshold, the impact of this change is required to be accounted for under IAS 8.

Since the threshold does not constitute a monetary amount in the financial statements that is subject to measurement uncertainty, nor is it an input to a measurement technique, it could be argued that this change is not a change in accounting estimate.

A potential view is that the threshold qualifies as a specific convention, rule or practice applied in preparing financial statements. Under this view, altering such a threshold impacts the criteria used to determine the application of different measurement models. This affects how transactions are recorded and reported and could possibly constitute a change in accounting policy, which will require retrospective application.

However, IFRS 17 requires an insurer to assess whether these conditions are met using its expectations at inception of the contract and explicitly states that it shall not reassess the conditions afterwards unless the contract is modified.

It could be argued that this requirement deals with ***subsequent changes*** as a result of changing circumstances or new expectations after initial recognition and that it does not address or override the requirements of IAS 8 in respect of changes in accounting policies. Conversely, it could be argued that this explicit requirement prohibits an insurer from subsequently changing a threshold applied to a group of contracts that has been recognised and that retrospective application would contradict the requirements of IFRS 17 and is not allowed.

Another possible view includes the consideration that an insurer's accounting policy is to apply IFRS 17 with regards to the measurement requirements of direct participating contracts. Assessing whether the threshold criterion is met is a judgement made in applying that accounting policy. Changing ***how*** the judgement is made is not a change in an accounting policy.

This assessment is complex and requires further consideration and scrutiny based on the specific facts and circumstances of the insurer.

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6. Changes in presentation of the financial statements

Changes in the presentation of items reflected in the financial statements that affect the comparability of financial statements subsequent to first year implementation, are generally treated as **changes in accounting policies** even when IFRS 17 does not explicitly provide an accounting policy choice.

Examples of changes in presentation that should be treated as changes in accounting policies include where insurers elect to change the previous basis of presentation to now instead:

- disaggregate insurance finance income or expense for the period between profit or loss and other comprehensive income; or
- disaggregate the change in the risk adjustment for non-financial risk between (i) a change related to non-financial risk; and (ii) the effect of the time value of money and changes in the time value of money.

Given the complexity of this analysis under IAS 8, insurers should ensure that sufficient disclosure is provided to the users of the financial statements when making such changes or corrections.

Disclosure requirements for IFRS 17-related changes or corrections

Both IAS 8 and IFRS 17 contain specific disclosure requirements that insurers are required to include in their financial statements when changes are made in subsequent reporting periods.

IAS 8 disclosure requirements

IAS 8 provides specific disclosure requirements to enable users to understand the nature, amount and reason for the change or correction.

A summary of these disclosure requirements include:

<table>
<tr><th>Change in accounting policy policy</th><th>Correction of a prior period error</th><th>Change in accounting estimate</th></tr>
<tr><td colspan="2">The nature of the change in accounting policy or prior period error.</td><td rowspan="2">Nature and amount of the change in accounting estimate that has an effect in the current period or is expected to have an effect in future periods, to the extent practicable.</td></tr>
<tr><td colspan="2">For the current period* and each prior period presented, the amount of the adjustment or correction:
(a) for each financial statement line item affected; and
(b) for basic and diluted earnings per share, if applicable.</td></tr>
<tr><td>Amount of the adjustment relating to periods before those presented, to the extent practicable.</td><td></td><td></td></tr>
<tr><td>The reasons why applying the new accounting policy provides reliable and more relevant information.</td><td></td><td></td></tr>
<tr><td colspan="2">If retrospective application or restatement is impracticable, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.</td><td>If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.</td></tr>
</table>

* Only applicable to changes in accounting policies

IFRS 17 disclosure requirements

IFRS 17 also contains specific disclosure requirements that may be relevant when changes are made to accounting policies and accounting estimates.

Referring to the example where companies may change the reference portfolio from a target reference portfolio to the actual reference portfolio, IFRS 17 requires useful disclosure to be provided that will allow users to assess the effects of changes in the judgements applied to determine the discount rates, including disclosure of the effect of changes in the composition of the assets in the reference portfolio as a result of the change. Such disclosures need to be sufficient to enable the user to understand the impact of the change in the reference portfolio.

Relevant disclosures may include the effect of the change on the measurement of insurance contracts, the difference in basis points in the discount rate that results from the change in the reference portfolios and the impact on the statement of profit or loss.

Insurers need to identify the circumstances in which IFRS 17 requires additional disclosure in respect of changes or corrections and such disclosures should be provided in addition to IAS 8 disclosure requirements.

Conclusion

Navigating improved 'IFRS 17 financial reporting vision' post the first year of IFRS 17 implementation is more difficult than we anticipated. It brings about an additional layer of complexity to the already intricate insurance landscape. Insurers are encouraged to carefully assess changes and corrections based on the accounting and disclosure requirements of IAS 8 and IFRS 17 to ensure such changes or corrections are correctly accounted for and that sufficient disclosure is provided in the financial statements for the next reporting period.

However, as insurers continue applying IFRS 17 as part of business-as-usual, the clarity and insights gained after transition, much like new corrective lenses, present the opportunity to better analyse shortfalls in the 2023 reporting period and will allow insurers to pursue IFRS 17 financial reporting in 2024 that drives quality beyond compliance.