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IFRS 17

Assurance on methodology choices

Why are IFRS 17 methodology choices an audit focus area?

IFRS 17 *Insurance Contracts* is a complex standard with a number of methodology choices. From 2023 it will drive accounting for a wide range of contracts issued by insurers across the world. The degree of change from existing practice will vary by business, but will lead to significant change for nearly all insurers who apply IFRS.

As IFRS 17 is a principles-based standard, reporters are required to apply judgment in making methodology decisions and accounting policy choices. The working assumptions made at the outset will drive the entire implementation process and lead to organisation-wide changes. Delivering assurance on the integrity of governance over methodology choices is a fundamental part of the early IFRS 17 assurance timeline. With the recent announcement of a one-year extension in IFRS 17's effective date to 2023, Internal Audit has the opportunity to ensure the building blocks for a successful implementation are in place.

What are some key methodology considerations for Internal Audit to be aware of?

Measurement Models

The default measurement model for IFRS 17 is the general model ("GM"). However, for direct participating contracts the Variable Fee Approach may be used to reduce volatility, and for shorter duration contracts insurers can adopt the simplified premium allocation approach ("PAA"). IFRS 17 provides principles for selecting models, but significant judgment must be applied when interpreting these, considering contract duration, ancillary product features and more.

- ✓ The decisions made by organisations in this respect can lead to **different profit emergence and IT architecture**. For example for general insurers, PAA and GM are calculated differently and a number of general insurers will measure some groups of insurance contracts using the GM and others the PAA.
- ✓ Internal Audit should evaluate the scope and depth of the governance processes, challenge provided and the quality of information presented to management when determining measurement model(s).
- ✓ **Unusual risk profiles, driven by COVID-19 type events, may require PAA measurement to be measured using GM** (if PAA is no longer a close approximation to GM for contracts >12 months in duration). Firms and auditors should be aware of this.

Aggregation of Contracts

Contract aggregation begins by identifying portfolios of insurance contracts with "similar risks that are managed together", such as classes of business.

- ✓ To identify groups of contracts expected to be profitable at inception, those expected to be onerous and all other contracts within the portfolio requires **significant management judgement and a wide range of data**.
- ✓ Decisions made around the level of aggregation can affect whether the resulting groups of contracts may be initially assessed as profitable. Internal Audit should seek to **evaluate the process for making these judgments of whether risks are truly "similar"**.
- ✓ Internal Audit should evaluate the effectiveness and sustainability of the processes and controls in place for segmenting, aggregating and grouping insurance contracts including governance and oversight processes.

Coverage Units

Coverage units are used as a mechanism for releasing the CSM as insurance services are delivered. The decision about coverage units therefore directly impacts the timing of top line income recognition – which will be a key performance indicator for most insurers.

- ✓ Identifying and defining coverage units requires significant management judgement as **the Standard does not provide prescriptive guidance**. Internal Audit should understand management's process for defining coverage units – considering the nature of the insurance contract, product features and the time value of money in quantifying the provision of services – and the review processes that took place to approve this.
- ✓ In addition, Internal Audit should consider whether methodology decisions around coverage units are consistent between classes of business and annual cohorts.

Implementation Strategy

Many large insurers take a centrally-led approach for IFRS 17 implementation with targeted involvement of local teams. Different implementation strategies will create different risks in methodology decisions as regional/local business units may offer products that are different to the rest of the group.

- ✓ **Ensure responsibilities between Internal Audit teams in different locations and the business are clear**, to avoid duplication and leverage work of other assurance providers in the assurance timeline.

Transition

Transition is one of the key working assumptions insurers are determining early in implementation. There are three main approaches which can be cross-sectioned across the business provided certain requirements are met.

- ✓ Internal Audit should **understand the process for determining and approving all working assumptions** including whether appropriate data was used and the right people in the business made the decisions.

Running parallel: Co-ordination with external audit

There have been varying levels of engagement with external auditors - the business should be leading this and agreeing expectations about what external audit will review and when with respect to methodology choices and decisions.

- ✓ Internal Audit should understand the **level of engagement between the business and external audit in respect of methodology papers** and whether this is sufficient to achieve implementation targets.

What should Internal Audit teams do now?

Action	Description
Understand what the business has already done	Make sure the business has identified the decision makers at group and, where applicable, subsidiary levels for determining accounting policy choices and governance processes for change mechanisms are in place, noting that these may currently be untested. In particular, IFRS 17 working assumptions should have been approved and IA should explore how the integrity of this process was maintained.
Gather information	To help evaluate the consistency of decision making between countries, business units or classes of business and understand whether reasons for differences are appropriate, auditors will need access to relevant information on an ongoing basis. Information may be in the form of simple or complex data, or more strategic in nature such as future acquisitions which may bring in new lines of business.
Assess IA capability	Assess whether IA has the right skills in the team to appropriately challenge the business and be confident whether appropriate information has been considered.

Contacts

Charlie Scarr
Senior Manager
IFRS 17 IA

Matt Cox
Partner
Insurance IA