Australian Government
Australian Accounting Standards Board

# AASB Transition Resource Group for AASB 17 *Insurance Contracts*
# Submission form for potential implementation question

| | |
|---|---|
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| **Stakeholder group** | Industry Group |
| **Do you wish to present to the TRG?** | Yes |

**Potential implementation question**

How would an insurer interpret and apply the requirements of AASB 17, when performing the impairment tests for asset for insurance acquisition cash flows?

**Paragraph of IFRS 17 *Insurance Contracts***

Various, including, in particular, AASB 17 paragraphs 28E, B35D(a) and B35D(b)

**Analysis of the question**
*The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.*

Please refer to Appendix A

**Is the question pervasive?**
*Explain whether the question is expected to be relevant to a wide group of stakeholders.*

The asset for insurance acquisition cash flows arises when insurers incur acquisition costs which relate to current and renewing insurance contracts. It is likely to predominantly impact Australian life insurers actively writing new business and potentially could impact other insurers. This paper was discussed at the AALC on 4 February 2021. The topic discussed was considered to be of broader interest to insurers outside of the AALC and therefore it was agreed the paper should be tabled at the AASB TRG for discussion.

# Impairment tests for asset for insurance acquisition cash flows (Deloitte)

## BACKGROUND

The Amendments to IFRS 17 published in June 2020 substantially revised the accounting for insurance acquisition cash flows ("IACF"). The key changes are:

- Expanded the scope of IACF that could be capitalised in an asset for allocation to future groups of insurance contracts by including also IACF specific to a group of contracts;
- Introduced new guidance on how to allocate the IACF asset to a group of contracts; and
- Introduced a two-step impairment test to be carried out when facts and circumstances indicate that the asset may be impaired

The scope of IACF that can be capitalised in an asset originally included the IACF that are specific to a portfolio of insurance contracts. As a minimum, IFRS 17 requires an insurer to determine up to three groups of insurance contracts within a portfolio every twelve months. This means that a portfolio is a larger, open-ended unit of account while the group of insurance contracts is a small unit of account that belongs to a portfolio. When a group is formed, it will only have additional contracts added to it if they were issued within the twelve months that bind the time span of the group and if they are initially recognised later than the end of the twelve months in question. For example, when an insurer issues profitable insurance contracts with a forward starting coverage period for which no payment is made when they are issued. When the policyholder renews a contract at the end of the coverage period, the renewal is a new contract that would belong to a different group in the same portfolio. The group that comprises the renewed contract will also have contracts issued to new policyholders that have purchased their insurance contracts in the same twelve months period.

The original IFRS 17 text recognised that IACF incurred and paid are part of the cash flows of an insurance contract (IFRS 17:B65(e)) and that the allocation to a group may occur later than the point in time the IACF are accounted for thus creating an IACF asset (IFRS 17:27).

*B65 Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:*

*(e) an allocation of insurance acquisition cash flows attributable to the portfolio to which the contract belongs.*

*27 An entity shall recognise an asset or liability for any insurance acquisition cash flows relating to a group of issued insurance contracts that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised (see paragraph 38(b)).*

The amended text of IFRS 17 deleted paragraph 27, provided an expanded definition of what IACF can be allocated by introducing the allocation of IACF directly attributable to a group of contracts (IFRS 17:28B and IFRS 17:B35A(a)) and added guidance on how to perform the allocation (IFRS 17:28A and IFRS 17:B35A):

*28A An entity shall allocate insurance acquisition cash flows to groups of insurance contracts using a systematic and rational method applying paragraphs B35A–B35B, unless it chooses to recognise them as expenses applying paragraph 59(a).*

*28B An entity not applying paragraph 59(a) shall recognise as an asset insurance acquisition cash flows paid (or insurance acquisition cash flows for which a liability has been recognised applying another IFRS Standard) before the related group of insurance contracts is recognised. An entity shall recognise such an asset for each related group of insurance contracts.*

*B35A To apply paragraph 28A, an entity shall use a systematic and rational method to allocate:*

*(a) insurance acquisition cash flows directly attributable to a group of insurance contracts:*

*(i) to that group; and*

*(ii) to groups that will include insurance contracts that are expected to arise from renewals of the insurance contracts in that group.*

*(b) insurance acquisition cash flows directly attributable to a portfolio of insurance contracts, other than those in (a), to groups of contracts in the portfolio.*

The capitalisation of IACF directly attributable to a group of contracts and their subsequent allocation is new. As explained in the Basis for Conclusions, IFRS 17:BC184B *"Before the amendment, an entity was required to allocate insurance acquisition cash flows directly attributable to a group to only that group. In contrast, insurance acquisition cash flows directly attributable to a portfolio of insurance contracts but not directly attributable to a group of insurance contracts are systematically and rationally allocated to groups of insurance contracts in the portfolio."*

In the original text these IACF would only be allowed to be allocated to the group that generated them. An example of these IACF are commissions paid to intermediaries triggered by the intermediary procuring an insurance contract with a new policyholder. During the TRG discussion the IASB appreciated that these IACF are often paid in anticipation of future renewals and amended IFRS 17 to allow the allocation to future groups for this category of IACF as long as these groups include contracts that renew the first contract previously purchased by a given policyholder. The other category of IACF directly attributable to a portfolio (IFRS 17:B35A(b)) continues to be allocated to future groups of contracts as before.

The fact pattern in this paper considers an insurer that has an IACF asset as at 31 December 2024 with both categories as follows:

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025* | *Expected allocation in 2026* | *Expected allocation in 2027* |
|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* |
| Generated in 2023 | **50** | *30* | *20* | *-* |
| Generated in 2022 | **30** | *20* | *10* | *-* |
| Sub-total (a) | **180** | ***90*** | ***60*** | ***30*** |
| **IACF asset B35A(b)** | | | | |
| Generated in 2024 | **200** | *50* | *60* | *90* |
| Generated in 2023 | **150** | *50* | *60* | *40* |
| Generated in 2022 | **130** | *20* | *40* | *70* |
| Generated in 2021 | **60** | *20* | *30* | *10* |
| Sub-total (b) | **540** | ***140*** | ***190*** | ***210*** |
| | | | | |
| **Total (a) + (b)** | **720** | ***230*** | ***250*** | ***240*** |

The total row of the table is a required disclosure under IFRS 17:109A:

*An entity shall disclose quantitatively, in appropriate time bands, when it expects to derecognise an asset for insurance acquisition cash flows applying paragraph 28C.*

As at 31/12/2024 the fact pattern assumes that facts and circumstances indicate that the asset may be impaired. The guidance on impairment is in IFRS 17:B35D:

*To apply paragraph 28E:*

- *(a) an entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of an asset for insurance acquisition cash flows so that the carrying amount of the asset does not exceed the expected net cash inflow for the related group of insurance contracts, determined applying paragraph 32(a).*
- *(b) when an entity allocates insurance acquisition cash flows to groups of insurance contracts applying paragraph B35A(a)(ii), the entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of the related assets for insurance acquisition cash flows to the extent that:*
  - *i. the entity expects those insurance acquisition cash flows to exceed the net cash inflow for the expected renewals, determined applying paragraph 32(a); and*
  - *ii. the excess determined applying (b)(i) has not already been recognised as an impairment loss applying (a).*

The test described in IFRS 17:B35D(a) is referred to as "the first impairment test", while the test described in IFRS 17:B35D(b) is referred to as "the second impairment test".

In developing these impairment tests the IASB explained their conclusion in IFRS 17:BC184K (emphasis added)

*The Board noted that an entity measures an asset for insurance acquisition cash flows at the level of a group of insurance contracts. <u>An impairment test at a group level compares the carrying amount of an asset for insurance acquisition cash flows allocated to a group with the expected net cash inflow of the group.</u> That net cash inflow includes cash flows for contracts unrelated to any expected renewals but expected to be in that group. The Board therefore decided to require an additional impairment test specific to cash flows for expected renewals. This additional impairment test results in the recognition of any impairment losses when the entity no longer expects the renewals supporting the asset to occur, or expects the net cash inflows to be lower than the amount of the asset. Without the additional impairment test, cash flows from contracts unrelated to any expected renewals might prevent the recognition of such an impairment loss.*

As at 31/12/2024, the insurer computes its expectations of future net inflows from the portfolio to which the IACF assets relates to:

| **Net inflows from renewals of contracts initially issued in the year** | Expected net inflows in 2025 | Expected net inflows in 2026 | Expected net inflows in 2027 | Expected net inflows later than 2027 |
|---|---|---|---|---|
| 2024 | 100 | 70 | 70 | 70 |
| 2023 | 20 | 20 | - | - |
| 2022 | 10 | 20 | - | - |
| **Sub-total of net inflows from renewals by future year** | **130** | **110** | **70** | **70** |
| **New contracts net inflows** | | | | |
| Expected in 2025 | 90 | | | |
| Expected in 2026 | | 300 | | |

| | | | | |
|---|---|---|---|---|
| Expected in 2027 | | | 300 | |
| Expected later | | | | 400 |
| | | | | |
| **Total net inflows by future year** | **220** | **410** | **370** | **470** |

## Question 1:
## Using the illustrative scenario above, how would an insurer interpret and apply the requirements of IFRS 17, para. B35D(a) ["first impairment test"] when performing the impairment test?

### View 1:
Supporters of this view argue that during the IASB December 2019 meeting, the IASB confirmed that the unit of account for an asset for IACF is the group of insurance contracts to which those cash flows have been allocated. Although such guidance was not included in the final wordings of the Amendments to IFRS 17, one could argue that it is inferred from the words in IFRS 17:BC184K where the IASB indicated that the asset for IACF is measured at the level of a group of insurance contracts.

IFRS 17:BC184K further explains that the impairment test at a group level compares the carrying amount of an asset for IACF allocated to a group with the expected net cash inflows of the group. This indicates that the IASB intended the impairment test to be performed on the IACF balance allocated to the group of contracts. This means that a separate impairment test should be performed for each of the IACF asset balances expected to be allocated to a future group by comparing the future net inflows from that future group of contracts to which it will be allocated to.

Applying View 1 to the example scenario above, as at the end of 31 December 2024, the impairment calculation is done as follows:

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025* | *Expected allocation in 2026* | *Expected allocation in 2027* |
|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* |
| Generated in 2023 | **50** | *30* | *20* | - |
| Generated in 2022 | **30** | *20* | *10* | - |
| Sub-total (a) | **180** | ***90*** | ***60*** | ***30*** |
| **IACF asset B35A(b)** | | | | |
| Generated in 2024 | **200** | *50* | *60* | *90* |
| Generated in 2023 | **150** | *50* | *60* | *40* |
| Generated in 2022 | **130** | *20* | *40* | *70* |
| Generated in 2021 | **60** | *20* | *30* | *10* |
| Sub-total (b) | **540** | ***140*** | ***190*** | ***210*** |
| | | | | |
| **Total (a) + (b)** | **720** | ***230*** | ***250*** | ***240*** |
| | | | | |
| **Total net inflows by future year** | **1,000** | ***220*** | ***410*** | ***370*** |
| **Headroom / (Impairment)** | | ***(10)*** | ***160*** | ***130*** |

This would result in an impairment loss of 10 currency units.

Supporters of this view note that this view aligns with the illustrative example in paragraph A9 of the IASB Agenda Paper 2B discussed at the IASB meeting in December 2019.

## View 2

This view argues that the impairment test for IACF asset should be performed by comparing the outstanding IACF asset balance for the portfolio against the future net cash inflows from that portfolio.

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025* | *Expected allocation in 2026* | *Expected allocation in 2027* |
|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* |
| Generated in 2023 | **50** | *30* | *20* | - |
| Generated in 2022 | **30** | *20* | *10* | - |
| Sub-total (a) | **180** | *90* | *60* | *30* |
| **IACF asset B35A(b)** | | | | |
| Generated in 2024 | **200** | *50* | *60* | *90* |
| Generated in 2023 | **150** | *50* | *60* | *40* |
| Generated in 2022 | **130** | *20* | *40* | *70* |
| Generated in 2021 | **60** | *20* | *30* | *10* |
| Sub-total (b) | **540** | ***140*** | ***190*** | ***210*** |
| | | | | |
| **Total (a) + (b)** | **720** | ***230*** | ***250*** | ***240*** |
| | | | | |
| **Total net inflows by future year** | **1,000** | ***220*** | ***410*** | ***370*** |
| **Headroom / (Impairment)** | **280** | | | |

Under this view, there will not be a "first impairment test" loss for the year ended 31/12/2024.

Supporters of this view provide the following supporting arguments:

1. IFRS 17 amended the accounting for IACF assets by adding a new type of IACF that would be considered in the asset that arises from IACF. The new IACF to be capitalised is the one that arises from the IACF directly attributable to a group e.g. the "multi-year" commissions paid for new policyholders being procured. These IACF were originally deemed unsuitable for inclusion in the IACF asset that always existed in IFRS 17 as evidenced by the original text of IFRS 17:27.

2. The first impairment test in IFRS 17:B35D(a) is designed at the original level of aggregation for the IACF asset which is the portfolio of insurance contracts. This is evidenced by the distinction in IFRS 17:B35A between the asset originated from IACF attributable to the group (IFRS 17:B35A(a) – the new IFRS 17 asset from IACF) and those from IACF attributable to the portfolio. Given the specific impairment test for the IFRS 17:B35A(a) portion of the asset (the second impairment test), supporters of this view believe that the first impairment test is required at portfolio level for the total carrying amount of the IACF asset. The net inflows calculated for the test include both renewal net inflows from the existing contracts in the portfolio and the new contracts that would be added to the portfolio in future periods.

3. IFRS 17:B35B is clear that the prospective allocation of the asset is not locked down and it should be revised at each reporting date. Supporters of this view argue that this must be taken into account in the execution of the impairment test which means that the asset is impaired as a whole rather than on its individual expected allocation amounts.

## Question 2:

**Using the illustrative scenario above, how would an insurer interpret and apply the requirements of IFRS 17, para. B35D(b) ["second impairment test"] when performing the impairment test?**

### View 1

Supporters of this view argue that the wording in IFRS 17:B35D indicates that the first impairment test as required by IFRS 17:B35D(a) is a test for a IACF asset and that the second impairment test as required by IFRS 17:B35D(b) is for the related IACF asset.

This means that supporters of View 1 look at the unit of account for the first impairment test being aligned with View 1 for Question 1 above. Using the fact pattern, the insurer would calculate the impairment test as follows:

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025* | *Expected allocation in 2026* | *Expected allocation in 2027* |
|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* |
| Generated in 2023 | **50** | *30* | *20* | - |
| Generated in 2022 | **30** | *20* | *10* | - |
| Sub-total (a) | **180** | *90* | *60* | *30* |
| **Sub-total of net inflows from renewals by future year** | | ***130*** | ***110*** | ***70*** |
| **Headroom / (Impairment)** | | ***40*** | ***50*** | ***40*** |

View 1 would not recognise any "second impairment test" loss in 2024. The only loss recognised would be from the first impairment test (applying View 1) for 10 currency units.

Supporters of View 2 for question 1 above that support view 1 for the second impairment test would calculate the "second impairment test" loss in the same way as illustrated in the table above and they would not recognise any impairment loss in 2024.

## View 2

According to this view, the impairment test is performed for the total carrying amount of the IACF asset originating from each past group, or renewal group [original contract + future renewals of such contract].

Supporters of this view argue that IFRS 17:B35D(b) refers to when an entity has allocated the IACF asset to groups of contracts applying the requirements of IFRS 17:B35A(a)(ii), which is done at each past group level. As such, the second impairment test should mirror the guidance of IFRS 17:B35A(a)(ii).

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025* | *Expected allocation in 2026* | *Expected allocation in 2027* | **Headroom / (Impairment)[1]** |
|---|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* | **210** |
| Generated in 2023 | **50** | *30* | *20* | - | **(10)** |
| Generated in 2022 | **30** | *20* | *10* | - | **-** |
| Sub-total (a) | **180** | ***90*** | ***60*** | ***30*** | |

1 – Headroom/(Impairment) = IACF asset B35A(a) generated in, for example, 2023, less net inflows from renewals of contracts initially issued in the year, e.g. renewal group 2023.

| **Net inflows from renewals of contracts initially issued in the year** | **Total net inflows for the second impairment test** | *Expected net inflows in 2025* | *Expected net inflows in 2026* | *Expected net inflows in 2027* | *Expected net inflows later than 2027* |
|---|---|---|---|---|---|
| Renewal group 2024 | **310** | *100* | *70* | *70* | *70* |
| Renewal group 2023 | **40** | *20* | *20* | - | - |
| Renewal group 2022 | **30** | *10* | *20* | - | - |

View 2 would recognise a "second impairment test" loss of 10 currency units in 2024. IFRS 17:B35D(b)(ii), however, requires that an impairment loss resulting from the "second impairment test" would only be recognised provided that it has not already been recognised as an impairment loss resulting from the "first impairment test". The insurer would need to determine the portion of the "second impairment test" loss that it would recognise in addition to the "first impairment test" loss.

Using the fact pattern, the "first impairment test" applying View 1 resulted in an impairment loss of CU10. Using a systematic and rational allocation method the portion of the "first impairment test" loss allocated to the IACF subject to the "second impairment test" is CU 3.9 ([90/230]*CU10). The allocation method used in this analysis is the relative carrying amount of the two types of IACF making up the total IACF asset balance expected to be allocated in 2025, the future year when the impairment is detected. This allocation approach is used for illustration purposes only.

The total impairment loss applying the combination of View 1 for the first impairment test and View 2 for the second impairment test is:

| | CU |
|---|---|
| First impairment test loss | 10 |
| Second impairment test loss | 10 |
| Less portion already included in the first impairment test | -3.9 |
| Total impairment loss for 2024 | 16.1 |

Supporters of this view note that this view aligns with the illustrative example in paragraph A10 of the IASB Agenda Paper 2B discussed at the IASB meeting in December 2019.

For supporters of View 2 for the "first impairment test" who support View 2 for the "second impairment test" the total impairment loss of CU10 in 2024 would arise from the "second impairment test" only.

## View 3

Some supporters of view 3 agree with view 1 on question 1 and they argue that the same logic must be applied for the "second impairment test" within each renewal group asset. This view is that an IACF asset is an expected future allocation amount that needs to be tested only against the net inflows of the relevant future group of contracts thus breaking up the renewal group IACF asset in its expected allocation amounts for individual recoverability testing.

With reference to the IACF asset originated by the 2023 group the second impairment test should be performed for each of the expected allocated amounts i.e. 30 expected to be allocated in 2025 and 20 expected to be allocated in 2026, against the net cash inflows for the expected renewals the respective future groups arising from contracts issued in the 2023 renewal group, i.e. expected net inflows of 20 in 2025 and 20 in 2026.

This view performs the second impairment test at the most granular level and would calculate the impairment as follows:

| **IACF asset B35A(a)** | **Balance at 31/12/24** | *Expected allocation in 2025 and related net inflows* | *Expected allocation in 2026 and related net inflows* | *Expected allocation in 2027 and related net inflows* |
|---|---|---|---|---|
| Generated in 2024 | **100** | *40* | *30* | *30* |
| Net inflows – Renewal group 2024 | **240** | *100* | *70* | *70* |
| Headroom / (Impairment) | | ***60*** | ***40*** | ***40*** |
| | | | | |
| Generated in 2023 | **50** | *30* | *20* | - |
| Net inflows – Renewal group 2023 | **40** | *20* | *20* | - |
| Headroom / (Impairment) | | ***(10)*** | **-** | **-** |
| | | | | |
| Generated in 2022 | **30** | *20* | *10* | - |
| Net inflows – Renewal group 2022 | **30** | *10* | *20* | - |
| Headroom / (Impairment) | | ***(10)*** | ***10*** | **-** |

This view would recognise a "second impairment test" loss of 20 currency units in 2024. In applying IFRS 17: B35D(b)(ii), the insurer determines the portion of the "first impairment test" loss of CU10 using a systematic and rational allocation method the portion of the "first impairment test" loss allocated to the IACF subject to the "second impairment test" is CU 3.9 ([90/230]*CU10). The allocation method used in this analysis is the relative carrying amount of the two types of IACF making up the total IACF asset balance expected to be allocated in 2025, the future year when the impairment is detected. This allocation approach is used for illustration purposes only.

The total impairment loss to be recognised in 2024 is CU26.1, calculated as follows:

| | CU |
|---|---|
| First impairment test loss | 10 |
| Second impairment test loss | 20 |
| Less portion already included in the first impairment test | -3.9 |
| Total impairment loss for 2024 | 26.1 |

Some supporters of view 3 favour view 2 in question 1 for the logic stated there. For them the total impairment loss in 2024 is CU20 arising entirely from the "second impairment test".

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The table below summarises the impairment losses, if any, across the two questions offering the combinations that should represent all valid alternatives given the discussion to date.

| | *First impairment test* | *Second impairment test* | *Total impairment in 2024* |
|---|---|---|---|
| *Combination 1* | View 1 - (10) | View 1 - Nil | (10) |
| *Combination 2* | View 1 - (10) | View 2 - (10) | (16.1) |
| *Combination 3* | View 1 - (10) | View 3 - (20) | (26.1) |
| *Combination 4* | View 2 - Nil | View 1 – Nil | Nil |
| *Combination 5* | View 2 - Nil | View 2 - (10) | (10) |
| *Combination 6* | View 2 - Nil | View 3 – (20) | (20) |

## Technical References

B35A

To apply paragraph 28A, an entity shall use a systematic and rational method to allocate:

(a) insurance acquisition cash flows directly attributable to a group of insurance contracts:

(i) to that group; and

(ii) to groups that will include insurance contracts that are expected to arise from renewals of the insurance contracts in that group.

(b) insurance acquisition cash flows directly attributable to a portfolio of insurance contracts, other than those in (a), to groups of contracts in the portfolio.

B35B

At the end of each reporting period, an entity shall revise amounts allocated as specified in paragraph B35A to reflect any changes in assumptions that determine the inputs to the method of allocation used. An entity shall not change amounts allocated to a group of insurance contracts after all contracts have been added to the group (see paragraph B35C).

B35D

To apply paragraph 28E:

(a) an entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of an asset for insurance acquisition cash flows so that the carrying amount of the asset does not exceed the expected net cash inflow for the related group of insurance contracts, determined applying paragraph 32(a).

(b) when an entity allocates insurance acquisition cash flows to groups of insurance contracts applying paragraph B35A(a)(ii), the entity shall recognise an impairment loss in profit or loss and reduce the carrying amount of the related assets for insurance acquisition cash flows to the extent that:

(i) the entity expects those insurance acquisition cash flows to exceed the net cash inflow for the expected renewals, determined applying paragraph 32(a); and

(ii) the excess determined applying (b)(i) has not already been recognised as an impairment loss applying (a).

December 2019 IASB paper 2B

ap2b-amendments-to-ifrs-17.pdf

IFRS

# STAFF PAPER

December 2019

**IASB® meeting**

| | |
|---|---|
| **Project** | **Amendments to IFRS 17** |
| Paper topic | Expected recovery of insurance acquisition cash flows |


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## Purpose of the paper

1. This paper discusses staff analysis and recommendations about the amendment proposed in the Exposure Draft *Amendments to IFRS 17* relating to insurance acquisition cash flows. This paper follows the tentative decision of the International Accounting Standards Board (Board), at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this proposed amendment.

## Summary of staff recommendations

2. The staff recommend the Board:
   (a) finalise the proposed amendment to IFRS 17 *Insurance Contracts* that would require an entity to allocate insurance acquisition cash flows that are directly attributable to a group of insurance contracts applying a systematic and rational method:
      (i) to that group; and
      (ii) to any groups that include contracts that are expected to arise from renewals of the contracts in that group.
   (b) confirm that the unit of account for an asset for insurance acquisition cash flows is the group of insurance contracts to which those cash flows have been allocated.

(c) finalise the proposed requirements for an entity to assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

(d) finalise the proposed requirements for an entity to disclose:

(i) a reconciliation from the opening to the closing balance of assets for insurance acquisition cash flows, showing separately any recognition of impairment losses and reversals of impairment losses; and

(ii) quantitative information, in appropriate time bands, about when an entity expects to derecognise an asset for insurance acquisition cash flows and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.

(e) retain, unchanged, the requirement in IFRS 17 for an entity to present any asset for insurance acquisition cash flows in the carrying amount of the related portfolios of insurance contracts issued.

## Structure of the paper

3. This paper provides:

(a) an overview of the proposals in the Exposure Draft;

(b) an overview of the feedback;

(c) the specific feedback, staff analysis, recommendations and questions for Board members on each of the following areas:

(i) allocation of insurance acquisition cash flows;

(ii) recognition of an asset;

(iii) impairment test;

(iv) disclosures;

(v) presentation; and

(vi) transition.

4. Appendix A to this paper provides an example of applying the two impairment tests proposed in the Exposure Draft.

### Proposals in the Exposure Draft[1]

5. Appendix A of IFRS 17 defines insurance acquisition cash flows as cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs. IFRS 17 requires an entity to recognise an asset for any insurance acquisition cash flows relating to a group of insurance contracts that the entity pays before the group is recognised.

6. The Exposure Draft proposed that an entity:

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts:

(i) to that group; *and*

(ii) to any groups that include contracts that are expected to arise from renewals of the contracts in that group.

(b) consistent with the existing requirements of IFRS 17, recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised.

(c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

(d) provide the following disclosures about such assets:

(i) a reconciliation from the opening to the closing balance of assets for insurance acquisition cash flows, showing separately

[1] See paragraphs 28A–28D, 105A–105C and B35A–B35C of the Exposure Draft and paragraphs BC31–BC49 of the Basis for Conclusions on the Exposure Draft.

any recognition of impairment losses and reversals of impairment losses; and

(ii) quantitative information, in appropriate time bands, about when an entity expects to derecognise an asset for insurance acquisition cash flows and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.

## Overview of the feedback

7. Most respondents who commented on the proposed amendment relating to insurance acquisition cash flows agreed with the Board's proposal and rationale for proposing the amendment to IFRS 17 as set out in the paragraph 6 of this paper.

8. A small number of respondents, including one insurer, one user of financial statements, one national standard-setter and one regulator, from different jurisdictions, disagreed with the proposal because, in their view, it would:

(a) impair comparability between entities, in the light of the significant judgement they think would be involved in allocating insurance acquisition cash flows to expected renewals; and

(b) add complexity to IFRS 17 implementation and application.

## Specific feedback, staff analysis and recommendations

### *Allocation of insurance acquisition cash flows*

9. Some respondents commented on the following aspects of the proposal to allocate insurance acquisition cash flows to groups of insurance contracts:

(a) guidance on allocating insurance acquisition cash flows (paragraphs 10–12 of this paper);

(b) reallocation of insurance acquisition cash flows between groups of insurance contracts (paragraphs 13–14 of this paper);

(c) allocation on a systematic and rational basis (paragraphs 15–17 of this paper); and

(d) interaction between the wording of the proposed amendment and the requirements in IFRS 17 (paragraphs 18–19 of this paper).

*Guidance on allocating insurance acquisition cash flows*

10. Some respondents suggested the Board provide guidance on allocating, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts:

(a) to that group; and

(b) to any groups that include contracts that are expected to arise from renewals of the contracts in that group.

11. The staff think that providing guidance on, or specific examples of, a systematic and rational basis of allocation could:

(a) have unintended consequences by unduly restricting an entity's ability to apply judgement in specific facts and circumstances (see paragraph 16 of this paper).

(b) disrupt implementation given that systematic and rational allocation is required by other paragraphs of IFRS 17. For example, paragraph B65(l) of IFRS 17 requires an allocation of fixed and variable overheads to groups of contracts using methods that are systematic and rational and are consistently applied to all costs that have similar characteristics.

12. Therefore, the staff think the Board should not provide guidance on, or specific examples of, a systematic and rational basis of allocation of insurance acquisition cash flows.

*Reallocation of insurance acquisition cash flows between groups of insurance contracts*

13. One respondent asked whether an entity would be required or permitted to reallocate insurance acquisition cash flows between groups of insurance contracts each reporting period. For example, this respondent questioned whether an entity would be required or permitted to reallocate insurance acquisition cash flows allocated to expected renewals if there was a change in the entity's expectation about the number of renewals.

14. The staff note that a systematic and rational allocation would be required at the end of each reporting period. The staff think that an entity should apply the same systematic and rational method of allocation consistently over time. However, that method of allocation could result in changes in the amounts being allocated to groups if there are changes in facts and circumstances upon which the method depends. To clarify this approach, the staff intend to revise the wording to refer to 'methods that are systematic and rational', consistent with the wording of B65(l) of IFRS 17.

*Allocation on a systematic and rational basis*

15. Some respondents expressed the view that a requirement to allocate insurance acquisition cash flows to renewals on a systematic and rational basis would be unduly complex. A small number of those respondents provided the following alternative suggestions:

    (a) requiring an entity to allocate insurance acquisition cash flows to groups based on expected recovery—that is, based on how the entity expects to recover the insurance acquisition cash flows; and

    (b) permitting, rather than requiring, an entity to allocate insurance acquisition cash flows to expected renewals to reduce the complexity and cost of applying IFRS 17.

16. In the staff view, an allocation to groups based on expected recovery is one systematic and rational basis of allocation. However, it is not the only systematic and rational basis. The staff think that a requirement to allocate insurance acquisition cash flows based on expected recovery as suggested in paragraph 15(a) of this paper could be

restrictive and burdensome for some entities to apply. Instead, in the staff view, requiring allocation on a systematic and rational basis allows an entity to use judgement to decide whether to allocate on an expected recovery basis, or a different basis. Such judgement would allow an entity to consider both the usefulness of information that would be provided to users of financial statements applying different allocation bases and the costs and benefits of different allocation bases. In addition, the staff note that any lack of recoverability of an asset for insurance acquisition cash flows would be identified by the proposed impairment test (see paragraph 33 of this paper).

17. In regard to the suggestion from respondents discussed in paragraph 15(b) of this paper, in the staff view, the proposed amendment does not necessarily add operational complexity as explained in paragraph 16 of this paper. In addition, the staff note that renewals often arise from short-term insurance contracts, many of which could be accounted for applying the premium allocation approach. Applying that approach an entity is permitted to recognise insurance acquisition cash flows as expenses when incurred rather than recognising an asset, and so the proposed amendment would not be applicable.

*Interaction between the wording of the proposed amendment and the requirements in IFRS 17*

18. Some respondents suggested the Board clarify the interaction between the wording of the proposed amendment and the requirements in IFRS 17. This is because:

    (a) in defining insurance acquisition cash flows, Appendix A of IFRS 17 refers to costs that are directly attributable to the *portfolio* of insurance contracts to which the group belongs; whereas

    (b) the proposed amendment refers to an allocation of insurance acquisition cash flows that are directly attributable to a *group* of insurance contracts.

19. The staff note that the proposed allocation requirement refers only to the insurance acquisition cash flows that are directly attributable to a *group* because the proposed amendment is not relevant to those attributable to a *portfolio.* An entity is already required by IFRS 17 to allocate insurance acquisition cash flows attributable to a

portfolio to groups of contracts on a systematic and rational basis. When finalising any amendments to IFRS 17, the staff will consider whether drafting changes are needed to align the proposed amendments and the definition of insurance acquisition cash flows.

*Staff recommendation*

20. Considering the analysis in paragraphs 10–19 of this paper, the staff recommend the Board finalise the proposed amendment to IFRS 17 that would require an entity to allocate insurance acquisition cash flows that are directly attributable to a group of insurance contracts applying a systematic and rational method:

(a) to that group; and

(b) to any groups that include contracts that are expected to arise from renewals of the contracts in that group.

| **Question 1 for Board members** |
|---|
| Do you agree the Board should finalise the proposed amendment to IFRS 17 that would require an entity to allocate insurance acquisition cash flows that are directly attributable to a group of insurance contracts applying a systematic and rational method:<br>(a) to that group; and<br>(b) to any groups that include contracts that are expected to arise from renewals of the contracts in that group? |

### *Recognition of an asset*

21. Some respondents suggested the Board clarify the unit of account for an asset for insurance acquisition cash flows. A small number of those respondents expressed the view that the unit of account should be an entity level asset, similar to the unit of account used by entities applying some existing insurance accounting practices to recognise deferred acquisition costs as assets.

22. Applying IFRS 17, the unit of account for any asset recognised for insurance acquisition cash flows is the group of insurance contracts to which the insurance

acquisition cash flows have been allocated. This is consistent with the recognition and measurement requirements of IFRS 17.

23. The staff note that applying IFRS 17 as originally issued, an entity that recognises an asset for insurance acquisition cash flows is required to identify the future groups to which those insurance acquisition cash flows relate. Applying the proposed amendment, an entity would be required to identify groups further into the future—because the entity would be required to identify the future groups that will include expected renewals. The staff acknowledge that this could be complex. However, the staff think that an entity must identify the future group to which insurance acquisition cash flows paid have been allocated in order to recognise those insurance acquisition cash flows as an asset.

24. In addition, the staff note that if the unit of account for the asset was at an entity level, as suggested by some respondents, the proposed impairment test would be performed at an entity level. If the impairment test was performed at an entity level, the asset for insurance acquisition cash flows would relate to a specific subset of insurance contracts but it would be tested for impairment against the expected net cash inflows of all insurance contracts the entity expects to issue. Therefore, the staff expect that it would be highly unlikely that an impairment test at an entity level would identify any impairment losses. Consequently, the staff view is that setting the unit of account at an entity level would result in a significant loss of useful information.

*Staff recommendation*

25. The staff recommend the Board confirm that the unit of account for an asset for insurance acquisition cash flows is the group of insurance contracts to which those cash flows have been allocated.

| **Question 2 for Board members** |
| --- |
| Do you agree the Board should confirm that the unit of account for an asset for insurance acquisition cash flows is the group of insurance contracts to which those cash flows have been allocated? |

### *Impairment test*

26. Some respondents commented on the following aspects of the proposal to assess the recoverability of an asset for insurance acquisition cash flows:

    (a) frequency of the impairment test (paragraphs 27–30 of this paper); and

    (b) application of the impairment test (paragraphs 31–34 of this paper).

*Frequency of the impairment test*

27. A small number of respondents suggested that an entity should be required to assess the recoverability of an asset for insurance acquisition cash flows annually, regardless of the existence of facts and circumstances indicating the asset may be impaired.

28. The staff note that requiring an entity to test an asset for insurance acquisition cash flows for impairment only when facts and circumstances indicate the asset may be impaired is consistent with:

    (a) paragraph 26 of IFRS 17 for the recognition of a group of onerous contracts before the beginning of the coverage period or the date when the first payment from a policyholder in the group becomes due; and

    (b) IAS 36 *Impairment of Assets*, which requires that an entity assess at the end of each reporting period whether there is any indication that an asset may be impaired.

29. In the staff view, requiring an entity to test the recoverability of an asset for insurance acquisition cash flows annually, regardless of whether facts and circumstance indicate the asset may be impaired, could lead to an unnecessary operational burden for entities.

30. Therefore, the staff think that, as proposed in the Exposure Draft, the Board should require an entity to test the recoverability of an asset for insurance acquisition cash flows at the end of a reporting period if facts and circumstances indicate the asset may be impaired.

*Application of the impairment test*

31. Some respondents expressed concerns that the proposed requirements to assess the recoverability of an asset for insurance acquisition cash flows, if facts and circumstances indicate the asset may be impaired, are unduly complex. Specifically, those respondents noted that the Exposure Draft proposes a two-step impairment test. Those steps are:

    (a) an impairment test at the level of a group of insurance contracts (group level impairment test); and

    (b) an additional impairment test specific to insurance acquisition cash flows allocated to expected contract renewals (additional impairment test).

32. Those respondents suggested the Board not require the additional impairment test discussed in paragraph 31(b) of this paper because, in their view, the group impairment level test discussed in paragraph 31(a) of this paper would be sufficient to identify any impairment loss. In addition, some of those respondents noted that the information that would be required to perform the additional impairment test is more detailed than the information about expected renewals that entities typically maintain applying some existing insurance accounting practices.

33. As explained in paragraph BC45 of the Basis for Conclusions on the Exposure Draft, the proposed group level impairment test compares the carrying amount of an asset for insurance acquisition cash flows allocated to a group with the expected net cash inflow of that group. That net cash inflow includes cash flows for expected renewals of contracts with current policyholders and cash flows for contracts with future policyholders expected to be in that same group. The Board decided to require an additional impairment test specific to cash flows for expected contract renewals. The additional impairment test results in the recognition of any impairment losses on expected future renewals when the entity no longer expects those renewals to occur. Without the additional impairment test, cash flows from future policyholder contracts might prevent the recognition of such an impairment loss.

34. Appendix A to this paper provides an example illustrating how an entity would apply the impairment test requirements discussed in paragraphs 31(a) and 31(b) of this

paper. In that example, an impairment loss is identified by both tests. In other examples, either test could identify an impairment loss that would not be identified by the other test, for example:

(a) the group impairment level test could identify an impairment loss when entities do not expect any renewals (so the additional impairment test would not apply) and fewer contracts have been issued than expected initially; or

(b) the additional impairment test could identify an impairment loss when entities allocate insurance acquisition cash flows to a future group of expected renewals, subsequently no longer expect those renewals but do expect to issue profitable contracts to new policyholders (as discussed in paragraph 33 of this paper).

*Staff recommendation*

35. The staff acknowledge that the impairment tests are an additional operational task for entities. However, as discussed in paragraph 30 of this paper, the staff continue to recommend that any impairment test would be required only when facts and circumstances indicate an asset may be impaired. In those circumstances, the staff view is that the benefit of identifying potential impairment losses outweighs the operational cost. The staff also recommend the Board confirm that the impairment test includes two steps as set out in paragraph 31 of this paper.

| Question 3 for Board members |
|---|
| Do you agree the Board should finalise the proposed requirements to assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired? |

## Disclosures

36. Some respondents agreed with the Board's view that the following proposed disclosure requirements would provide useful information:

(a) a reconciliation from the opening to the closing balance of assets for insurance acquisition cash flows, showing separately any recognition of impairment losses and reversals of impairment losses; and

(b) quantitative information, in appropriate time bands, about when an entity expects to derecognise an asset for insurance acquisition cash flows and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.

37. A small number of respondents expressed concerns that the proposed disclosure described in paragraph 36(b) of this paper would require entities to disclose commercially sensitive information about projections of future business. Some of those respondents think that information about the recoverability of an asset for insurance acquisition cash flows is sufficiently addressed by the proposed impairment test requirements.

38. As explained in paragraph BC46 of the Basis for Conclusions on the Exposure Draft, the proposed amendment would extend the period for which an asset for insurance acquisition cash flows would be recognised compared to IFRS 17 as originally issued. In the light of this extended period, the Board's view is that it would be useful for users of financial statements to know when that asset is expected to be derecognised and the insurance acquisition cash flows are expected to be included in the measurement of a group of insurance contracts.

39. In the staff view:

(a) the Board's view discussed in paragraph 38 of this paper continues to hold. Feedback from outreach with users of financial statements supports the Board's view.

(b) the proposed recoverability assessment identifies when an impairment loss exists, it does not provide users of financial information with information about when an asset for insurance acquisition cash flows is expected to be derecognised.

(c) the proposed disclosure requirements are similar to disclosures required by other IFRS Standards (for example, IFRS 15 *Revenue from Contracts with*

*Customers* requires entities to disclose when they expect to recognise as revenue the amounts allocated to unsatisfied performance obligations).

*Staff recommendation*

40. The staff recommend the Board finalise the proposed amendment that would require an entity to disclose:

(a) a reconciliation from the opening to the closing balance of assets for insurance acquisition cash flows, showing separately any recognition of impairment losses and reversals of impairment losses; and

(b) quantitative information, in appropriate time bands, about when an entity expects to derecognise an asset for insurance acquisition cash flows and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.

| **Question 4 for Board members** |
| --- |
| Do you agree the Board should finalise the proposed amendments that would require an entity to disclose:<br>(a) a reconciliation from the opening to the closing balance of assets for insurance acquisition cash flows, showing separately any recognition of impairment losses and reversals of impairment losses; and<br>(b) quantitative information, in appropriate time bands, about when an entity expects to derecognise an asset for insurance acquisition cash flows and include those cash flows in the measurement of the group of insurance contracts to which they are allocated? |

## *Presentation*

41. A small number of respondents suggested that any asset for insurance acquisition cash flows should be presented separately in the statement of financial position (rather than as part of the carrying amount of the related portfolios of insurance contracts issued as required by the proposed amendment). In their view, separate presentation would provide useful information because it would be aligned with the proposed disclosure

requirements for assets for insurance acquisition cash flows described in paragraph 6(d) of this paper.

42. The staff note that the proposed amendment could extend the period for which an asset for insurance acquisition cash flows would be recognised and could increase the amount of the asset compared to IFRS 17 as originally issued. For that reason, the staff understand why some respondents think that separate presentation would provide useful information.

43. However, the staff note that an asset for insurance acquisition cash flows will subsequently be included in the measurement of a group of insurance contracts. Therefore, in the staff view, presenting any such asset in the carrying amount of the related portfolio of insurance contracts would provide useful information.

44. In addition, the disclosures would provide further information about assets for insurance acquisition cash flows. This is consistent with other IFRS 17 balances that an entity is required to present as a part of the portfolio of insurance contracts rather than separately in the statement of financial position (for example, the contractual service margin).

*Staff recommendation*

45. Therefore, the staff recommend the Board retain, unchanged, the requirement to present any asset for insurance acquisition cash flows in the carrying amount of the related portfolio of insurance contracts issued.

| **Question 5 for Board members** |
| --- |
| Do you agree the Board should retain, unchanged, the requirement to present any asset for insurance acquisition cash flows in the carrying amount of the related portfolios of insurance contracts issued? |

### *Transition*

46. Some respondents suggested the Board provide transition reliefs to determine an asset for insurance acquisition cash flows when applying IFRS 17 for the first time.

47. The staff analysis and recommendations about respondents' feedback on transition reliefs for insurance acquisition cash flows will be provided in a separate paper of a future Board meeting.

## Appendix A—example of applying the two impairment tests proposed in the Exposure Draft

A1. The following example illustrates how the two impairment tests proposed in the Exposure Draft would identify any impairment losses on an asset for insurance acquisition cash flows.

### *Fact pattern*

A2. At the beginning of Year 1 an entity pays commissions of CU38[2] relating to a group of insurance contracts yet to be issued. Those commissions meet the definition of insurance acquisition cash flows.

### *Allocation and recognition*

A3. The commission of CU38 is directly attributable to insurance contracts the entity expects to issue later in Year 1 (Group 1). The entity expects that some policyholders of those insurance contracts that will be issued in Year 1 will renew those contracts in Year 2 (Group 2), Year 3 (Group 3) and Year 4 (Group 4). Accordingly, applying the proposed amendment, at the beginning of Year 1, the entity allocates the commissions of CU38 on a systematic and rational basis to the expected future groups of insurance contracts as follows:

| | **Year 1 (Group 1–initial contracts)** | **Year 2 (Group 2–expected renewals)** | **Year 3 (Group 3–expected renewals)** | **Year 4 (Group 4–expected renewals)** | **Total** |
|---|---:|---:|---:|---:|---:|
| Assets for insurance acquisition cash flows at the beginning of Year 1 | 25 | 5 | 5 | 3 | **38** |

A4. The entity recognises assets for insurance acquisition cash flows of CU38 at the beginning of Year 1.

[2] In this paper amounts are denominated in ‘currency units’ (CU).

A5. At the end of Year 1, the entity derecognises the asset of CU25 allocated to Group 1 and includes the insurance acquisition cash flows in the measurement of Group 1. At the end of Year 1 there are no facts and circumstances indicating that the assets for insurance acquisition cash flows allocated to each of Groups 2 to 4 may be impaired. Therefore, at the end of Year 1 the carrying amount of the assets for insurance acquisition cash flows is CU13:

| | **Year 1** (Group 1– initial contracts) | **Year 2** (Group 2– expected renewals) | **Year 3** (Group 3– expected renewals) | **Year 4** (Group 4– expected renewals) | **Total** |
|---|---|---|---|---|---|
| Assets for insurance acquisition cash flows at the end of Year 1 | - | 5 | 5 | 3 | **13** |

### *Impairment*

A6. At the end of Year 2, the entity derecognises the asset of CU5 allocated to Group 2, and includes the insurance acquisition cash flows in the measurement of Group 2. At the end of Year 2, facts and circumstances indicate that the assets for insurance acquisition cash flows for Groups 3 and 4 may be impaired. The carrying amount of the assets for insurance acquisition cash flows subject to impairment testing is CU8:

| | **Year 1** (Group 1– initial contracts) | **Year 2** (Group 2– expected renewals) | **Year 3** (Group 3– expected renewals) | **Year 4** (Group 4– expected renewals) | **Total** |
|---|---|---|---|---|---|
| Assets for insurance acquisition cash flows at the end of Year 2 | - | - | 5 | 3 | **8** |

A7. Applying the proposed amendment, the entity performs a group level impairment test to each of the assets for the two future groups. In addition, because the entity has allocated amounts to expected renewals, the entity performs the additional impairment test specific to expected renewals.

A8. To perform the two impairment tests, the entity estimates the following amounts:

| Expected net cash inflows | Year 3 (Group 3) | Year 4 (Group 4) |
| --- | ---: | ---: |
| (a) expected renewals | 3 | 1 |
| (b) other than renewals | 6 | 1 |
| **Total expected net cash inflows** | **9** | **2** |

A9. Applying the group level impairment test the entity compares the asset for insurance acquisition cash flows for each future group to the expected net cash inflows for that group, as follows:

| Group level impairment test | Year 3 (Group 3) | Year 4 (Group 4) |
| --- | ---: | ---: |
| Assets for insurance acquisition cash flows | 5 | 3 |
| Total expected net cash inflows | 9 | 2 |
| **Impairment** | **-** | **(1)** |

A10. Applying the additional impairment test specific to insurance acquisition cash flows allocated to expected contracts renewals, the entity compares the amount of insurance acquisition cash flows allocated to expected renewals to the total expected net cash inflows for those expected renewals, as follows:

| Additional impairment test specific to expected renewals | Year 3 (Group 3) | Year 4 (Group 4) | Total |
| --- | ---: | ---: | ---: |
| Amount of insurance acquisition cash flows allocated to expected renewals | 5 | 3 | **8** |
| Expected net cash inflows for expected renewals | 3 | 1 | **4** |
| **Impairment** | | | **(4)** |

A11. Accordingly, the entity recognised as an expense in profit or loss an impairment of CU4 comprising of:

(a) CU1 identified applying paragraph B35B(a) of the Exposure Draft; and

(b) CU4 identified applying paragraph B35B(b)(i) of the Exposure Draft less CU1 identified in A11(a) applying paragraph B35B (b)(ii) of the Exposure Draft.

A12. After recognising the impairment loss described in paragraph A11 of this paper the entity will allocate the total amount of insurance acquisition cash flows remaining in the assets of CU4 to the groups of contracts still to be recognised (Group 3 and Group 4 in this example) on a systematic and rational basis.