



IASB amends IFRS 17 to permit a classification overlay for financial assets presented in comparative periods on initial application of IFRS 17

What you need to know

IASB agrees to finalise the classification overlay:

- ▶ On 9 December 2021, the IASB amended IFRS 17 to add a transition option for a “classification overlay” to address possible accounting mismatches between financial assets and insurance contract liabilities in the comparative information presented on initial application of IFRS 17.
- ▶ If an entity elects to apply the classification overlay, it can only do so for comparative periods to which it applies IFRS 17 (i.e., from transition date to the date of initial application of IFRS 17).
- ▶ No amendments have been made to the transition requirements of IFRS 9.

Overview

On 9 December 2021, the International Accounting Standards Board (IASB or the Board) issued an amendment to IFRS 17 *Insurance Contracts* (IFRS 17 or the standard), to add a transition option relating to comparative information presented on initial application of IFRS 17 and IFRS 9. This amendment follows from the Exposure Draft (ED) on *Initial Application of IFRS 17 and IFRS 9—Comparative Information*, published in July 2021, and subsequent redeliberations based on feedback from stakeholders.

The IASB decided to introduce this transition option, a classification overlay for financial assets in the comparative period, in response to concerns raised by stakeholders regarding accounting mismatches that could arise between financial assets and insurance contract liabilities in the comparative information when IFRS 17 and IFRS 9 *Financial Instruments* (IFRS 9) are first applied in 2023.

Such differences could arise due to differences in transition requirements for IFRS 9 and IFRS 17. IFRS 17 requires restatement of comparatives, whereas restatement under IFRS 9 is permitted (but not mandatory) if hindsight is not required. However, restatement is prohibited for financial assets derecognised before the initial application date of IFRS 9. The accounting mismatch caused by financial assets derecognised during the comparative period is relevant to several insurers; the mismatch is potentially significant and could make financial statements more difficult to understand.

Scope

The classification overlay may be applied by:

- ▶ Entities that adopt IFRS 17 and IFRS 9 at the same time and choose to restate comparative information applying IFRS 9. These entities can apply the classification overlay to financial assets derecognised in the comparative period (to which IFRS 9 cannot be applied).
- ▶ Entities that adopt IFRS 17 and IFRS 9 at the same time and do not restate comparative information applying IFRS 9. For these entities, the classification overlay can be applied to any financial asset in the comparative period.
- ▶ Entities that applied IFRS 9 before they apply IFRS 17 for the first time. These entities can apply the classification overlay to assets that would have been redesignated in accordance with paragraph C29 of IFRS 17 if they had not been derecognised in the comparative period.

The scope of the classification overlay is broader than originally proposed in the ED, allowing an entity that first applies IFRS 17 and IFRS 9 at the same time to apply the classification overlay to any financial asset for which comparative information has not been restated for IFRS 9, rather than only those held in respect of an activity connected with contracts within the scope of IFRS 17. The Board concluded that this increase in scope was appropriate because the use of the classification overlay would only increase the usefulness of comparative information about financial assets presented on application of IFRS 17.

The scope has also been extended to allow an entity that has already applied IFRS 9 before the date of initial application of IFRS 17, to apply the overlay to a financial asset that has been derecognised in the comparative period. Entities that have already applied IFRS 9 are allowed, or in some cases required, under the transition guidance in IFRS 17, to redesignate financial assets on initial application of IFRS 17 in order to reduce accounting mismatches. However, this redesignation cannot be applied to financial assets derecognised in the comparative period, since it applies only from the date of initial application of IFRS 9. The classification overlay can also be applied to such financial assets for the purpose of presenting comparative information, as if the redesignation guidance in IFRS 17 had been applied to them based on how the entity expects the assets would be designated at the date of initial application of IFRS 17.

The application of the classification overlay is optional on an instrument-by-instrument basis to allow an entity to determine whether for a particular financial asset the benefits of applying the classification overlay outweigh the costs. However, this does not prevent an entity from applying it at a higher level of aggregation, for example, by considering the level at which the entity would assess its business model when applying IFRS 9.

If an entity elects to apply the classification overlay, it can only do so for comparative periods to which it applies IFRS 17 (i.e., between the transition date to IFRS 17 and the date of initial application of IFRS 17).

Classification and measurement

An entity that applies the classification overlay to a financial asset should:

- ▶ Use reasonable and supportable information available at the transition date to determine how the entity expects that financial asset would be classified and measured on initial application of IFRS 9 (for example, using preliminary assessments performed to prepare for initial application of IFRS 9)
- ▶ Present comparative information as if the classification and measurement requirements of IFRS 9 had been applied to that financial asset

The IASB noted that an entity could, for example, use preliminary assessments of the business model and cash flow characteristics performed to prepare for the initial application of IFRS 9 as reasonable and supportable information for the classification overlay. Applying the classification overlay, the carrying amount of a financial asset would be determined consistently with how it would be measured on initial application of IFRS 9. For example, for a financial asset previously measured at amortised cost, that is presented at fair value through profit or loss when applying the classification overlay, its carrying amount at the transition date to IFRS 17 would be its fair value at that date.

Any difference between the previous carrying amount of a financial asset and the carrying amount at the transition date that results from applying the classification overlay is recognised in opening retained earnings (or other component of equity, as appropriate) at the transition date (i.e., 1 January 2022 for most entities).

The amendment does not change any of the requirements of IFRS 9. Entities that apply the classification overlay to some or all of their financial assets will therefore still need to apply the transition requirements of IFRS 9 to any financial assets that continue to be recognised at the date of initial application of IFRS 9. For example, entities will need to assess whether the classification of financial assets that continue to be recognised at that date is in accordance with IFRS 9. If the classification determined applying the classification overlay does not meet the requirements of IFRS 9 on the date of initial application of IFRS 9, the entity would be required to update the classification of a financial asset on that date and apply the updated classification retrospectively as per the transition requirements of IFRS 9.

Impairment

In applying the classification overlay, an entity is permitted but not required to apply the impairment requirements of IFRS 9. If a financial asset would be subject to the impairment requirements of IFRS 9 following the classification under the classification overlay but the entity does not apply those impairment requirements, it will still continue to present any IAS 39 impairment amount recognised in the prior reporting period. Otherwise, any impairment amount previously recognised for that financial asset should be reversed.

The Board allowed this choice of impairment model observing that some entities may not yet be prepared to apply the impairment requirements of IFRS 9, and that comparative information would still be improved by applying the classification overlay, even without applying the impairment requirements of IFRS 9.

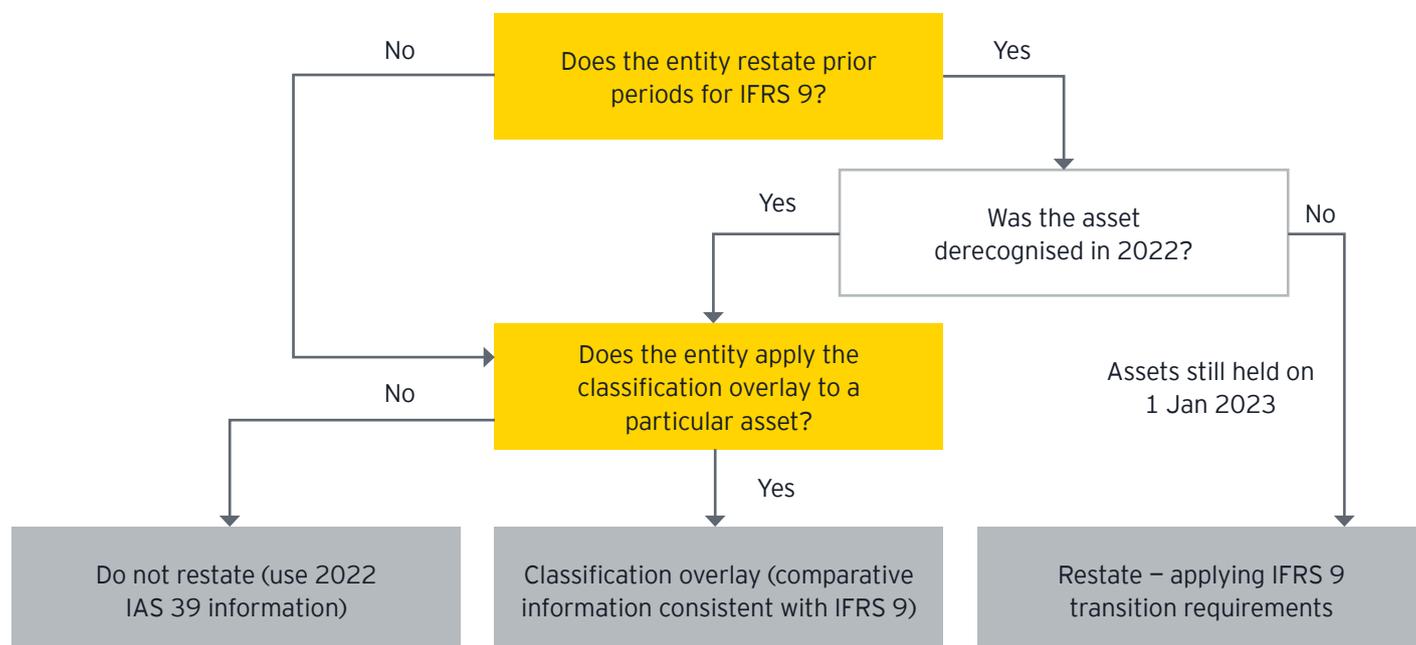
Disclosure

An entity that applies the classification overlay should disclose qualitative information that enables users of financial statements to understand the extent to which the classification overlay has been applied (such as whether it has been applied to all financial assets derecognised in the comparative period).

Furthermore, the entity is required to disclose whether and to what extent the impairment requirements in IFRS 9 have been applied under the classification overlay.

The Board rejected respondents' suggestions that additional quantitative disclosures of the effects of the classification overlay were necessary. The Board considered that the costs of such disclosure requirements would likely outweigh the benefits, since the classification overlay is time-limited, targeted in scope and relates to an accounting mismatch only. Also, other IFRS standards, such as IAS 1 *Presentation of Financial Statements*, might require further disclosure about the impact of the classification overlay.

Decision tree on the classification overlay and presentation of comparative information about financial assets on initial application of IFRS 9 and IFRS 17:



Based on October 2021 IASB staff paper Agenda Ref 2

How we see it

Insurers will welcome the efforts of the IASB to finalise this amendment before the transition date for IFRS 17. Insurers will also welcome the extension of the scope by removing the need for entities to determine, for the purposes of the classification overlay, those financial assets that are deemed to be in respect of an activity that is unconnected with insurance contracts and those that are not.

Bank subsidiaries, and other insurers who have already applied IFRS 9, will also welcome the increased scope as they may be faced with the same issue regarding accounting mismatches that could arise in the comparative period relating to derecognised assets.

The classification overlay should, as stated by the IASB staff, increase the usefulness of comparative information about financial assets presented on initial application of IFRS 17. However, it remains to be seen how well users of financial statements will be able to understand how the classification overlay is applied, with only qualitative disclosure requirements.

Background

The IASB issued IFRS 17 in May 2017, it then issued targeted amendments to IFRS 17 in June 2020, following the Exposure Draft (ED) on proposed *Amendments to IFRS 17* (published in June 2019 and subsequent re-deliberations based on feedback received on the ED from stakeholders). Our publication, [Applying IFRS 17: A closer look at the new insurance contracts standard \(June 2021\)](#), provides further details on the requirements. The IASB issued Exposure Draft (ED) *Initial Application of IFRS 17 and IFRS 9—Comparative Information* in July 2021. Further details can be found in our [July 2021 Insurance Accounting Alert](#).

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