

Auditor's views on IFRS 17 *Insurance contracts*

EFRAG Board meeting 26 May 2020

IASB is expected to issue the final IFRS 17 standard by Q2 2020. The views expressed by ACE in this document are based on the original IFRS 17 standard issued in May 2018, plus the content of the re-deliberation notes made public by IASB. Some considerations might change in light of the final version issued by IASB.



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51 INSTITUTES



35 COUNTRIES

Addressing EFRAG's request



- Usefulness and reliability of information in the financial statements
- Auditability
- Potential challenges related to estimates and actuarial matters
- Timing issues and implementation of IFRS 17
- Skills and competencies
- Audit delivery model
- Hedge accounting in an insurance context

What ACE did on IFRS 17 since we last met?

- May 2018: Presentation on auditability of IFRS 17 to EFRAG Board resulting from a structured and comprehensive methodological approach
- Participation in the public debate among stakeholders and promoted convergence towards common views
- October 2019: Issuance of FCL on IASB ED Amendments to IFRS 17, which among others commented on:
 - Annual cohorts
 - MRA at transition
 - Effective date
- Participation in recent discussions on hedge accounting application to insurance liabilities
- 2020: We refreshed the auditability analysis, following our 2018 methodology, based on IASB re-deliberations

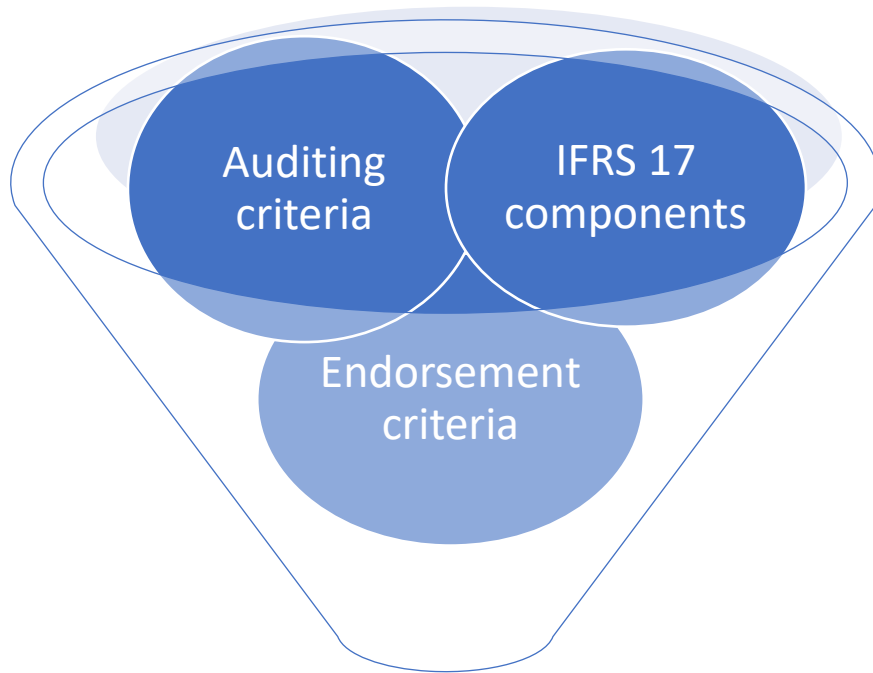
Our key messages to EFRAG

- We welcome the introduction of IFRS 17
- The standard is auditable
- Time will help to fully implement the requirements
- Transparency and practical experience will drive consistent application over time
- Professional judgement and scepticism will play an important role in auditing IFRS 17
- Auditors and actuaries will work in integrated teams
- Educational material and guidelines for the profession will be key in creating a level playing field
- Audit firms will invest in technical excellence and leverage on technology to deliver high quality and effective audits

Our approach for today's discussion

- Refresh of the work done in 2018 in light of the IASB redeliberations
- Today we will discuss:
 - Methodology followed (Details in the Appendix)
 - What's new in insurance accounting under IFRS 17? (Details in the Appendix)
 - How do auditors see it?

The methodology 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

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

How does Accountancy Europe see it?

Usefulness and reliability of information in the financial statements

We welcome IFRS 17 introduction, including its redeliberations, 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

- IFRS 17 is a highly complex accounting standard
- As a result of the methodology followed, we concluded that the standard as it stands is **auditable**
- High quality audit and convergence of reporting will depend on:
 - Time
 - Experience
 - Transparency
 - Quality of data

Auditability

Key implications for the auditor's professional judgement will relate to:

- Challenges around areas of significant management judgement
- Assessing the adequacy and reliability of disclosures of significant estimates
- Calibration of materiality and benchmarks of materiality

Potential challenges related to estimates and actuarial matters

In view of consistent interpretation of the standard, institutional stakeholders and regulators should:

- Promote thematic reviews (similarly to role played in IFRS 9 with banks)
- Encourage continuous involvement of those charged with governance with respect to:
 - Technical education
 - Communications to the market; and
 - Oversight on implementation projects

Potential challenges related to estimates and actuarial matters

- Continue the journey to develop common views on the application of the Standard
- Stimulate a debate to develop educational material, best practices and guidelines for the audit profession (e.g. related to ISA 540 (revised), ISA 530, ISA 200)
- Establish a dialogue between the audit and actuarial profession
 - Develop integrated auditing programs and guidelines to carry out consistent high quality and effective audits

Timing issues and implementation of IFRS 17

- The preparers would need to:
 - Get ready for 2023 (including for IAS 8 disclosures)
 - Ensure judgement is supported by relevant backup documentation, processes and controls
 - Redefine the closing timelines of the financial statements
 - Consider the impact of Covid-19
- 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 consequently
- More awareness and understanding of actuarial techniques
- Involve more 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)

Audit delivery model

- Consistent exercise of professional judgment and skepticism throughout the whole IFRS 17 audit cycle
- Closer collaboration/integration with:
 - Actuaries
 - IT Auditors
 - Regulatory experts
- Significant investments in technology:
 - Digital auditing platforms
 - Using the computational capabilities of big data analyzers
 - Applying artificial intelligence in actuarial models

Hedge accounting in an insurance context

- EFRAG's request concerning the interaction between IFRS 9 Hedge Accounting and IFRS 17 Insurance Contracts: Hedge accounting of insurance liabilities and their risk components
 - In a nutshell *“Do the existing hedging requirements work for insurance liabilities?”*
- 16 April: Discussion of draft response with EFRAG TEG
- 23 April: Issuance of final response (see website)

Hedge accounting in an insurance context

- **Professional skepticism** to be applied by auditor
 - Effectiveness of the hedging strategy: Expert judgement underpinning the actuarial valuation and applied assumptions
- The gathered **audit evidence** should cover the:
 - Quality of historical data underpinning the assumptions
 - Data quality
 - Integrity of the IT environment, including implementation
 - Competency, skills and availability of personnel
 - Robustness of the governance model
 - Consistency between derivatives used, hedging strategy objective and management actions included in actuarial models

Hedge accounting in an insurance context

- **Conclusion:**
 - Hedge accounting might be adopted, depending on:
 - Underlying facts and circumstances
 - Features of the insurance contracts
 - Used hedging instruments
 - Underpinning hedge documentation
 - Not all risk types eligible for hedging
 - Hedge accounting (HA) auditable if:
 - All relevant HA conditions are met
 - Insurers investing in necessary systems and tools

**BECAUSE
QUESTIONS
COUNT.**

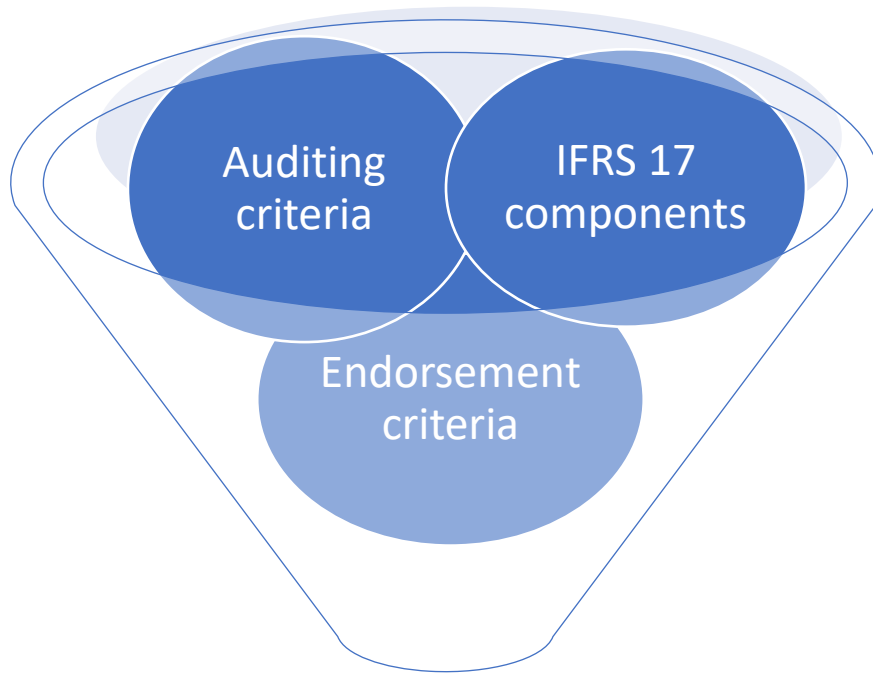


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APPENDIX

METHODOLOGY FOLLOWED

The approach followed



Three drivers:

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- **Meaningful** with regards to the objectives
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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)
TOPICS <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
Accounting issues that results in auditing issues					
<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>					

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Balance sheet presentation

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

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

What's new	Auditing considerations	Could impact
Transition	<ul style="list-style-type: none"> • Measurement the CSM on transition requires: <ul style="list-style-type: none"> ➤ analysis of significant volumes of historical data ➤ use of practical expedients ➤ significant judgment • Direct impact on the determination of future profits and the subsequent pattern of their release • Sufficient time needed to audit, ahead of results being published • Requires significant vigilance by auditors 	<ul style="list-style-type: none"> • Relevance • Reliability • Comparability

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

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

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

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

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

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

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

What's new	Auditing considerations	Could impact
<p>Balance sheet presentation</p>	<ul style="list-style-type: none"> ● Separate disclosure of groups that are assets and groups that are liabilities is different in concept from current reporting ● Most insurers still need to: <ul style="list-style-type: none"> ➤ understand systems implications and potential cost ➤ find a vision how to operationalize the requirements ● Auditors will need to adapt their audit procedures to address the final solutions adopted 	<p>Reliability</p>

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