



HM TREASURY

Financial Reporting Advisory Board Paper

IFRS 4 *Insurance contracts*

Issue:	The application of IFRS 4 <i>Insurance contracts</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual (FReM)
Impact on guidance:	The proposed text in Annex A relates to the IFRS-based FReM
IAS/IFRS adaptation?	No
IPSAS compliant?	Yes
Interpretation for the public sector context?	No
Impact on budgetary regime?	No
Alignment with National Accounts	Yes
Impact on Estimates?	No
Recommendation:	That the Board agree to apply IFRS 4
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. IFRS 4 *Insurance contracts* was revised in 2003 to be applied for annual periods beginning on or after 1 January 2005, replacing the 2000 version of the standard. It represents the conclusion of Phase 1 of the IASB's project on insurance contracts and was issued because the IASB saw an urgent need for improved disclosures for insurance contracts, and modest improvements to recognition and measurement practices, in time for the adoption of IFRS by listed companies

throughout Europe and elsewhere in 2005. The improvements to recognition and measurement are ones that will not likely have to be reversed when the IASB completes the second phase of the project.

2. IFRS 4 applies to most insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. It does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of IAS 39 Financial Instruments: Recognition and Measurement. Nor does it cover accounting by policyholders. It defines an insurance contract as a "contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder."

Improved disclosures

3. The IFRS requires extensive disclosures of information that helps users understand the assets, liabilities, income, expense, and cash flows in the insurer's financial statements that arise from insurance contracts, including the accounting policies and estimation techniques used. Further information is required on the amount, timing and uncertainty of future cash flows from insurance contracts, including on risk management objectives and policies, the terms and conditions of insurance contracts, insurance risk, (with sensitivity analysis), and interest rate risk and credit risk.

Improvements to recognition and measurement practices

4. The IFRS does not prescribe the use of specific accounting policies. Instead it aims to prohibit some. For example, it prohibits those involving the use of provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions), and accounting policies that de-recognise insurance liabilities before they are discharged or cancelled, or expire. And it requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets.

5. It also limits changes to accounting policies to those that produce better information. For example, an accounting policy that measures insurance liabilities on an undiscounted basis can be continued under IFRS 4 but may not be introduced as a new policy.

Main differences from UK GAAP

6. There is no direct equivalent in UK GAAP to IFRS 4. Entities in the UK that carry out insurance business apply the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance (SORP), whereas the IFRS is wider in its scope in applying to all insurance contracts issued by any reporting entity. Insurance contracts as defined in IFRS 4 that are issued by entities in the UK that do not undertake insurance business apply the UK accounting standards that underlie the SORP, eg FRS 5, 12 (other than as issued by an insurance entity) and 13. Application of either these accounting standards or the SORP would be unlikely to lead to significant inconsistency with the IFRS for recognition and measurement, though the IFRS based disclosures would be more extensive.

Impact of IFRS 4 on the public sector

7. IFRS 4 is likely to have little significant impact on the recognition and measurement practices for insurance contracts undertaken by entities covered by the requirements of the FReM.

8. It may affect disclosures in the accounts of the ECGD, but elsewhere there may be few changes as government does not issue significant insurance contracts widely otherwise.

IAS/IFRS compliance

9. The proposal is compliant with international accounting standards.

IPSAS compliance

10. There is no IPSAS accounting standard on insurance contracts. Entities accounting for such contracts under IPSASs would apply the relevant standard for example, IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets (other than if they are insurance entities). Compliance with these standards is unlikely to be inconsistent with the IFRS for recognition and measurement, though the IFRS based disclosures may be more extensive.

Proposed text for the IFRS-based Government Financial Reporting Manual

11. See Annex A for the proposed amendments to the IFRS-based FReM.

Impact on the budgetary regime

12. The proposal has no impact on budgetary control.

Alignment with the National Accounts

13. The proposal is not inconsistent with the National Accounts treatment.

Summary and recommendation

14. IFRS 4 has limited requirements for the recognition and measurement of insurance contracts and more extensive ones for disclosures. Its impact in government is likely to be only that some more information will be disclosed by the few entities that issue significant insurance contracts.

15. The Board is asked to agree the adoption of IFRS 4.

HM Treasury

12 February 2007

PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL

IFRS 4 *Insurance contracts*

Applicability

IFRS 4 applies in full.

Objective of IFRS 4

The objective of this IFRS is to specify the financial reporting for insurance contracts by any entity that issues such contracts until the Board completes the second phase of its project on insurance contracts. In particular, this IFRS requires:

- (a) limited improvements to accounting by insurers for insurance contracts.
- (b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.