IFRS Alert

Applying IFRS 9 with IFRS 4 (Amendments to IFRS 4)

Issue 2016-07

Executive summary

The IASB has published 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' which makes narrow scope amendments to IFRS 4 'Insurance Contracts' ('the Amendments'). The Amendments provide temporary accounting solutions, for entities that issue insurance contracts, for the practical challenges of implementing IFRS 9 'Financial Instruments' before the forthcoming insurance contracts Standard.

Background

The IASB has issued the Amendments to address the temporary accounting consequences of the different effective dates of IFRS 9 'Financial Instruments' and the anticipated new insurance contracts Standard. The new insurance contracts Standard is yet to be finalised and will have an effective date no earlier than 2020. This means its mandatory effective date will be after the 2018 effective date of IFRS 9.

As companies that issue insurance contracts will be affected by both IFRS 9 and the new insurance contracts Standard, there was considerable concern over the practical challenges of implementing these two significant accounting changes on different dates. Further concerns were raised over the potential for increased volatility in profit or loss if IFRS 9's new requirements for financial instruments come into force before the new insurance accounting rules.

To address these concerns while still fulfilling the needs of users of financial statements, the IASB has responded by amending IFRS 4 and introducing the:

- **overlay approach**
  - an option for all entities that issue insurance contracts to adjust profit or loss for eligible financial assets by removing any additional accounting volatility that may arise as a result of IFRS 9.
- **temporary exemption**
  - an optional temporary exemption from applying IFRS 9 for entities whose activities are predominantly connected with insurance. These entities will be permitted to continue to apply the existing financial instrument requirements of IAS 39.

These two amendments are discussed in further detail overleaf.

Overlay approach

The overlay approach aims to remove from profit or loss any additional volatility that may arise if IFRS 9 is applied together with IFRS 4. All entities would be permitted to apply it but only to certain assets (see below). Furthermore, the approach must be chosen on the initial adoption of IFRS 9.

Entities applying the overlay approach are required to apply IFRS 9 from its 1 January 2018 effective date. However they are permitted to reclassify from profit or loss to other comprehensive income an amount equal to the difference between:

- the amount reported in profit or loss when IFRS 9 is applied to the qualifying financial assets (see below); and
- the amount that would have been reported in profit or loss if IAS 39 were applied to those assets.

The Amendments require the reclassification to be shown as a separate line item on the face of the statement of both profit or loss and other comprehensive income, with additional disclosures being given in order to enable users to understand it.

Only financial assets that meet both of the following criteria would qualify for the overlay approach:

- the financial assets are measured at fair value through profit or loss when applying IFRS 9 but would not have been so measured in their entirety when applying IAS 39
- the financial assets are designated by the entity as relating to insurance activities for the purposes of the overlay approach

Temporary exemption

Temporary exemption is an option for entities whose activities are predominantly connected with insurance to defer the application of IFRS 9 until the earlier of:

- the application of the new insurance contracts standard
- 1 January 2021.

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If an entity elects to use this temporary exemption, it will continue to apply IAS 39 during this period and will be required to provide some key disclosures to assist users of financial statements to make comparisons with entities applying IFRS 9.

Entities are eligible for this deferral approach only if they have activities that are predominantly connected with insurance when considering their activities as a whole. This should be considered at the reporting entity level and they must not have previously applied IFRS 9.

As eligibility is assessed at a reporting entity level, a separate assessment should be made for separate financial statements and consolidated groups. It is therefore possible for a group still to be eligible for the exemption even if there is a non-qualifying subsidiary (for its individual financial statements) within the group, or vice versa.

Predominance should be assessed by comparing the amount of an entity's insurance contract liabilities with the total amount of its liabilities.

Unlike the overlay approach, the temporary exemption will be applied to all, rather than some, financial assets of the limited population of entities that qualify for and elect to apply this approach.

Effective date

The Amendments are effective as follows:

- the overlay approach is applied when entities first apply IFRS 9
- a temporary exemption from IFRS 9 is applied for accounting periods on or after 1 January 2018.

Contact

Fergus Condon
Partner, Financial Accounting and Advisory Services
E fergus.condon@ie.gt.com
T +353 (0)1 680 5610

Louise Kelly
Partner, Audit
E louise.kelly@ie.gt.com
T +44 (0)28 9587 1100

Stephen Murray
Partner, Corporate Audit
E stephen.murray@ie.gt.com
T +353 (0)1 680 5689

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