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Dear Sir

Exposure Draft ED/2021/8: Initial Application of IFRS 17 and IFRS 9 - Comparative Information

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We support the efforts of the IASB to amend the requirements in IFRS to simplify the initial application of IFRS 9 and IFRS 17 for insurance entities. The proposed requirements will simplify the transition as well as enhance the comparability of financial statements in the year of initial application of IFRS 9 and IFRS 17.

In addition to our comments supporting the proposals, we have a number of suggestions to improve and clarify the proposals.

Our responses to the questions in the ED are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS and Corporate Reporting

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Appendix

Question 1

Do you agree with the proposed amendment in this Exposure Draft? Why or why not?
If not, what alternative do you propose and why?

We agree with the proposed amendments in the Exposure Draft (ED). When an insurance entity applies IFRS 9 and IFRS 17 for the first time, substantially all assets and liabilities will be recognised and measured in accordance with a new set of requirements compared to the predecessor standards (IAS 39 and IFRS 4). For many insurance entities, the effect of the transition will be significant. We believe the proposed amendments will enhance the comparative information provided to users of financial statements, as they will result in the comparative period being presented in a manner more consistent with the accounting policies applied from 1 January 2023 onwards.

We have three suggestions relating to how the proposed amendments may be improved. They relate to the following areas, which are discussed in further detail below:

1. Scope of the classification overlay compared to the scope of the IFRS 9 deferral
2. Disclosure of the scope and effect of the classification overlay
3. Drafting suggestion – policy choice relating to the impairment requirements of IFRS 9

<u>Scope of the classification overlay compared to the scope of the IFRS 9 deferral</u>

C28E of the proposals set out the proposed scope of the classification overlay as follows:

> *An entity shall not apply paragraphs C28B–C28C to:*
> *(a) a financial asset that is held in respect of an activity that is unconnected with contracts within the scope of IFRS 17; and*
> *(b) comparative information for reporting periods before the transition date to IFRS 17 (see paragraphs C2 and C25).*

This differs from the scope of the optional deferral from IFRS 9, which is set out in IFRS 4.20B:

> *An insurer may apply the temporary exemption from IFRS 9 if, and only if:*
> *(a) it has not previously applied any version of IFRS 9 2, other than only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7-5.7.9, 7.2.14 and B5.7.5–B5.7.20 of IFRS 9; and*
> *(b) its activities are predominantly connected with insurance, as described in paragraph 20D, at its annual reporting date that immediately precedes 1 April 2016, or at a subsequent annual reporting date as specified in paragraph 20G.*

The proposed scope of the classification overlay is that it applies to only certain financial assets held by an entity, whereas the scope of the IFRS 9 deferral is 'entity wide', as it applies to all financial instruments in the scope of IFRS 9 held by an entity that qualifies for the IFRS 9 deferral.

If the amendments were applied by an entity that had recognised both financial assets held in respect of contracts in the scope of IFRS 17 and financial assets held in respect of an activity unconnected with contracts in the scope of IFRS 17, then that entity would be required to account for financial assets in the comparative period (i.e. 2022) as follows, assuming the entity elects to apply the recognition and measurement requirements of IFRS 9 on a retrospective basis to financial assets that had not been derecognised by 1 January 2023:

1. IFRS 9: financial assets that were not derecognised by 1 January 2023
2. Classification overlay: financial assets that were derecognised by 1 January 2023
3. IAS 39: financial assets held in respect of an activity that is unconnected with contracts within the scope of IFRS 17, if the financial assets were derecognised by 1 January 2023 (i.e. the classification and measurement requirements of IFRS 9 could not be applied to such assets and they are also not eligible for the classification overlay due to the scoping of IFRS 17.C28E(a)).

We believe this level of complexity is not warranted given that all entities will apply IFRS 9 as at 1 January 2023, resulting in identical 'day 1' accounting as of the date of transition to IFRS 9.

Additionally, for an entity to have applied the IFRS 9 deferral in IFRS 4, the majority of its activities must have been related to insurance activities, meaning the quantum of financial assets that would fall into the third category as described above would likely be minimal.

We acknowledge that IFRS 4.20D, which establishes the criteria for applying the IFRS 9 deferral, is based on the carrying amount of liabilities rather than financial assets, however, we believe that our observation about the third category of financial assets noted above still holds true because for an entity to apply the IFRS 9 deferral, its overall operations would have had to have been primarily related to insurance, which would be true of its financial assets as well, or else the liability-based test in IFRS 4.20D would not have been met.

Disclosure of the scope and effect of the classification overlay

The proposed amendments only include a single disclosure requirement, which is that an entity that applies the classification overlay should disclose that fact (proposed paragraph C28A).

We do not believe that it would be consistent with the objective of the proposed amendments to include a precise quantification of the effect of applying the classification overlay. This is because such a requirement would defeat the purpose of the proposed amendments, which are meant to simplify the preparation of comparative information by an entity and enhance consistency.

However, we do believe that entities should be required to disclose, at a minimum, a narrative description of the types of financial assets that the overlay has been applied to and the basis underlying why an entity selected to apply the classification overlay to the financial assets selected. Without such a requirement, a user of the financial statements would have no ability to assess the consequence, i.e. which types of financial assets are affected by this accounting policy.

While the overlay may be applied on an instrument-by-instrument basis, we still believe the introduction of a narrative disclosure requirement would be appropriate. This is particularly the case where an entity applies the classification overlay to only some financial assets that are of a similar nature to other financial assets, as an entity should be required to explain the basis for this choice.

<u>Drafting suggestion – policy choice relating to the impairment requirements of IFRS 9</u>

Paragraph C28C of the proposed amendments states that, in applying the classification overlay, an entity is not required to apply the impairment requirements in Section 5.5 of IFRS 9. The proposed amendments also allow an entity to apply the classification overlay on an instrument-by-instrument basis to financial assets that meet the criteria in paragraph C28E.

We believe it is the intention of the IASB for an entity to either apply or not apply the impairment requirements of Section 5.5 of IFRS 9 consistently to financial assets to which the classification overlay has been applied. However, we have observed that some have interpreted the exposure draft to mean that the choice relating to impairment is also available on an instrument-by-instrument basis.

We do not believe this is the case because the application of the classification overlay is an instrument-by-instrument decision, however, in applying the classification overlay, an entity must develop a consistent accounting policy for similar transactions, other events and conditions unless an IFRS specifically requires or permits some other categorisation (IAS 8.13). Said another way, while the classification overlay is optional on an instrument-by-instrument basis, we do not believe it is the intention of the IASB to make the manner in which an entity applies the classification overlay an instrument-by-instrument choice.

If this is in fact the intention of the IASB, we propose the following amendment to paragraph C28C to clarify this (<u>proposed texted underlined</u>):

> *An entity shall use the expected classification determined applying paragraph C28B to present comparative information as if the classification and measurement requirements of IFRS 9 had been applied to that financial asset. However, in applying the classification overlay, an entity is not required to apply the impairment requirements in Section 5.5 of IFRS 9. <u>An entity either applies or does not apply the impairment requirements in Section 5.5 of IFRS 9 consistently to all financial assets to which the classification overlay is applied.</u> Any difference between the previous carrying amount of the financial asset and the carrying amount at the transition date that results from applying the classification overlay shall be recognised in opening retained earnings (or other component of equity, as appropriate) at the transition date.*