HM Treasury

Financial Reporting Advisory Board

IFRS 17 Update

Issue:	An update on the implementation of IFRS 17- Insurance Contracts in the public sector.
Impact on guidance:	HM Treasury is in the early stage of developing IFRS 17 Application Guidance. Any interpretations and/or adaptations will be brought into the Government Financial Reporting Manual (FReM).
IAS/IFRS adaptation?	Some interpretations and adaptations are likely to be necessary to fit IFRS 17 effectively to public sector conditions.
Impact on WGA?	IFRS 17 will impact on WGA when implemented; the potential impact is being considered with each issue raised.
IPSAS compliant?	There is no equivalent insurance accounting standard in IPSAS.
Interpretation for the public sector context?	Some interpretations and adaptations are likely to be necessary to fit IFRS 17 effectively to public sector conditions.
Impact on budgetary and Estimates regimes?	The budgetary regime will need to recognise insurance contracts and related cashflows. The mechanism may be shaped by the policy direction set out in HMT's report "The Government as Insurer of Last Resort.
Alignment with National Accounts	ESA10 does not have an equivalent recognition of government insurance contracts so there will be misalignment; HMT staff have raised this issue with the ONS.
Recommendation:	FRAB members are invited to provide comments on this paper and provide feedback on the questions asked throughout the paper.
Timing:	IFRS 17 will be implemented in the public sector in the financial year 2023-24 (assuming the Standard is endorsed as expected by the UK Endorsement Board). Application guidance must be published by December 2022 at the latest.

DETAIL

Background

1. The International Accounting Standards Board (IASB) has issued IFRS 17 Insurance Contracts (the Standard), which replaces IFRS 4 Insurance Contracts.

2. At the November 2020 FRAB meeting HM Treasury presented an updated timetable for implementing the Standard in the public sector. Since the last FRAB meeting HM Treasury has held two Technical Working Groups (TWG), where implementation of the Standard has been discussed in detail. The purpose of this paper is to update FRAB on these discussions.

Scope of the Standard

3. The two TWG discussions focused predominantly on the scope of the Standard in the public sector. As stated in the IFRS 17 update at the March 2020 FRAB meeting, the scope of the Standard is broad, however it is essentially unchanged from the scope of IFRS 4 (the standard it is replacing) and this is stated in the IFRS Foundation's training on the scope of the Standard. The detail of why the scope of the Standard is broad is explained in paragraphs 17 to 28 of the March 2020 paper linked above.

4. While the scope of IFRS 17 is similar to its predecessor IFRS 4, its breadth and the fact it is new suggests the scope of application should be carefully considered including addressing whether government services could be interpreted as a form of insurance. Parameters on the scope of the Standard will likely need to be set out in any application guidance.

5. To illustrate this point, consider a scenario where a citizen injures themselves in March 2021, receives healthcare treatment and receives social benefits as they cannot work. Could the provision of healthcare services and benefits by government to that citizen during March 2021 be considered as a form of insurance expenditure? To facilitate an efficient implementation of the Standard, such matters of scope may need to be addressed directly in the application guidance or potentially through interpretations or adaptations.

6. The next paragraphs set out the discussions regarding the scope of the Standard.

Adapting IFRS 17 para 8

7. IFRS 17 para 8 states the following:

   Some contracts meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee. An entity may choose to apply IFRS 15 instead of IFRS 17 to such contracts that it issues if, and only if, specified conditions are met. The entity may make that choice contract by contract, but the choice for each contract is irrevocable. The conditions are:

   (a) the entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;

   (b) the contract compensates the customer by providing services, rather than by making cash payments to the customer; and

(c) the insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

8. IFRS 17 para 8 acknowledges that some fixed fee services contracts could also fall within the definition of an insurance contract. Examples include roadside assistance and maintenance contracts. Such contracts are currently accounted for under IFRS 15.

9. A key difference between fixed fee service contracts and as described in the Standard and public sector services is that public sector entities do not often directly charge the service user a fee; the service is funded from general taxation or borrowing.

10. HM Treasury set out a proposition to adapt IFRS 17 para 8 to apply to services provided by a public sector entity where no fee is charged. For example, if a public sector entity provided services and charged no fee and fell within the definition of an insurance contract, if the three criteria in IFRS 17 para 8 are met, those services would be scoped out of IFRS 17 and accounted for under another relevant standard or the conceptual framework.

11. Feedback from the TWG was that application guidance should be more specific in what should and should not be scoped out of the Standard. For example, the application guidance should list out services such as healthcare, benefits etc as being outside the scope of the Standard.

12. It was generally felt, by the TWG, that adapting/ interpreting IFRS 17 para 8 to include services where no fee is paid was not as effective as clearly stating which services should be scoped out of IFRS 17. HM Treasury therefore agreed to rethink how to scope services out of the Standard.

Benefits

13. There was some discussion on how to remove benefits from the scope of the Standard. HM Treasury attempted to use the definition of social benefits in IPSAS 42 to define social benefits for the purpose of scoping out benefits from the IFRS 17. For ease of reference IPSAS 42 defines social benefits as follows:

    Social benefits are cash transfers provided to:

    a) Specific individuals and/ or households who meet eligibility criteria;
    b) Mitigate the effect of social risks; and
    c) Address the needs of society as a whole.

    Social risks are events or circumstances that:

    a) Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
    b) May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

14. The TWG raised concerns regarding referencing IPSAS 42 in the IFRS 17 application guidance. In particular, IPSAS 42 includes an option to account for certain social benefits under an 'insurance approach'. The detail is noted in IPSAS 42 para 26 – 28,

but in short where certain criteria are met an entity may account for social benefits using national or international accounting standards on insurance contracts, which takes you back to IFRS 17. For reference, these criteria are:

- the social benefit scheme is intended to be fully funded from contributions; and
- there is evidence the entity manages the scheme in the same way as an issuer of insurance contracts.

15. As IPSAS 42 includes the option to account for certain social benefits as insurance contracts, it was felt that referencing IPSAS 42 could be confusing to accounts preparers, so another approach should be identified.

The way forward on scope

16. Given the feedback from the TWG, HM Treasury will develop alternative approaches to clarify the scope of application of the Standard in the public sector. It should be noted that, at a high level, there is agreement between HM Treasury and the TWG that lines need to be drawn when applying the scope of the Standard, i.e. applying the Standard in its pure form could lead to uncertainty as to whether significant transaction streams which are not 'traditional' insurance contracts should be accounted for under IFRS 17.
17. Even it was concluded that transactions streams need not be accounted for under IFRS 17, without HM Treasury drawing clearer lines on what is and isn't within the scope of the Standard there could be some very lengthy discussions and debates on the correct accounting treatment. Additionally, there is a consistency risk if clear lines are not drawn on the scope of the Standard.
18. Therefore, the current discussion is how we get to a point where the Standard is scoped in the public sector in an appropriate way.
19. It is likely that the application guidance will frame the scope of the Standard to note that, though government engages in insurance-like activity, the nature of the relationship between the government and those receiving such provision is quite different to that of a private sector entity and a policyholder. Government often provides these services as they are statutory responsibilities, aiming to achieve wider policy objectives. Frequently they are non-exchange transactions. As a result, the application guidance may need to more specifically scope out areas of public sector activity and transactions streams than is normally the case.
20. That said, the application guidance also needs to note the government does undertake insurance activities which are appropriately captured by the Standard. In particular, there may be insurance arrangements between public sector entities within the same group. There are also genuine government insurance entities such as UK Export Finance and Flood Re.
21. We would then set out guidelines on what services would be outside of the scope of the Standard. **How to do this is the sticking point at the moment**. For example, if we say benefit expenditure is outside the scope of the Standard, how should we define benefits expenditure? It is not currently defined in the FReM, and the only definition we are aware of is in IPSAS 42, but concerns were raised regarding using IPSAS 42's definition.

22. An option could be to scope out all activity where compensation to service users is through the delivery of services, but such an adaptation is very broad brush and could result in certain transaction streams being inappropriately scoped out.

23. HM Treasury is still working on scoping the Standard in the public sector in light of the feedback from the TWG. HM Treasury plan to hold another TWG meeting once more work on defining the scope of the Standard has been completed.

We welcome comments from FRAB on the work done on the scope to date.

We would be particularly interested in FRAB's views on the best approach to clarifying the scope of application of the Standard, including whether to specify (list) the exclusion of certain areas (which may need to be carefully defined) or to apply a more principled based approach?

Definition of 'customary business practices'

24. Under IFRS 17 a contract can be written, oral or implied by an entity's customary business practices. There is a question regarding what a contract 'implied by an entity's customary business practices' means in the public sector.

25. To answer this question, we looked to adaptations made to the definition of a contract for IFRS 15, which expanded the definition of a contract as follows:

    Therefore, the definition of a contract has been expanded to **include legislation or regulations** which provides the ability for the entity to impose a charge on the customer and the requirement for the customer undertaking the relevant activities to be liable to pay the charge. **The existence of such legislation/regulations and the practice of the government imposing the fee, levy or charge is deemed akin to customary business practices.** The legislation would also provide the enforceability of the obligations on both parties. Box 1A overleaf provides an illustrative example of this intent. [IFRS 15 application guidance para 1.4]

26. To ensure consistency with IFRS 15 and to ensure all appropriate transactions can be scoped into IFRS 17, we proposed to expand the definition of a contract for the purposes of applying IFRS 17 to include legislation or regulations providing the ability for the entity to take on insurance risk from another party. The TWG agreed this was a necessary adaptation.

Question for FRAB: does FRAB agree that this proposed adaptation/ interpretation is appropriate?

27. On review of the FReM there is another interpretation which may need to be incorporated into the IFRS 17 definition of a contract as well. IFRS 16 adaptation 2 expands the definition of a contract to include intra-UK government agreements where non-performance may not be enforceable by law. The applicability of this adaptation has not yet been considered by the IFRS 17 TWG; we will do so at a later date.

Remote contingent liabilities

28. A unique reporting requirement in central government accounts is the disclosure of material remote contingent liabilities. Remote contingent liabilities fall outside the scope of IAS 37, but are disclosed in government annual reports and accounts for parliamentary accountability purposes as a requirement of Managing Public Money.

29. HM Treasury reviewed- at a high level- the Whole of Government Accounts for remote contingent liabilities which could fall within the scope of IFRS 17. Most remote contingent liabilities do not transfer insurance risk, so would be outside the scope of the Standard. However, government entities do issue a number of indemnities to private sector bodies to make projects commercially viable. **It is possible that these indemnities will be within the scope of IFRS 17 and therefore be on the public sector balance sheet.**

30. The next question is how to address Parliamentary accountability requirements in conjunction with the accounting requirements. As noted in the March 2020 IFRS 17 update paper (paras 29 to 32) there may need to be a dual reporting mechanism to ensure high standards of Parliamentary accountability are maintained. However, the mechanism for this dual reporting requirement has not been agreed upon. A few mechanisms were discussed at the last TWG:

    - There could be enhanced IFRS 17 disclosures or sensitivity analysis to incorporate Parliamentary accountability reporting.
    - There is already a form of dual reporting with losses and special payments being included in the financial statements and separately reported in the Parliamentary Accountability report. This mechanism could also be used for remote contingent liabilities which are also on-balance sheet IFRS 17 insurance liabilities.

31. The TWG also noted that guidance in Managing Public Money and the Contingent Liability Approval Framework may also need to be updated, which HM Treasury acknowledged.

Question for FRAB: we would appreciate your thoughts on the potential dual reporting mechanism noted above. In particular:

- Do you agree or disagree that a dual reporting mechanism is needed?
- And if a dual reporting mechanism is needed, based on the options noted above do you have a preferred reporting mechanism for the annual report and accounts?

Government as insurer of last resort

32. We also discussed the concept of government being the insurer of last resort with the TWG. As explained in the Government as insurer of last resort policy paper, the UK Government takes on risks that private sector insurers cannot take on (e.g. flood risk and terrorism insurance). Additionally, many contingent liabilities are taken on by government departments on the assumption that the Exchequer will cover the financial impact of the risk if it crystallises.

33. There is a question regarding how the concept of government as insurer of last resort interacts with the concept of reinsurance in IFRSs. Under IFRS 17 a reinsurance contract

need only be a contract, transfer significant insurance risk and compensate another entity for claims arising from the insurance contracts.

34. However, the process of how government funds contingent liabilities is different from reinsurance. The process would look something like this:
    - The entity would recognise the impact of the contingent liability or insurance liability crystallising as expenditure in their SoCNE.
    - The expenditure will also hit the entity's budget in year either as AME or DEL depending on the timing of the cashflows and whether it is reclassified to a provision or not.
    - If the liability crystallised as a cash payment in year it would also impact the entity's net cash requirement.
    - If the entity was able to absorb the crystallisation of the contingent liability or insurance contract through its existing budgets there would be no claim on the Exchequer as no further funds are needed.
    - If the entity was not able the absorb the crystallisation of the liability in its existing budgets the entity would have an excess vote. The excess vote would be regularised though the excess vote process in the next financial year. The entity would not be able to recognise a receivable or reinsurance asset from the Exchequer as it has no authority to do so.
35. Therefore, entities should not recognise reinsurance assets with the Exchequer for insurance contracts or other contingent liabilities which crystallise.
36. The TWG agreed that the above guidance is helpful and should be included in the application guidance.

Question for FRAB: are you content with the logic of this guidance, the conclusion and its inclusion in the IFRS 17 application guidance?

Discount Rates

37. HM Treasury and the TWG discussed the approach for discount rates for IFRS 17 insurance liabilities. IFRS 17 requires entities to discount cash flows to present value using an appropriate discount rate.
38. HM Treasury already provide discount rates for some balances, e.g. pensions. The TWG would welcome a central HM Treasury discount rate for insurance liabilities, but some entities would also like the option to use their own discount rates where appropriate.
39. HM Treasury agreed to develop a central discount rate. HM Treasury will be liaising with UK Export Finance and Flood Re to understand how they develop their own discount rates and potentially use those principles and methodologies to develop a central HM Treasury discount rate.
40. HM Treasury therefore intend to develop a central discount rate but also allow entities to use their own discount rate if it is more appropriate. This approach is similar to that used for IFRS 16 (refer to IFRS 16 interpretation 2).

Question for FRAB: are you content with the decision to develop a central discount rate for entities to use, but still allow entities to use their own discount rate if it is more appropriate?

Accounting policy choices

41. IFRS 17 includes many accounting policy choices which need to be considered by HM Treasury. Key choices include:

    - Accounting for financial guarantees under IFRS 9 or IFRS 17
    - Accounting for fixed fee service contracts under IFRS 15 or IFRS 17
    - Using the premium allocation approach rather than the general measurement model for insurance contracts with a duration of 12 months or less.

42. The accounting policy choices were briefly discussed and, in general, it was agreed that it may be too early to determine which choices to mandate. Some entities were still analysing their insurance contract portfolio and determining which accounting policy choices would be most appropriate for their portfolios. It was agreed that these choices will be revisited at a later date.

No questions for FRAB. The accounting policy choices will be revisited at a later date.

Timing of implementing the Standard

43. At the last TWG meeting we briefly discussed the timing of implementing the Standard. Though implementation in IFRS accounts is not until 2023-24, there are a number of challenges accounts preparers are facing, including the implementation of IFRS 16 in 2022-23 and the need to move back to a pre-recess laying date.

44. Though delaying IFRS 17 would reduce the accounts preparation burden, it was agreed that implementation in 2023-24 should still be the target to ensure best practice financial reporting and accountability to Parliament and other stakeholders.

No questions for FRAB. The TWG agree that the target of implementing IFRS 17 in 2023-24 remains appropriate.

HM Treasury

25th March 2021