Fiji Institute of Accountants

Technical Workshop

20 March 2021

Agenda

1. Introduction
2. IFRS 17 Insurance Contracts
3. Financial reporting implications of COVID-19

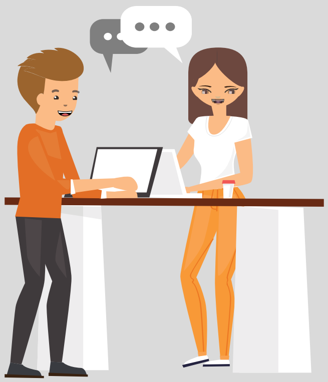
IFRS 17 *Insurance contracts*

IFRS 17

- Who is affected?
- Why has IFRS 17 been developed
- What is IFRS 17?
- IFRS 17 amendments
- Key presentation changes
- Potential accounting changes for insurers
- Effective date
- Resources

Who is affected?

- IFRS 17 applies to all entities that issue insurance contracts
- Primarily expected to affect entities in the insurance industry
- Excludes from scope
  - Product warranties issued by manufacturer, dealer or retailer
  - Some financial guarantee contracts
  - Some fixed-fee service contracts



Why has IFRS 17 been developed?

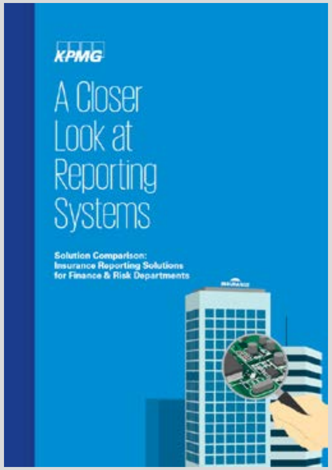
- Lack of useful information
  - Fundamental economics are not necessarily reflected in the reported IFRS numbers
- Lack of transparency about profitability
  - Profits recognised at different points
  - Use of many non-GAAP measures
  - Comparing companies by source of profitability is a needlessly difficult task
- Lack of comparability among insurers
  - IFRS companies report insurance contracts using different practices
  - New framework will replace huge variety of accounting treatments

Why has IFRS 17 been developed? (cont'd)

- Inconsistency with other industries
    - Revenue reported on a cash basis
    - Revenue will reflect the services provided like any other industry

What is IFRS 17?

- IFRS 17 is the first truly international, comprehensive accounting Standard for insurance.
- IFRS 17 replaces IFRS 4 — an interim Standard that results in widely divergent practices
- IFRS 17
  - Consistent accounting for all insurance contracts
  - Updated information about obligations, risks and performance of insurance contract
  - Increases transparency in financial information reported by insurance companies

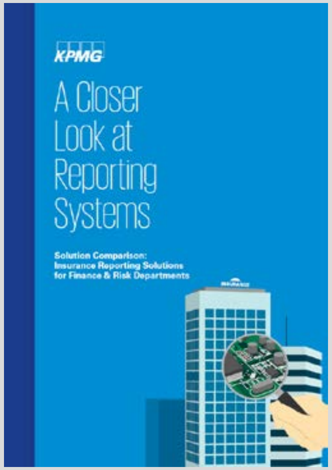


What is IFRS 17? (cont'd)

- IFRS 17's **general measurement model** (GMM) is based on a fulfilment objective and uses current assumptions

- It introduces a **single, revenue recognition** principle to reflect services provided

- And is modified for certain contracts



Initial recognition

Key components

Fulfilment cash flows

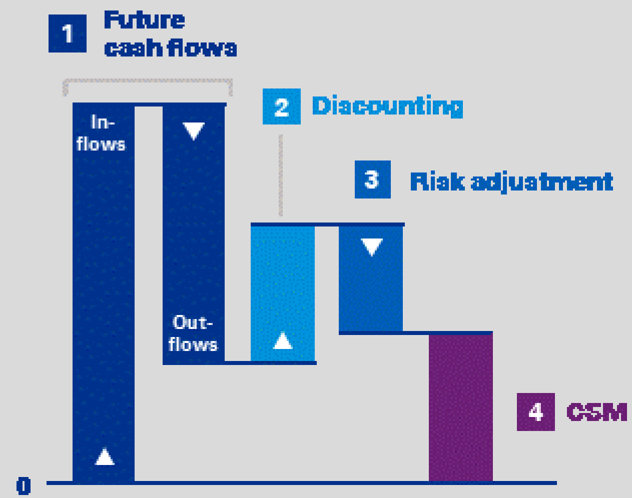
Risk-adjusted present value
of future cash flows – e.g. premiums, claims

1
2
3

Contractual service margin (CSM)

Represents unearned profit –
results in no gain on initial recognition

4



Net cash outflows result in no CSM – a loss is recognised immediately

Subsequent measurement - Composition

Total liability of a group of insurance contracts

Liability for remaining coverage (LRC)

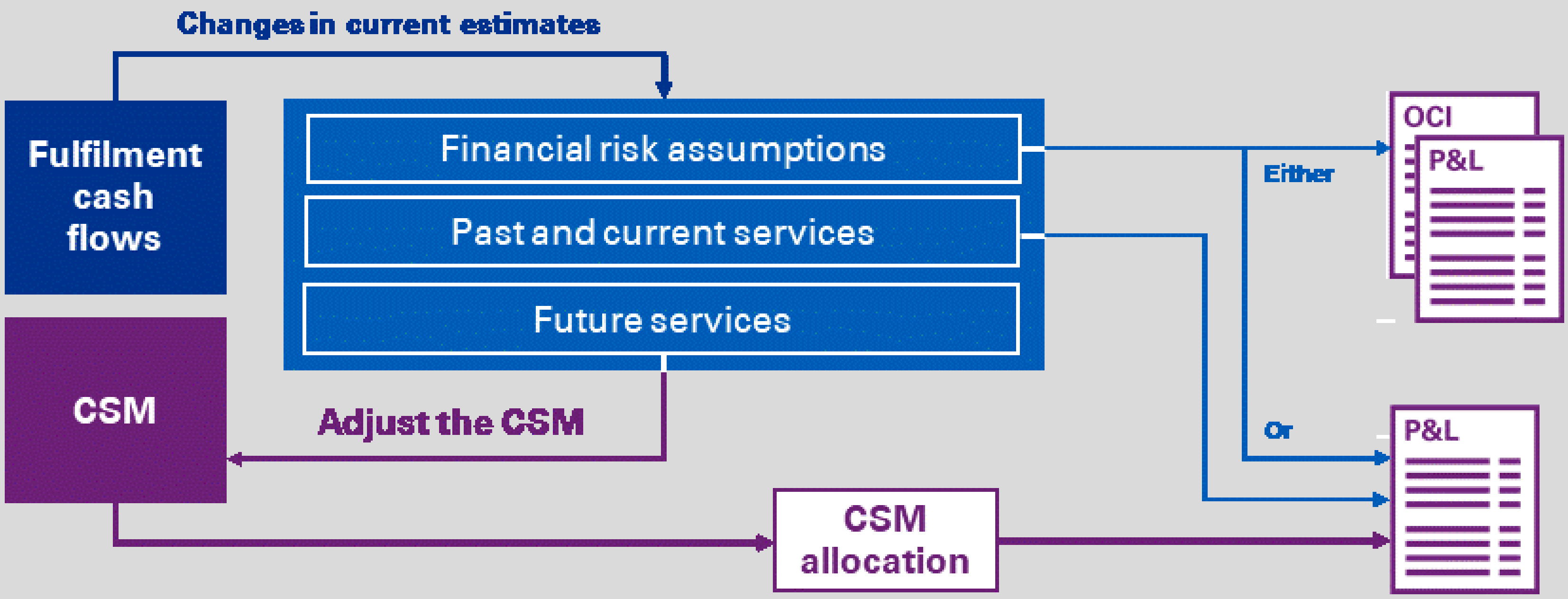
Fulfilment cash flows related to future services, plus **CSM (unearned profit)** remaining

+

Liability for incurred claims (LIC)

Fulfilment cash flows for claims incurred, but not yet paid

Subsequent measurement



Recognising insurance revenue

- Insurance revenue is derived from the **changes in the Liability for Remaining Coverage** for each reporting period, covering…

Expected insurance claims and expenses	Risk adjustment	CSM allocation	Acquisition cash flows

These items represent a company's consideration for providing services

IFRS 17 amendments

NOV 2019
Redeliberation Plan

FEB 2020
Discussions Complete

JUN 2020
Final revised standard

1 January 2022
Opening balance sheet

SEP 2019
Comment period closed

INTENSE ACTIVITY

Amendments subject to the Board's normal Due Process

Effective Date

1 January 2023

IFRS 17 amendments (cont'd)

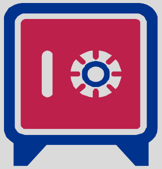
The IASB applied the following criteria when considering potential topics for amendment and the feedback from comment letters. The Board decided that amendments to IFRS 17 must not:

- Change the fundamental principles of IFRS 17 as that would result in a significant loss of useful information for users of the financial statements;
- Unduly disrupt the implementation already underway; or
- Further delay the effective date of IFRS 17

IFRS 17 amendments (cont'd)

The amendments address implementation challenges in seven areas of IFRS 17.

- Scope changes for certain credit cards and loans that provide insurance coverage.
- Accounting for investment services in an insurance contract.
- Allocating acquisition cash flows that relate to future contract renewals.
- Mitigating the financial risk of direct participating contracts.
- Presentation of insurance contract assets and liabilities.
- Reinsurance of onerous contracts.
- Accounting for acquired claims liabilities on transition.



Key presentation changes

New look income statement (1/3)

- An entity separates **underwriting** and **finance** results.
- An entity presents insurance revenue and service expenses in profit or loss.
  - **Investment components** are excluded.
  - **Information about premiums** that are not considered insurance revenue is not presented in other line items.

In millions of euro	2023
Insurance revenue	54,269
Insurance service expenses	(43,104)
Net expenses from reinsurance contracts	(1,230)
Insurance service result	**9,935**
Interest revenue calculated using the effective interest method	8,398
Other investment revenue	21,095
Net impairment loss on financial assets	(324)
Investment return	**29,169**
Net finance expenses from insurance contracts	(22,855)
Net finance income from reinsurance contracts	399
Movement in investment contract liabilities	(1,311)
Movement in third party interests in consolidated funds	(62)
Net financial result	**5,340**
Revenue from investment management services	432
Other income	735
Other operating expenses	(6,321)
Other finance costs	(615)
Share of profit of equity-accounted investees, net of tax	233
Profit before tax	**9,739**
Income tax expense	(2,644)
Profit for the year	**7,095**

Key presentation changes (cont'd)

New look income statement (2/3)

- Insurance finance income or expense comprises the **change in the carrying amount** arising from the effect of, and changes in:
  - **time value of money**; and
  - **financial risk**.
- An entity can choose to present insurance finance income or expense **fully in profit or loss**, or **disaggregate it between profit or loss and OCI**.

In millions of euro	2023
Insurance revenue	54,269
Insurance service expenses	(43,104)
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Income tax expense	(2,644)
Profit for the year	**7,095**

Key presentation changes (cont'd)

New look income statement (3/3)

- Income or expenses from **reinsurance contracts held** are presented separately from those from insurance contracts issued:
  - as a **single amount**; or
  - with amounts recovered and allocation of premiums paid **shown separately**.
- Insurance finance income or expenses from **reinsurance contracts held** may be presented in profit or loss in its entirety, or disaggregated between profit or loss and OCI.

In millions of euro	2023
Insurance revenue	54,269
Insurance service expenses	(43,104)
Net expenses from reinsurance contracts	(1,230)
Insurance service result	9,935
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Key presentation changes (cont'd)

Balance sheet

- An entity separately presents:
  - groups of **insurance** contracts and groups of **reinsurance** contracts; and
  - groups that are **assets** and groups that are **liabilities**.

  The level of aggregation is also relevant for presentation purposes in order to identify the position-i.e. **asset** or **liability**.

  Insurance acquisition cash flows associated with a group could alter the position of the group.

In millions of euro	31 December 2023
Assets	
Cash and cash equivalents*	20,794
Financial investments	
– Measured at fair value*	412,526
– Measured at amortised cost	8,765
– Transferred under securities lending and repurchase agreements	8,267
Receivables*	7,609
Current tax assets	791
Insurance contract assets	717
Reinsurance contract assets	12,775
Liabilities	
Payables	10,401
Derivative liabilities*	1,240
Current tax liabilities	1,980
Investment contract liabilities	23,977
Third party interests in consolidated funds	491
Insurance contract liabilities	379,951
Reinsurance contract liabilities	884

Potential accounting changes for insurers

Profitability patterns

Volatility of financial results and equity

Level of transparency about profit drivers

Equity levels

The magnitude of the accounting change for life and non-life insurers will be different

Effective date

- **Before**: effective date of 1 January 2021
- **After**: effective date deferred by two years to 1 January 2023

May 2017
IFRS 17 issued

June 2020
Amendments to IFRS 17 issued

1 January 2021
Effective date prior to amendments

1 January 2022
Comparative period begins

1 January 2023
Effective date

- Companies can choose to apply IFRS 17 earlier, if they also apply IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*

Resources

- See links to our web articles on the IFRS 17 amendments on the ISG website: https://intra.ema.kpmg.com/sites/GQRM/depts/ISG/Pages/TInsuranceContracts.aspx

- See links to our global webcast on the final amendments to IFRS 17: https://event.webcasts.com/viewer/event.jsp?ei=1283390&tp_key=e70b15b4c9

- See link to our publication IFRS 17 First Impressions: 2020 Edition https://home.kpmg/content/dam/kpmg/xx/pdf/2020/07/ifrs17-first-impressions-2020.pdf

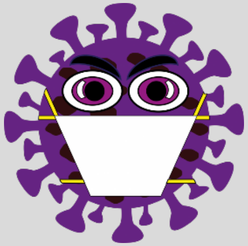
- See link to our revised Insurance illustrative financial statements https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/09/2020-ifs-insurance.pdf

- Request a trial and demo of the IFRS 17 Digital Learning Suite https://marketing.kpmg.co.uk/ifrs-digital-learning-suite/register/

Financial reporting implications of COVID-19

Financial reporting implications of COVID-19

- Are assets being carried at appropriate amounts?
- What are the key financial instruments impacts?
- What are the relevant going concern considerations?
- Are all liabilities fully recorded and properly considered?
- What is the impact on employee benefits?
- Have changes been made to lease contracts?
- How should COVID-19 impacts be disclosed?



Are assets being carried at appropriate amounts?

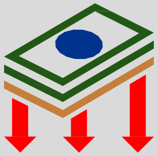
- Have non-financial assets become impaired – e.g. PPE, intangible assets and goodwill?
  - Consider whether there are any indicators of impairment for the company's CGUs or assets that are tested on a stand-alone basis. In particular, assess the impact of measures taken to contain COVID-19 on the company's business.
  - Consider whether budgets and cash flow projections reflect the following to the extent applicable to the company, based on information available at the reporting date:
    - projections of central banks and other international organisations about the duration and severity of the impact of COVID-19;
    - supply of and demand for the CGU's products or services;
    - the decline in economic activity;

Are assets being carried at appropriate amounts? (cont'd)

  - the impact of restrictions on transport, travel and quarantines;
  - the impact of exchange rates; and
  - the fiscal stimulus, liquidity provision and financial support from the state or international organisations, including the potential effects of the withdrawal thereof.
- Consider whether discount rates used in recent valuations have been updated to reflect the risk environment at the reporting date.
- Consider enhancing sensitivity disclosures and disclosures about the key assumptions and major sources of estimation uncertainty in the interim and annual reports.

Are assets being carried at appropriate amounts? (cont'd)

- Are fair values appropriately determined and disclosed?
  - Consider whether the valuation:
    - reflects market participants' assumptions based on information available and market conditions at the measurement date;
    - technique used is maximising the use of relevant observable inputs and minimising the use of unobservable inputs; and
    - incorporates the risk premiums that would arise from the increased uncertainty and other impacts of COVID-19.
  - Consider whether unobservable inputs have become significant, which would result in a Level 3 categorisation and require additional disclosures.
  - Consider expanding disclosures about the key assumptions, sensitivities and major sources of estimation uncertainty.



Are assets being carried at appropriate amounts? (cont'd)

- Will taxable profits be available to recover deferred tax assets?
  - Consider how the current economic conditions could affect the company's tax strategies and plans.
  - Consider whether there is any uncertainty about income tax treatments.
  - Update projections for the reversal of taxable temporary differences and for other future taxable profits, ensuring that the assumptions are consistent with those used for other recoverability assessments.
  - Provide clear and transparent disclosure about judgements and estimates made in recognising and measuring deferred tax assets.

Are assets being carried at appropriate amounts? (cont'd)

- Have lease assets become impaired?
  - Assess whether there are any indicators of impairment for the CGUs to which the right-of-use asset relates.
  - Assess whether IAS 36's requirements have been applied appropriately when testing if the right-of-use asset has been impaired.
  - Consider enhancing sensitivity disclosures and disclosures about the key assumptions and major sources of estimation uncertainty.

What are the key financial instruments impacts?

- Have borrowers considered changes to the terms of their liabilities?
  - Consider whether there are any changes to the terms and conditions of a financial liability and, if so, whether those changes are substantial;

What are the key financial instruments impacts? (cont'd)

- How are expected credit losses on trade receivables impacted?
  - When measuring ECLs for trade receivables:
    - assess how to incorporate forward-looking information about the impacts of the COVID-19 outbreak;
    - consider whether the segmentation applied to measure ECL appropriately captures the different types of customers or regions that are affected in different ways by the economic effects of the COVID-19 outbreak;
    - assess whether a trade receivable has been modified and if so whether it continues to be appropriate to use a discount rate of zero; and
    - consider how to incorporate the impact of any credit insurance and government support.

What are the relevant going concern considerations?

- When assessing a company's ability to continue as a going concern, you may need to do the following.
  - Update forecasts and sensitivities, as considered appropriate, taking into account the risk factors identified and the different possible outcomes. It is important to consider downside scenarios – e.g. taking into account the impacts of continued travel restrictions.
  - Review projected covenant compliance in different scenarios.
  - Assess plans to mitigate events or conditions that may cast significant doubt on the company's ability to continue as a going concern. In particular, reassess the availability of financing. The company needs to assess whether its plans are achievable and realistic.
  - Provide clear and robust disclosures, including disclosures about uncertainties identified in the going concern assessment where relevant.

KPMG

Are all liabilities fully recorded and properly considered?

- How does COVID-19 impact current and non-current classification of debt?
  - To assess whether debt subject to covenant clauses needs to be classified as current or non-current at the reporting date, perform the following.
    - Review covenant clauses in loan agreements and assess whether a breach has occurred or is likely to occur at the reporting date.
    - Assess whether it is necessary to obtain a waiver or grace period from the lender if a breach has occurred.
    - Evaluate the company's ability to maintain compliance with debt covenants and consider whether a renegotiation of covenant clauses with lenders is necessary.
    - Provide the disclosures required under IFRS Standards.

What is the impact on employee benefits?

- Have there been changes to employee benefits and employer obligations?
  - Consider the appropriate accounting for new employee benefit arrangements – e.g. new remuneration policies.
  - Assess when to recognise an expense and corresponding liability for termination benefits.
  - Update estimates used to measure employee benefits, as appropriate.

Have changes been made to lease contracts?

- Rent concessions
- Have expectations around lease renewal, termination or purchase options changed?
  - Consider whether COVID-19-related events and circumstances have triggered a requirement to reassess renewal, termination or purchase options.
  - Consider the impact of any changes in economic incentives on whether a company is reasonably certain to exercise, or not to exercise, such options.
  - Provide clear and meaningful disclosures about judgements and estimates made in reassessing lease options and lease terms.

How should COVID-19 impacts be disclosed?

- Communicating effectively has never been more important.
- Tell your story in your financial reports, and explain the judgements and the estimates made through clear, meaningful and specific disclosures.

Resources

See link to our COVID-19 supplement to our annual Guides to financial statements, which provides illustrations of some of those potential additional disclosures
https://home.kpmg/content/dam/kpmg/xx/pdf/2020/09/covid-19-supplement.pdf

Wrap up

Thank you

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