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## **IFRS 17 - Auditability Issues Paper**

### **Objective**

- 1 The objective of the paper is to consider a summary of auditability of IFRS 17 which is to be incorporated in the IFRS 17 DEA. This summary comes from the presentation made by Accountancy Europe in the joint EFRAG TEG/Board meeting on 26 May 2020 (available [here](#)).

### **Background information**

- 2 Accountancy Europe (ACE) did a presentation to the EFRAG Board in **May 2018** auditability of IFRS 17 resulting from a structured and comprehensive methodological approach. At the joint EFRAG Board and TEG meeting on **26 May 2020**, this was updated for the deliberations of the IASB to amend IFRS 17.

- 3 An EFRAG Board member suggested that the comments and conclusions be included in the DEA.

- 4 The EFRAG Secretariat proposes in Appendix II to only include references to this section of the DEA.

- 5 EFRAG TEG discussed the paper at its meeting on 2 July and had the following comments:

In paragraph 5, EFRAG TEG questioned the expectation that thematic review will be undertaken for IFRS 17 application. They also suggested to consider “stakeholders” or “constituents” rather than “regulators”. There was a concern that while for banking a review of IFRS 9 application was important as the regulatory position is derived from the accounting balance sheet, but this is not the case for insurance and so EIOPA and others may not be inclined to do such a review.

(a) There was also a comment whether there would not be a consolidation of understanding by auditors over time.

(b) On the table in paragraph 15 (which was derived from the appendix), there was a general comment that the outcome may be in several points mis-aligned with EFRAG assessment in the DEA. In particular the table seemed to focus on reliability and perhaps a neglect of understandability. Many detailed questions were raised by TEG members on the reconciliation of EFRAG and ACE assessment of the same requirements.

- 6 EFRAG Secretariat clarified with ACE's representatives that there is an expectation that quantitative case studies will be carried out in more detail with involvement of Regulators. They also confirmed that the consolidation of understanding by auditors over time means the development of generally accepted application guidance, which is the case for other IFRS standards recently adopted. With reference to the assessment of the qualitative characteristics of the standard and to what extent we could expect or wish to see alignment and reconciliation between the conclusions by ACE and the conclusions by EFRAG, it emerged that the two may have

similarities however they may as well diverge to a certain extent, as they have different areas of focus, reflecting the two respective underlying objectives (audit versus endorsement).

**Proposed wording in DEA Appendix III: Audit considerations of IFRS 17**

- 7 EFRAG had requested Accountancy Europe to provide it with feedback as to the auditability of IFRS 17. The following is a summary of their conclusions as presented to the EFRAG Board and EFRAG TEG in May 2020 based on IFRS 17 as issued in 2018 and the deliberations of the IASB with respect to the amendments.
- 8 Accountancy Europe welcomes IFRS 17 including the deliberations on the proposed amendments as it considers this will improve comparability, drive greater consistency of recognition and measurement criteria globally as well as deliver more insightful and relevant information to users.
- 9 Accountancy Europe also indicated that while IFRS 17 is a highly complex accounting standard, based on the methodology followed, it concludes that the standard is auditable. It acknowledges that the quality of the audit and convergence of the financial reporting under IFRS 17 will depend on time, experience, transparency, and quality of data.
- 10 Auditor judgement and professional scepticism will especially be required in the areas of significant management judgement similarly to the other topics under Solvency II. The same is true for assessments of the adequacy and reliability of disclosures of significant estimates as the disclosures may drive convergence and transparency over time. The determination of materiality and the evaluation of audit adjustments will require additional judgement in application of IFRS 17.
- 11 Accountancy Europe identified that in relation to potential challenges linked to estimates and actuarial matters, for the promotion of consistent interpretation of the standard, institutional stakeholders and regulators should promote thematic reviews (similar to the ones on IFRS 9 for banks). Furthermore, those charged with governance should be continuously encouraged to be involved with respect to technical education, communication to the market and oversight on implementation projects. It is also necessary to continue developing shared views on the application of IFRS 17 as well as prepare educational material, best practices and guidelines for the audit profession (e.g. related to ISA 540 (revised) *Auditing accounting estimates and related disclosures*, ISA 530 *Audit sampling*, ISA 200 *Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with ISA*).
- 12 On timing, Accountancy Europe emphasised that aside from preparing for the effective date, insurers would need to ensure that judgement is supported by documentation, processes, and controls. Closing timelines of the financial statements may need to be redefined by preparers and they would also need to involve auditors on a timely basis to assess and review the implementation programmes of IFRS 17 and IFRS 9. All of this is necessary against the backdrop of the impact of Covid-19.
- 13 It is also necessary to establish a dialogue between the audit and actuarial professions, integrate auditing programmes as well as guidelines to carry out consistent high quality and effective audits. It is important that the auditing and actuarial professions leverage each other's skills and competencies with extensive training required for auditors and the audit approach to be adapted. Auditors will require more awareness and understanding of actuarial techniques and this may involve more senior members of both the audit team as well as specialists. It is also important to allocated additional actuarial and IT audit resources as both of these become significantly more important in audit engagements.

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- 14 Audits of IFRS 17 will require consistent exercise of professional judgement and scepticism throughout the audit. It also requires closer collaboration or integration of audit team with actuaries, technology auditors and regulatory experts.
- 15 Furthermore, it demands significant investments in technology such as digital auditing platforms, big data analysis and the required computational capabilities as well as the application of artificial intelligence in actuarial models.
- 16 Accountancy Europe also considered the new aspects of IFRS 17 and the related auditing considerations.

<b>What is new</b>	<b>Auditing considerations</b>
Level of aggregation and identification of onerous contracts	<p>Greater degree of granularity:</p> <ul style="list-style-type: none"> <li>– Significant and complex professional judgement by preparers and auditors;</li> <li>– Appropriate disclosures and education of users</li> </ul> <p>Judgement in this area will require:</p> <ul style="list-style-type: none"> <li>– Vigilance and consistent application by auditors, building on audit of stochastic modelling (Solvency II);</li> <li>– Guidance to ensure consistent application</li> </ul>
Contractual Service Margin	<p>Release of the CSM is a key driver to understand profitability of the company</p> <p>Concept of coverage units requires the exercise of judgment</p> <p>Auditors to assess:</p> <ul style="list-style-type: none"> <li>– if identification and application of coverage units is appropriate and consistent</li> <li>– guidance is understood and applied consistently</li> </ul>
Transition	<p>Measurement of CSM on transition requires:</p> <ul style="list-style-type: none"> <li>– analysis of significant volumes of historical data</li> <li>– use of practical expedients</li> <li>– significant judgment</li> </ul> <p>Direct impact on the determination of future profits and the subsequent pattern of their release</p> <p>Sufficient time needed to audit, ahead of results being published</p> <p>Requires significant vigilance by auditors</p>
Contract boundaries and estimation of future cash flows	<p>Payment of future premiums may be at the discretion of the policyholder requiring judgment to determine contract boundary</p> <p>Greater difficulty for auditors when requirements are new e.g. comparing 'actuals' against estimates</p> <ul style="list-style-type: none"> <li>– Vigilance required</li> <li>– Disclosure of estimation uncertainties</li> </ul>
Contract classification and applying VFA	<p>The majority of life with profits contracts have:</p> <ul style="list-style-type: none"> <li>– significant investment management component</li> <li>– terms and conditions vary significantly</li> </ul> <p>Auditors to exercise professional judgment if groups of contracts have been appropriately classified</p>
Cash flows that affect or are affected by cash flows to policyholders of	<p>Contractual cash flows could be affected by certain variable benefits. Complexity arises when different lines of businesses are involved</p> <p>The impact of these changes is not yet known:</p> <ul style="list-style-type: none"> <li>– on preparers</li> <li>– on the reactions of users</li> </ul>

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other contracts ('Mutualisation')	<ul style="list-style-type: none"> <li>– if auditor's need to adapt their assessment of audit risk and audit procedures</li> </ul>
Discounting	<p>Exercise of professional judgment to determine discount rates reflecting the characteristics of the liabilities being discounted</p> <p>Vigilance will be needed to assess if discount rates are being correctly applied</p>
Risk adjustment	<p>IFRS 17 requires determination of the risk adjustment through the eyes of management</p> <ul style="list-style-type: none"> <li>– judgements may be difficult to challenge</li> </ul> <p>IFRS 17 vs IFRS 4 provides:</p> <ul style="list-style-type: none"> <li>– a more coherent framework</li> <li>– more disclosures</li> </ul>
Reinsurance contracts held	<p>Many reinsurance contracts contain investment components that will need to be unbundled</p> <p>These new effects will require:</p> <ul style="list-style-type: none"> <li>– education for preparers, users and auditors</li> <li>– vigilance by auditors</li> </ul>
Presentation and disclosure	<p>Integrated statement of financial performance and supporting notes under IFRS 17</p> <p>Current profit and loss account perceived as an aggregation of the effects of movements in balance sheet items</p> <p>The impact of these changes is not yet known:</p> <ul style="list-style-type: none"> <li>– on preparers</li> <li>– on the reactions of users</li> <li>– if auditors need to adapt their assessment of audit risk and audit procedures</li> </ul>
Balance sheet presentation	<p>Separate disclosure of portfolios that are assets and groups that are liabilities, is different in concept from current reporting</p> <p>Most insurers still need to:</p> <ul style="list-style-type: none"> <li>– understand systems implications and potential cost</li> <li>– find a vision how to operationalize the requirements</li> </ul> <p>Auditors will need to adapt their audit procedures to address the final solutions adopted</p>

**Questions for EFRAG Board**

- 17 Does EFRAG Board have comments on the proposed wording in Appendix III of the DEA on IFRS 17?
- 18 Agenda Paper 05-04A provided as background for this meeting is the version of this paper presented to TEG for comments. Following up the discussion in TEG and having clarified that the areas of focus of the assessment of the qualitative criteria done for audit purposes may be different from the one done in the Endorsement, the EFRAG Secretariat proposes to delete the column related to such assessment. Does EFRAG Board agrees with this proposal?