Your Ref : C/FRSC
Our Ref : Lv004/16

By Post & Email (commentletters@hkicpa.org.hk)

22 January 2016

Ms Christina Ng
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Hong Kong Institute of Certified Public Accountants
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Dear Ms Ng

Invitation to Comment on IASB Exposure Draft ED/2015/11
Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4)

Thank you for your letter dated 14 December 2015 inviting us to comment on the subject matter.

We have received the following comment from one of our member companies:

<u>Question 1</u>

Agreed, IASB should seek to address these concerns due to the following key factors.

- The application of IFRS 9 requires the reclassification of some financial assets to be measured at fair value through profit or loss (FVTPL) while they are measured at amortised cost or fair value using available-for-sale (AFS) category under IAS 39.
- If the effective date of the new insurance contracts Standard is not same as IFRS 9, the insurance contracts may be measured on a cost basis while the financial assets that relate to those insurance contracts may be measured at FVTPL leading to additional accounting mismatches and temporary volatility in profit or loss.
- In addition, reassessment of the classification and measurement of financial assets would be required when adopting the new insurance contracts Standard resulting in an additional cost and effort on doing so in a short period of time.

<u>Question 2</u>

We agreed there should be both an overlay approach and a temporary exemption from applying IFRS 9 in order to address different perspectives which may encountered by reporting entities.

- The temporary exemption is an option for insurers to solve the accounting mismatch issue by deferring application of IFRS 9 although there are disadvantages that it will reduce the comparability in the accounting for financial instruments and it is likely that the reporting entity has to apply both IAS 39 and IFRS 9 simultaneously.
- The overlay approach is an alternative option that permits the insurers or other entities which could not adopt the temporary exemption (some entities have early adopted the IFRS 9) to address the issue about temporary accounting mismatches and volatility in profit or loss arising from application of IFRS 9 before the new insurance contracts Standard.

<u>Question 3</u>

(a) Agreed. The objective of overlay approach is to address the additional accounting mismatches and temporary volatility in profit or loss arising from the different effective dates of applying IFRS 9 and the new insurance contracts Standard. Therefore, the overlay adjustment should only be applied by an entity which issues contracts that are accounted for under IFRS 4 and which applies IFRS 9 in conjunction with IFRS 4.

Accordingly, the financial assets eligible for the overlay adjustment should be restricted to (i) those designated as relating to contracts that are in scope of IFRS 4; (ii) classified as at FVTPL under IFRS 9; and (iii) not classified as at FVTPL in their entirety under IAS 39.

(b) Agreed. For ease of comparison by the users of financial statements, the entity which applies the overlay approach may need to explain the effect of overlay adjustment in profit or loss either on the face of the statement of profit or loss or in the notes to the financial statements.

However, it is not necessary to restrict the presentation format. Instead, IASB should permit the entities to determine the presentation format that is most relevant to an understanding of the entity’s financial performance.

(c) No further comments.

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Question 4

(a) Agreed. The temporary exemption from applying IFRS 9 intends to address some insurers' request to defer the application of IFRS 9 until the new insurance contracts Standard is applied. Therefore, it is reasonable that only the entities whose predominant activity is to issue contracts within the scope of IFRS 4 are eligible for the temporary exemption.

(b) Agreed. It is a simple and transparent approach to assess the predominant activity by comparing the liabilities arising from contracts within the scope of IFRS 4 with the total carrying amount of liabilities of the entity.

(c) Agreed. Predominant activity should be assessed at the reporting entity level. It requires the entity which issues contracts within the scope of IFRS 4 to assess whether the entity as a whole qualifies as predominant activity and is eligible for the temporary exemption from applying IFRS 9. The reporting entity then determines whether to apply IFRS 9 or IAS 39. It is simpler for preparers to apply and users to understand the financial statements.

Question 5

(a) Agreed. The application of overlay approach and the temporary exemption from applying IFRS 9 should be optional. Some entities may not apply either overlay approach or temporary exemption because the profit and loss impact is immaterial. For example, some entities already use a current interest rate to discount their insurance contracts. Even though there is an impact to profit or loss, they could explain the effect of IFRS 9 in the financial statements to meet the needs of users of financial statements.

(b) Agreed. Entities should be allowed to stop applying the overlay approach or the temporary exemption from applying IFRS 9 from the beginning of any annual reporting period before the new insurance contacts Standards is applied because the entities may not qualify for applying the overlay approach or temporary exemption due to changes in eligibility and re-designation of financial assets subsequently.

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Question 6

We agree the temporary exemption should have an expiry date but disagree the expiry date is fixed at the annual reporting periods beginning on or after 1 January 2021.

The expiry date of application of the temporary exemption should be same as the effective date of the new insurance contracts Standard which is consistent with the objective that it permits the entities to avoid the additional accounting mismatches and temporary volatility in profit or loss arising from the application of IFRS 9 before the effective date of the new insurance contracts Standard.

We look forward to hearing your views on the observations set out above.

Yours sincerely

Selina Lau
General Manager - Communications & Committee

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