

# **Auditor's views on IFRS 17**

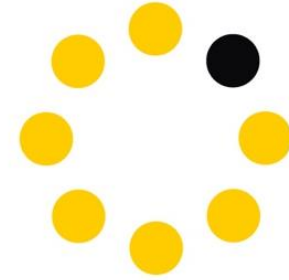
## ***Insurance contracts***

**EFRAG Board meeting 20 March 2018**





**1 MILLION  
PROFESSIONALS**



**28 EU  
MEMBER STATES**



**51 INSTITUTES**



**37 COUNTRIES**

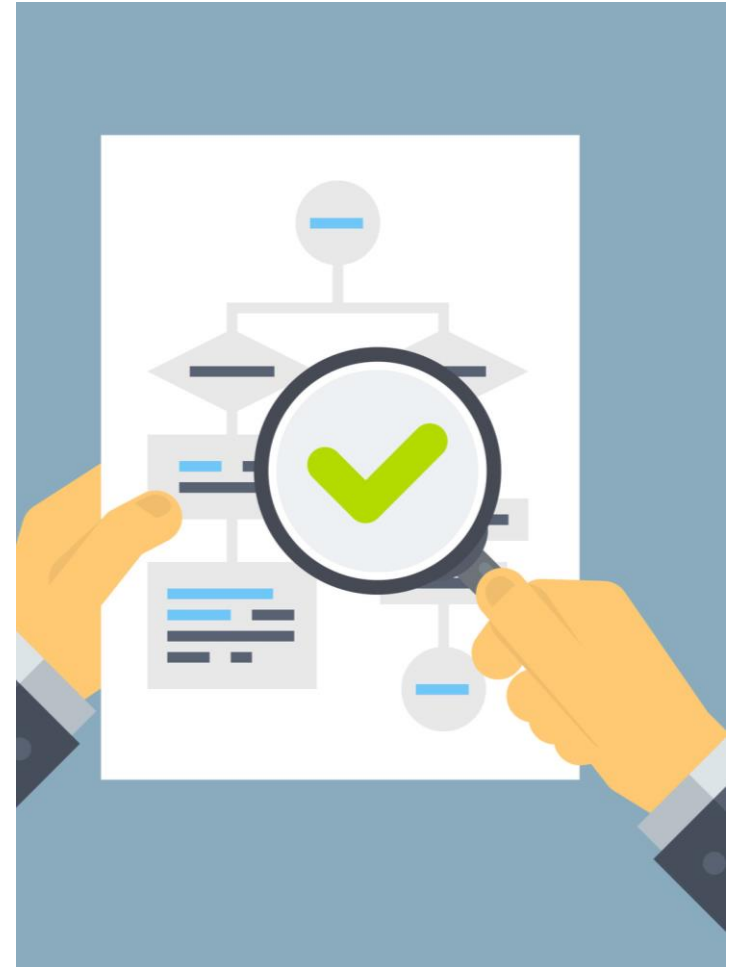
# Addressing EFRAG's request



- Usefulness and reliability of information in the financial statements
- Auditability
- Timing issues and implementation of IFRS 17
- Skills and competencies
- Potential challenges related to estimates and actuarial matters

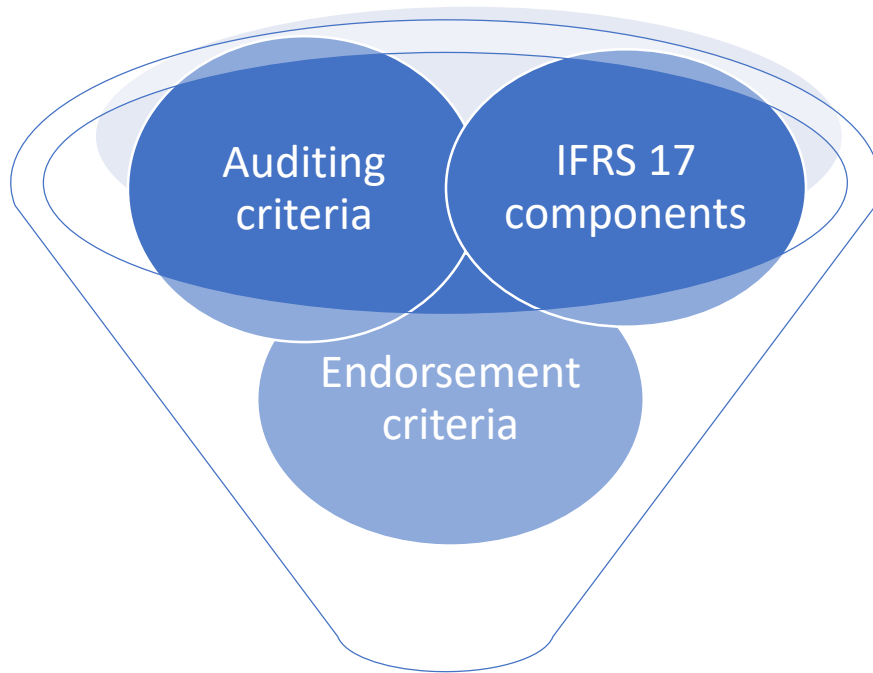
# Our approach for today's discussion

- Methodology followed
- What's new in Insurance accounting under IFRS 17?
- How do auditors see it?



# METHODOLOGY FOLLOWED

# The approach followed



## Three drivers:

- **Consistent** with the purpose of the discussion with EFRAG
- **Meaningful** with regards to the objectives
- **Sound and unbiased** with reference to potential actions

# IFRS 17 auditing consideration Matrix

## AUDITING CONSIDERATIONS

*conceptually and substantially overlapping*

| EFRAG endorsement criteria  | Understandability   | Relevance  | Reliability  | Comparability  | Neutrality (45.d)  |
|---|---|--|--|--|--|
| IAASB Assurance framework (auditability criteria)                         | Understandability (45.e)  | Relevance (45.a)   | Reliability (45.c)   | Completeness (45. b)   | Neutrality (45.d)  |
| <b>TOPICS</b><br><i>description</i>                                       | criteria result in subject matter information (SMI) that can be understood by intended users (IU) | relevant criteria result in SMI that assists decision-making by IU | allows for reasonably consistent measurement and evaluation of the underlying SMI, including where relevant P&D, when used in similar circumstances by different practitioners | criteria are complete when SMI prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decision of the IU made on the basis of the SMI. Complete criteria include, where relevant, benchmarks for P&D. | neutral criteria result in SMI that is free from bias as appropriate in the engagement circumstances |
| <b>Accounting issues that results in auditing issues</b>                  |   |  |  |  |  |
| <i>a) Level of aggregation</i>  |   |  |  |  |  |
| <i>b) Contractual Service Margin</i>                                      |   |  |  |  |  |
| <i>c) Disaggregation of investment component</i>                          |   |  |  |  |  |
| <i>d) Onerous Contracts</i>   |   |  |  |  |  |
| <i>e) Scope of VFA</i>  |   |  |  |  |  |
| <i>f) Reinsurance</i>   |   |  |  |  |  |
| <i>g) Discounting for PAA incurred claims liability</i>                   |   |  |  |  |  |
| <i>h) Presentation of groups of insurance contracts</i>                   |   |  |  |  |  |
| <i>i) Risk Mitigation - no hedge for indirect participation contracts</i> |   |  |  |  |  |
| <i>j) Transition</i>  |   |  |  |  |  |
| <i>k) Risk Margin</i>   |   |  |  |  |  |
| <i>l) Contract boundaries</i>   |   |  |  |  |  |
| <i>m) Disclosures and Presentation</i>                                    |   |  |  |  |  |
| <i>n) SME: small insurers do not have resources to apply IFRS 17</i>      |   |  |  |  |  |
| <i>o) Determining cash flows</i>  |   |  |  |  |  |
| <i>p) Discount rates</i>  |   |  |  |  |  |
| <i>q) Business combinations</i>   |   |  |  |  |  |
| <i>r) PAA Scope</i>   |   |  |  |  |  |

# What's new in Insurance accounting under IFRS 17?



# What's new in Insurance accounting under IFRS 17?

**Contract boundaries**

SII

**Variable Fee Approach**

**Mutualisation**

**Level of Aggregation**

**Onerous contracts**

**Discounting**

SII

**Risk Adjustment**

SII

**Contractual Service Margin**

**Reinsurance contracts held**

**Transition**

**Presentation and Disclosure**

**Balance sheet presentation**

| What's new  | Auditing considerations  | Could impact  |
|---|--|---|
| <b>Level of Aggregation and Identification of Onerous Contracts</b> | <ul style="list-style-type: none"> <li>● Greater degree of granularity <ul style="list-style-type: none"> <li>➤ significant and complex professional judgements by preparers and auditors,</li> <li>➤ appropriate disclosures and education of users</li> </ul> </li> <br/> <li>● Judgements in this area will require: <ul style="list-style-type: none"> <li>➤ vigilance and consistent application by auditors, building on audit of stochastic modelling through Solvency II</li> <li>➤ guidance to ensure consistent application</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>● Understandability</li> <li>● Comparability</li> <li>● Reliability</li> </ul> |

| What's new                              | Auditing considerations   | Could impact  |
|---|---|---|
| <b>Contractual Service Margin (CSM)</b> | <ul style="list-style-type: none"> <li>● Release of the CSM is a key driver to understand profitability of the company</li> <li>● Concept of coverage units requires the exercise of judgment</li> <li>● Auditors to assess: <ul style="list-style-type: none"> <li>➤ if identification and application of coverage units to amortise the CSM is appropriate and consistent</li> <li>➤ guidance is understood and applied consistently</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>● Relevance</li> <li>● Reliability</li> <li>● Comparability</li> </ul> |

| What's new        | Auditing considerations  | Could impact  |
|-------------------|--|---|
| <b>Transition</b> | <ul style="list-style-type: none"><li>● Measurement the CSM on transition requires:<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></li><li>● Direct impact on the determination of future profits and the subsequent pattern of their release</li><li>● Sufficient time needed to audit, ahead of results being published</li><li>● Requires significant vigilance by auditors</li></ul> | <ul style="list-style-type: none"><li>● Relevance</li><li>● Reliability</li><li>● Comparability</li></ul> |

| What's new                                       | Auditing considerations  | Could impact                          |
|--|--|---------------------------------------|
| <b>Contract boundaries</b>                       | <ul style="list-style-type: none"> <li>• Exercise of judgment required in determining contract boundary</li> <li>• Vigilance needed by auditors</li> <li>• Disclosure of estimation uncertainties</li> </ul> | Reliability                           |
| <b>Contract classification/<br/>Applying VFA</b> | Accounting implications of judgment used will likely be significant  | Reliability                           |
| <b>Mutualisation</b>                             | <ul style="list-style-type: none"> <li>• Complexity arises when different lines of businesses are involved</li> <li>• Impact of changes unknown</li> </ul>   | Relevance, Reliability                |
| <b>Discounting</b>                               | Exercise of professional judgment to determine discount rates  | Relevance, Reliability                |
| <b>Risk Adjustment</b>                           | Discretion to determine risk adjustment<br>➤ judgement may be difficult to challenge   | Reliability, Neutrality               |
| <b>Reinsurance contracts held</b>                | New effects will require: <ul style="list-style-type: none"> <li>• education for preparers, users, auditors</li> <li>• vigilance by auditors</li> </ul>  | Relevance, Reliability, Comparability |
| <b>Presentation and disclosure</b>               | Impact of changes under IFRS 17 unknown  | Reliability                           |
| <b>Balance sheet presentation</b>                | <ul style="list-style-type: none"> <li>• Different in concept from current reporting requiring insurers and auditors to adapt</li> </ul>   | Reliability                           |

# How does Accountancy Europe see it?

# Usefulness and reliability of information in the financial statements

We welcome IFRS 17 introduction which will:

- 👍 improve comparability
- 👍 drive greater consistency of recognition and measurement criteria globally
- 👍 deliver more insightful information to the Intended Users
- 👍 provide relevant information for investors

# Auditability

- The Standard as it stands is auditable
- The current debate with preparers, standard setters and accountants at the IASB Transition Resource Group meetings is expected to:
  - progress further
  - bring clarification where needed
  - provide a basis for pragmatic application



# Auditability

- Challenges around areas of significant judgement
- Assessing the adequacy and reliability of disclosures of significant estimates
- Materiality and benchmarks of materiality to be recalibrated
- ISA 540 is currently undergoing revision

# Timing issues and implementation of IFRS 17

- The preparers would need to:
  - get ready for 2021 (also for IAS 8 disclosures)
  - ensure the judgement is supported by relevant backup documentation, processes and controls
  - redefine the closing timelines
- Involve auditors on a timely basis to properly assess and challenge the implementation programs of the new standards (including IFRS 9)

# Skills and competencies

- Auditing and Actuarial profession to mutually leverage each other's skills and competencies
- Extensive trainings for auditors and the audit approach to be adapted as a consequence
- More awareness and understanding of actuarial techniques
- Involve most senior members of the audit team and specialists
- Allocate additional actuarial and IT audit resources (IFRS 17 elevates significantly the actuaries' role in the audit engagement teams)

# Operating model

- Audit teams need even closer collaboration or integration with:
  - Actuaries
  - IT Auditors
  - Regulatory experts, where needed
- Audit firms will need to make significant investments in automation to equip the integrated teams with auditing tools
- Audit teams will need to demonstrate the consistent exercise of professional judgment throughout the planning, execution and delivery of IFRS 17 audits

**BECAUSE  
QUESTIONS  
COUNT.**



**ACCOUNTANCY  
EUROPE.**

# APPENDIX

| What's new   | Auditing considerations  | Could impact |
|--|--|--------------|
| <b>Contract Boundaries and Estimation of Future Cash Flows</b> | <ul style="list-style-type: none"><li>• Payment of future premiums may be at the discretion of the policyholder requiring the exercise of judgment in determining contract boundary</li><br/><li>• Greater difficulty for auditors when requirements are new e.g. comparing 'actuals' against estimates<ul style="list-style-type: none"><li>➤ Vigilance required</li><li>➤ Disclosure of estimation uncertainties</li></ul></li></ul> | Reliability  |

| What's new  | Auditing considerations  | Could impact |
|---|--|--------------|
| <b>Contract classification and applying the Variable Fee Approach</b> | <ul style="list-style-type: none"><li>● The majority of life with profits contracts have:<ul style="list-style-type: none"><li>➤ significant investment management component</li><li>➤ their terms and conditions vary significantly</li></ul></li><br/><li>● Auditors to exercise professional judgment if groups of contracts have been appropriately classified</li></ul> | Reliability  |



| What's new   | Auditing considerations  | Could impact   |
|--|--|--|
| <p><b>Cash flows that affect or are affected by cash flows to policyholders of other contracts ('Mutualisation')</b></p> | <ul style="list-style-type: none"> <li>● Contractual cash flows could be affected by certain variable benefits. Complexity arises when different lines of businesses are involved</li> <li>● The impacts of these changes is not yet known: <ul style="list-style-type: none"> <li>➤ on preparers</li> <li>➤ on users' reactions</li> <li>➤ if auditors need to adapt their assessment of audit risk and audit procedures</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Relevance</li> <li>• Reliability</li> </ul> |

| What's new         | Auditing considerations   | Could impact  |
|--------------------|---|---|
| <b>Discounting</b> | <ul style="list-style-type: none"><li>• Exercise of professional judgment to determine discount rates reflecting the characteristics of the liabilities being discounted</li><li>• Vigilance will be needed to assess if discount rates are being correctly applied</li></ul> | <ul style="list-style-type: none"><li>• Relevance</li><li>• Reliability</li></ul> |

| What's new                    | Auditing considerations   | Could impact  |
|-------------------------------|---|---|
| <p><b>Risk Adjustment</b></p> | <ul style="list-style-type: none"> <li>● IFRS 17 requires determination of the risk adjustment through the eyes of management <ul style="list-style-type: none"> <li>➤ judgements may be difficult to challenge</li> </ul> </li> <br/> <li>● IFRS 17 vs IFRS 4: <ul style="list-style-type: none"> <li>➤ provides a more coherent framework</li> <li>➤ provides greater disclosure</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Reliability</li> <li>• Neutrality</li> </ul> |

| What's new                        | Auditing considerations  | Could impact  |
|-----------------------------------|--|---|
| <b>Reinsurance Contracts Held</b> | <ul style="list-style-type: none"><li>• The measurement model for reinsurance gives rise to asymmetries</li><li>• Many reinsurance contracts contain investment components that will need to be unbundled</li><li>• These new effects will require:<ul style="list-style-type: none"><li>➤ education for preparers, users and auditors</li><li>➤ vigilance by auditors</li></ul></li></ul> | <ul style="list-style-type: none"><li>• Relevance</li><li>• Reliability</li><li>• Comparability</li></ul> |

| What's new                         | Auditing considerations   | Could impact |
|------------------------------------|---|--------------|
| <b>Presentation and disclosure</b> | <ul style="list-style-type: none"><li>● Integrated statement of financial performance and supporting foot notes under IFRS 17</li><li>● Current profit and loss account perceived as an aggregation of the effects of movements in balance sheet items</li><li>● The impacts of these changes is not yet known:<ul style="list-style-type: none"><li>➤ on preparers</li><li>➤ on users' reactions</li><li>➤ if auditors need to adapt their assessment of audit risk and audit procedures</li></ul></li></ul> | Reliability  |

| What's new                               | Auditing considerations   | Could impact       |
|--|---|--------------------|
| <p><b>Balance sheet presentation</b></p> | <ul style="list-style-type: none"> <li>● Separate disclosure of groups that are assets and groups that are liabilities is different in concept from current reporting</li> <br/> <li>● Most insurers still need to: <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> </li> <br/> <li>● Auditors will need to adapt their audit procedures to address the final solutions adopted</li> </ul> | <p>Reliability</p> |

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