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Interim reporting choices under IFRS 17




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April 2021

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What's the issue?

Under the new insurance standard – IFRS 17 – companies preparing interim reports need to make an **accounting policy choice**: Do they change the treatment of accounting estimates made in previous interim financial statements at each reporting date under a **year-to-date (YTD) approach** or apply a **period-to-period (PTP) approach** to treat each interim period as a discrete reporting period?

What's the impact?

A company's choice of accounting policy will affect its reported financial performance and potentially its disclosures. Under the **YTD approach**, annual financial performance reflects the treatment of estimates made up to and as at the reporting date. Under the **PTP approach**, it is the sum of the results reported in each interim period. This choice will affect **system design, processes and controls.**

What's next?

Companies should **act now to assess the potential impacts for their financial reporting and for their systems, processes and controls**.

Advance planning will allow more time to address potential complexities, manage internal resources and stakeholders' expectations.

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Introduction

Initial recognition

The liability (or asset) recognised for a group of insurance contracts is measured, on initial recognition and subsequently, as the sum of the:

— **fulfilment cash flows** – a risk-adjusted, explicit, unbiased and probability-weighted estimate of the present value of expected cash flows that will arise as the company fulfils the contracts; and

— **CSM** – the amount that represents the unearned profit that the company will recognise in profit or loss as services are provided.

Subsequent measurement

Measuring fulfilment cash flows at the end of each reporting period may give rise to experience adjustments in profit or loss if:

— the current measurement differs from previous estimates; and

— the differences relate to current or past service.

If these differences relate to future services, then this may give rise to adjustments to the CSM.

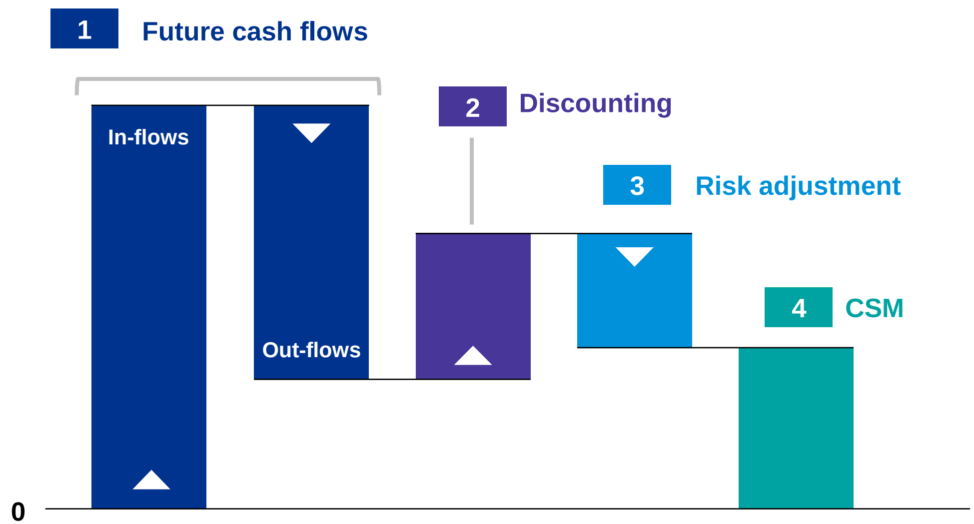
Key components of a profitable contract

Fulfilment cash flows (1, 2, 3)

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

Contractual service margin (CSM) (4)

Represents unearned profit and
results in no gain on initial recognition



Note: Depending on the facts and circumstances, the size and direction of each of the components above could vary

Your policy choice

Under IAS 34 *Interim Reporting*, the effects of changes in estimates:

— are reflected in the current period; and

— require no recalculation of results for prior annual or interim periods.

The measurement of annual results is generally not affected by the frequency of a company's financial reporting – i.e. annual, half-yearly or quarterly – and amounts reported in interim and annual financial statements are measured on a year-to-date basis.

If a company applies paragraph B137 of IFRS 17 and publishes interim reports under IAS 34, then it chooses an accounting policy and applies it consistently to all groups of insurance contracts issued and reinsurance contracts held, as summarised below.

Your accounting policy choice in summary

	How to apply	Effect on annual financial performance
YTD approach	At each reporting date, disregard the treatment of estimates made in previous interim financial statements. When relevant, replace with updated estimates calculated on a YTD basis. The last reporting period reflects the change in treatment from that in previous interim financial statements.	Annual financial performance reflects the entire annual reporting period.
PTP approach	No change is made to the treatment of estimates in previous interim financial statements. Treat each interim period as a discrete reporting period (e.g. identify experience adjustments and changes related to future service).	Annual financial performance is the sum of the results reported in each interim period.

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Your policy choice illustrated

A Company A – Annual reporting only

Fact pattern

- Company A issues annual financial statements only.
- It has a group of contracts with an opening CSM of 50 at the start of Year 1.
- It expects to release CSM on a straight-line basis over a two-year period – i.e. 25 per year.
- At the end of Year 1, it expects additional claims to be incurred in Year 2 of 30.
- For simplicity, discount rates are 0%.

How do we explain the results?

- Company A estimates the CSM at the end of Year 1 as:

Opening CSM	50
Change in future claims estimate	(30)
Closing CSM (before allocation to revenue)	20

- It releases this CSM of 20 over 2 years and so recognises 10 in Year 1 and 10 in Year 2. On an annual basis this is the same outcome as an interim reporter that applies a YTD approach.

B Company B – YTD approach

Fact pattern

- As for Company A except that Company B issues half-yearly financial statements.

How do we explain the results?

- In H1, it releases CSM of 12.5 – i.e. 50/4 half-years.
- At the end of H2, Company B calculates a new CSM based on the full year of:

Opening H1 CSM	50
Change in future claims estimate	(30)
Closing CSM (before allocation to revenue)	20

- It releases this CSM of 20 over 2 years – i.e. 10 per year. Because it released 12.5 in H1, it adjusts the CSM release in H2 by 2.5 – i.e. (12.5) + 10 = (2.5). This results in negative insurance revenue in H2.
- On an annual basis, this is the same outcome as for Company A, which reports only annually.

Your policy choice illustrated (cont.)

C Company C – PTP approach

Fact pattern

- Company C issues half-yearly financial statements.
- It has a group of contracts with an opening CSM of 50 at the start of Year 1.
- C expects to release CSM on a straight-line basis over a two-year period – i.e. 12.5 per half-year (50/4 half-years). In H2, it expects additional claims to be incurred in Year 2 of 30.

How do we explain the results?

- Company C does not change its H1 CSM release of 12.5.
- In H2, it adjusts its CSM as follows.

Opening H1 CSM	50
Release of H1 CSM	(12.5)
Change in future claims estimate	(30)
Closing CSM (before allocation to revenue)	7.5

- It releases the adjusted CSM of 7.5 on a straight-line basis over the three remaining half-year periods – i.e. 2.5 per half year.

How do the results compare?

	Insurance revenue recognised from CSM release			Balance sheet at end of Year 1
	H1	H2	Year 1	Remaining CSM
Company A – Annual reporting only	-	-	10	10
Company B – YTD approach	12.5	(2.5)	10	10
Company C – PTP approach	12.5	2.5	15	5

Applying your policy choice

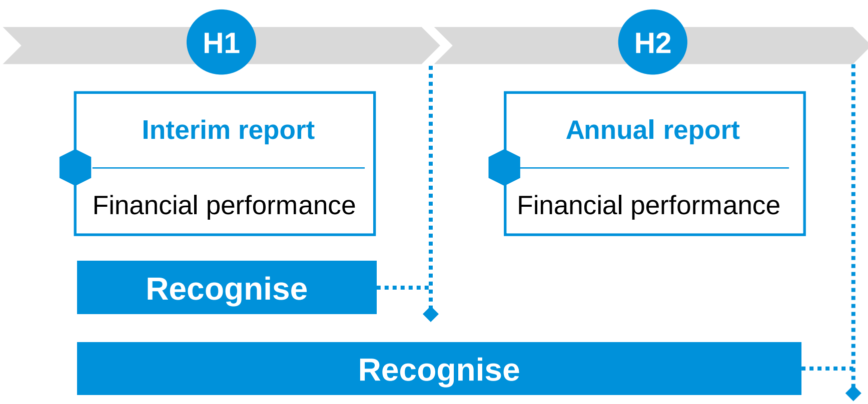
How do you apply the YTD and PTP approaches?

Under the YTD approach, any changes in estimates of cash flows relating to service during the current year relative to estimates at the start of the year are included as experience adjustments in profit or loss, even if those estimates were updated at a previous interim reporting date.

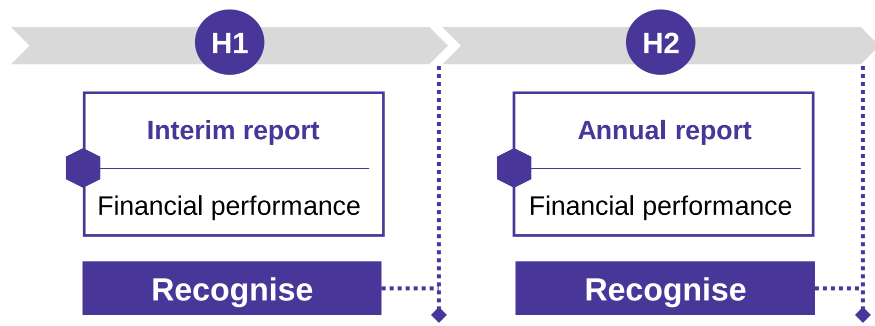
Changes in estimates of cash flows relating to future service will be regarded as an adjustment of the CSM in that interim period (unless the group of contracts is onerous). Those prior period interim financial statements are not subsequently restated. However, the treatment of estimates may change in subsequent financial statements.

Under the PTP approach, changes in estimates of cash flows relating to future service will be regarded as an adjustment to the CSM in the interim period in which they are made (unless the group of contracts is onerous). The treatment of estimates will not change in subsequent financial statements.

YTD approach



PTP approach



What are the impacts?

Reported numbers

- Analysing the CSM release may be more complex under the YTD approach because the cumulative YTD release is recalculated in each reporting period.
- The CSM reported under the PTP approach is affected by the frequency of interim reporting. The CSM reported under the YTD approach is the same as the CSM reported by a company reporting annually.
- Comparing the CSM and annual financial performance of companies that apply the PTP approach and those that apply the YTD approach may be difficult, particularly if there are changes in accounting estimates during the reporting period.

Approach to transition

- Relief is available on transition for those companies applying a modified retrospective approach (MRA) and that choose to apply the PTP approach. No such relief is needed under the YTD approach because the frequency of interim reporting does not impact the reported amounts.

Disclosure in the financial statements

- Specific disclosure requirements apply for significant changes in estimates under IAS 34 regardless of whether a company adopts the YTD approach or the PTP approach.
- Even though IAS 34 is unchanged, revised disclosures may be necessary because of the new IFRS 17 requirements (see page 10).

Accounting systems and processes

- IFRS 17 allows application of the YTD approach to accommodate groups in which certain subsidiaries do not present individual interim financial statements but do submit interim results to a parent presenting consolidated interim financial statements. This avoids the burden of maintaining two sets of accounting records, one for individual reporting and one for group reporting.
- A company will need to ensure that its systems have the capability to handle whichever accounting policy it selects.

Some questions answered

Can the approaches applied differ between financial statements of different companies in the same group?

Yes. Each group of companies will need to select a consistent accounting policy for reporting the group's results. However, different approaches might apply for the financial statements of subsidiaries within the group either because:

- an individual company within the group does not prepare interim financial statements under IAS 34 and so no policy option is available to that company;
- parent and subsidiaries make different policy choices (YTD approach vs PTP approach); or
- group companies report at different intervals – e.g. the group reports quarterly but a subsidiary presents interim financial statements in accordance with IAS 34 only half-yearly.

Different approaches could lead to a significant practical burden due to maintaining different sets of books for individual and group reporting.

This could increase cost and complexity significantly and potentially require investment in new processes to capture and maintain additional data and explain results on different bases.

Does one approach mean more work than the other?

Not necessarily, although new disclosures may be required in some circumstances.

Under the YTD approach, the treatment of estimates made in previous interim periods will need updating, although this may be automated. Both approaches require estimates to be made in each interim reporting period but the treatment of changes in estimates differs. Reported results under the PTP approach are determined for each discrete interim period; those under the YTD approach are determined on a cumulative basis.

Some questions answered (cont.)

Do I need to provide additional disclosures?

It depends. Whether a company adopts the YTD approach or the PTP approach, the specific disclosure requirements under IAS 34 apply in cases of a significant change in estimates.

If there is a significant change in estimates, then companies need to disclose the nature and amount of the change in estimates in its interim or annual financial statements[(a)]. This applies regardless of your policy choice – PTP approach or YTD approach.

Additional disclosures may also be required under IAS 34 if there are other significant events or transactions accounted for under IFRS 17.

Do I have options available on transition?

It depends. The full retrospective approach (FRA) is required unless this approach is impracticable. Relief is available on transition to those companies applying a modified retrospective approach (MRA) and that choose to apply the PTP approach.

As a consequence, companies can determine the CSM, any loss components and amounts related to insurance finance income or expenses as at the date of transition as if they had not prepared interim financial statements before that date.

No such relief applies under the YTD approach because the frequency of interim reporting does not impact the reported results on transition.

Companies applying the PTP approach may find it challenging to gather sufficient data to apply the FRA, because of the information needed to recalculate and roll forward amounts from previous interim reporting dates.

Note: (a) As set out in paragraph 39 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and paragraphs 16A(d) and 26 of IAS 34

Some questions answered (cont.)

Do I need to inform my stakeholders?

It depends. If the potential impact on your financial performance is material, then you will need to explain the impacts to your stakeholders and disclose the policy choice (if significant to the company) in the financial statements. This will require a thorough understanding of the mechanics of your selected approach.

Under the YTD approach, the financial performance in some interim reports may be challenging to explain. This is because the company will need to recalculate its results on a cumulative basis. It may require more effort to identify the difference between the CSM release related to services provided in the interim period and adjustments to reflect changing the treatment of accounting estimates made in prior interim periods.

Should I consider the grouping of insurance contracts?

Yes. Companies are permitted to close a group of contracts after a period of less than one year. For interim reporters, this means that they can align their cohorts with their interim reporting periods to simplify operational aspects of this accounting policy choice.

Groups of insurance contracts determined for the purposes of initial and subsequent measurement will remain open for up to one year.

Aligning cohorts with interim reporting periods could be easier operationally. However, smaller cohorts may have a higher risk of becoming onerous subsequently and may lead to more calculations in the systems.

Is there anything else that should be considered when making this accounting policy choice?

Yes. Applying different accounting policy choices would result in different outcomes. For example, the discount rate determined on initial recognition to reflect the time value of money, the recognition of insurance revenue and insurance service expenses..

It is important to thoroughly assess the effects on each item in the balance sheet and income statement and the potential operational implications for the differences identified.

What's next?

Your policy choice

Your accounting policy choice could have a significant impact on:

- **system design, processes and controls;** and
- how you **explain your results to stakeholders**.

Plan now

Advance planning will allow time for careful analysis of the appropriate policy choice and its operational consequences. It will also enable efficient use of internal resources by spreading the work required over a longer period.

Key actions to complete

Develop a thorough understanding of the potential financial impact of the YTD approach and the PTP approach.

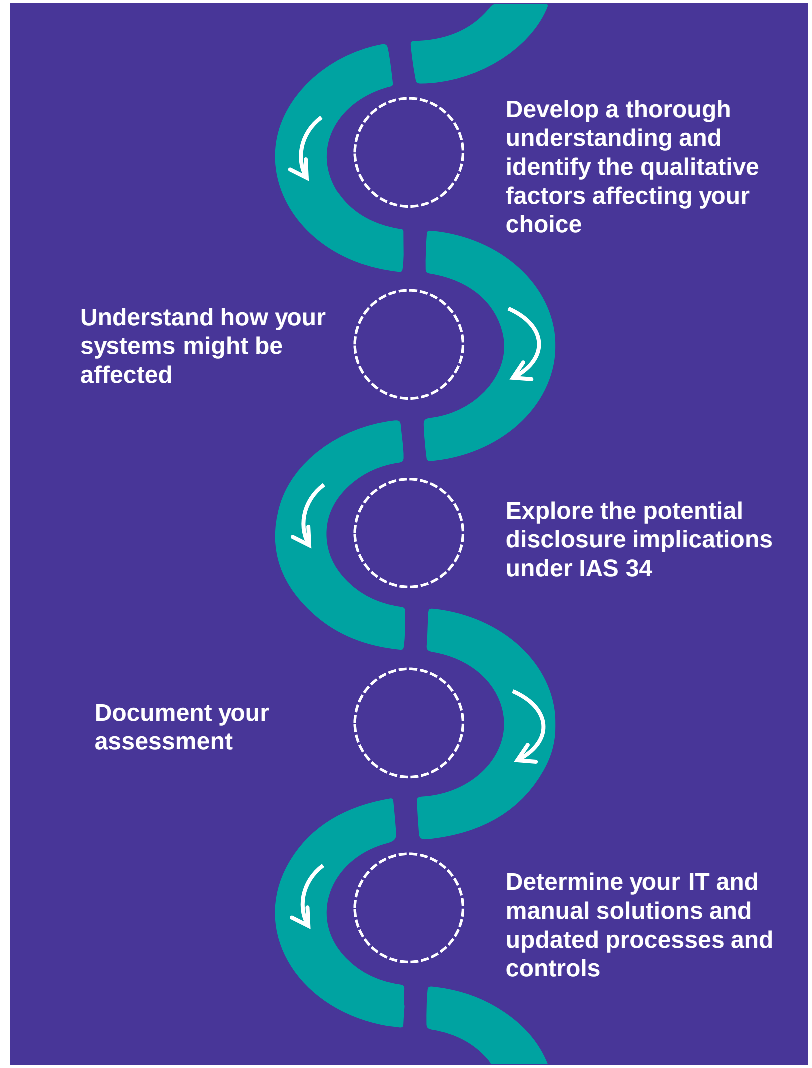
Identify the qualitative factors that may influence your choice. Key stakeholders may need to be engaged to understand which factors are more or less important.

Understand the implications for the design and flexibility of your system solution (especially the CSM engine).

Explore the implications for your initial interim financial report reflecting IFRS 17 (and potentially IFRS 9 *Financial Instruments*) and potential additional disclosures under IAS 34.

Document your assessments and calculations.

Determine IT and manual solutions, updated processes and controls to ensure completeness and accuracy of data required.



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About KPMG and IFRS 17

At KPMG, we have a top-down and business-focused approach to IFRS 17 implementation to help you accelerate progress towards your goals confidently and securely. This approach is tailored to help answer the questions that are important to you, while building on the knowledge of KPMG professionals who:

— have a hypothesis-driven approach, starting top down rather than bottom up with a gap analysis. This can enable design decisions to be taken earlier, reducing demands on resources;

— bring deep market insights from advising leading insurers on IFRS 17 and IFRS 9 and the experience from this work to help accelerate thinking in complex aspects of the new requirements;

— understand that one size does not fit all, enabling clear communication of the issues that matter to you;

— leverage proprietary tools and accelerators for your impact assessment, tailoring our approach to meet your needs and aspirations, whether quick wins, cost savings, efficient financial and regulatory reporting as well as improved teamwork and other benefits.

KPMG firms offer you insights and actively promote knowledge transfer to your people from the outset, so that you have a sound base of expertise to deliver new ways of working.

Please contact us to learn more about how KPMG firms can help unlock value from your IFRS 17 program or visit home.kpmg/ifrs17.

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Publication name: *Interim reporting choices under IFRS 17*

Publication number: 137597

Publication date: April 2021