AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

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Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

07 February 2016

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on *ED/2015/11 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (proposed amendments to IFRS 4).*

Principal authors of this comment letter were Marietta Preiss, Andreas Rauter, Thomas Smrekar and Roland Nessmann. In order to assure a balanced Austrian view on the ED, the professional background of these authors is diverse.

GENERAL REMARKS

We appreciate the opportunity to comment on ED/2015/11 because in the interim period of having a new standard on Financial Instruments (IFRS 9) without having a finalised new standard on Insurance Contracts (IFRS 4 “phase 2”) we should be guided by principles which ensure a consistent application of existing accounting practices. Developing and applying a new accounting regime for insurance contracts has proven to be a challenging task that has taken more than a decade. From our point of view, work on IFRS 4 (“phase 2”) appears to be very close to completion and the transition ought to be a smooth one-time process in order not to confuse users of the financial statements and stakeholders of the industries involved.

AFRAC therefore welcomes the IASB proposals providing a temporary exemption from applying IFRS 9 but considers that the temporary exemption should be available to all entities that issue material insurance contracts within the scope of IFRS 4, in order to avoid an uneven playing field in the insurance sector. In AFRAC’s view the most transparent way would be to apply this exemption to all regulated insurance companies within a group. As material non-insurance activities, in particular banking activities, follow separate accounting rules there is no benefit in exempting only entities “*whose predominant activity is issuing contracts within the scope of IFRS 4*”. The temporary exemption should therefore be available at entity level, both at and below the reporting entity level. AFRAC therefore rejects the prerequisite of insurance business as “predominant activity”. As pointed out in more detail in the comments to Q 4 below, we see some difficulties with respect to the proposed disclosures.

AFRAC also welcomes the “overlay approach”, as this addresses the accounting mismatches resulting from applying IFRS 9 without delaying its implementation. Nonetheless, this approach may result in a short-term increase in complexity.

AFRAC therefore agrees with the IASB's proposal of a temporary exemption only, and with the proposed expiry date.

SPECIFIC REMARKS

QUESTION 1—ADDRESSING THE CONCERNS RAISED

Paragraphs BC9–BC21 describe the following concerns raised by some interested parties about the different effective dates of IFRS 9 and the new insurance contracts Standard:

(a) Users of financial statements may find it difficult to understand the additional accounting mismatches and temporary volatility that could arise in profit or loss if IFRS 9 is applied before the new insurance contracts Standard (paragraphs BC10–BC16).

(b) Some entities that issue contracts within the scope of IFRS 4 have expressed concerns about having to apply the classification and measurement requirements in IFRS 9 before the effects of the new insurance contracts Standard can be fully evaluated (paragraph BC17–BC18).

(c) Two sets of major accounting changes in a short period of time could result in significant cost and effort for both preparers and users of financial statements (paragraphs BC19–BC21).

The proposals in this Exposure Draft are designed to address these concerns. Do you agree that the IASB should seek to address these concerns? Why or why not?

AFRAC's comment:

(a) We believe that the IASB should seek to address these concerns.

(b) Due to the difference in implementation dates, accounting mismatches may occur which may confuse users of financial statements.

(c) Preparers may face unnecessary costs in implementing and adopting the two new standards (IFRS 9 and IFRS 4 ["phase 2"]) step by step. Without the final full picture on accounting for insurance contracts, early implementation steps may necessitate subsequent corrections.

QUESTION 2—PROPOSING BOTH AN OVERLAY APPROACH AND A TEMPORARY EXEMPTION FROM APPLYING IFRS 9

The IASB proposes to address the concerns described in paragraphs BC9–BC21 by amending IFRS 4:

(a) to permit entities that issue contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income some of the income or expenses arising from designated financial assets that:

(i) are measured at fair value through profit or loss in their entirety applying IFRS 9 but

(ii) would not have been so measured applying IAS 39 (the 'overlay approach') (see paragraphs BC24–BC25);

(b) to provide an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4 (the 'temporary exemption from applying IFRS 9') (see paragraphs BC26–BC31).

Do you agree that there should be both an overlay approach and a temporary exemption from applying IFRS 9? Why or why not?

If you consider that only one of the proposed amendments is needed, please explain which and why.

AFRAC's comment:

(a and b) AFRAC welcomes IASB's offering both the overlay approach and the temporary exemption from applying IFRS 9, as they are complementary solutions to the problems caused by different implementation dates of IFRS 9 and the new insurance contracts Standard. In AFRAC's view the temporary exemption is a huge benefit for both preparers and users of financial statements. This approach will allow a single coordinated switch once the IFRS 4 ("phase 2") is finally adopted. However, the proposed disclosure requirements in the interim will reduce this achievement without bringing proportionate benefits (see further comments Q4).

The overlay approach, which should be available to early adopters of IFRS 9, gives rise to some concerns, since this approach may result in additional complexity of financial statements in the short term (see further comments Q 3).

QUESTION 3—THE OVERLAY APPROACH

Paragraphs 35A–35F and BC32–BC53 describe the proposed overlay approach.

(a) Paragraphs 35B and BC35–BC43 describe the assets to which the overlay approach can be applied. Do you agree that the assets described (and only those assets) should be eligible for the overlay approach? Why or why not? If not, what do you propose instead and why?

(b) Paragraphs 35C and BC48–BC50 discuss presentation of amounts reclassified from profit or loss to other comprehensive income applying the overlay approach. Do you agree with the proposed approach to presentation? Why or why not? If not, what do you propose instead and why?

(c) Do you have any further comments on the overlay approach?

AFRAC's comment:

(a) and (b) AFRAC agrees that the assets described in Paragraphs 35A-35F should be eligible for the overlay approach. We also share the view on presentation of the reclassified amount in a separate line item. Practical guidance may be necessary on the details of presentation and documentation of the relevant adjustments.

However the overlay approach, which should be available to early adopters of IFRS 9, leads to some concerns since this approach may result in additional complexity of financial statements in the short term. The additional information provided by this approach is of limited relevance for users as long as the impact of IFRS 4 (“phase 2”) cannot be taken into account. The overlay approach does not necessarily remedy all the existing accounting mismatch arising from current accounting practice under IFRS 4 (“phase 1”).

c) In addition, we doubt that the limited benefit of applying the overlay approach justifies the additional costs caused by this parallel approach (maintaining IFRS 9 and IAS 39 sub-ledgers).

QUESTION 4—THE TEMPORARY EXEMPTION FROM APPLYING IFRS 9

As described in paragraphs 20A and BC58–BC60 the Exposure Draft proposes that only entities whose predominant activity is issuing contracts within the scope of IFRS 4 can qualify for the temporary exemption from applying IFRS 9.

(a) Do you agree that eligibility for the temporary exemption from applying IFRS 9 should be based on whether the entity’s predominant activity is issuing contracts within the scope of IFRS 4? Why or why not? If not, what do you propose instead and why?

As described in paragraphs 20C and BC62–BC66, the Exposure Draft proposes that an entity would determine whether its predominant activity is issuing contracts within the scope of IFRS 4 by comparing the carrying amount of its liabilities arising from contracts within the scope of IFRS 4 with the total carrying amount of its liabilities (including liabilities arising from contracts within the scope of IFRS 4).

(b) Do you agree that an entity should assess its predominant activity in this way? Why or why not? If you believe predominance should be assessed differently, please describe the approach you would propose and why.

Paragraphs BC55–BC57 explain the IASB’s proposal that an entity would assess the predominant activity of the reporting entity as a whole (ie assessment at the reporting entity level).

(c) Do you agree with the proposal that an entity would assess its predominant activity at the reporting entity level? Why or why not? If not, what do you propose instead and why?

AFRAC’s comment:

(a-c) We do not agree with the proposed determination of the eligibility for the temporary exemption on a predominance basis. As the temporary exemption from applying IFRS9 helps mitigate all negative effects of the misalignment of the effective dates of IFRS 9 and the new insurance contracts Standard, AFRAC considers that it should be available to all entities undertaking insurance activities, so as to avoid damaging the level playing field in the insurance sector.

We do not see the relationship of liabilities arising from contracts within the scope of IFRS 4 to total liabilities as by itself a proper test of substantial insurance activities. A more qualitative assessment of an entity's operations in terms of "running a business with insurance activities" appears more appropriate than focusing on the "predominant activity".

By default, any regulated insurance entity should be allowed to apply this exemption without any further test of activities. This can be done partially (entity by entity) within a group.

We also wish to emphasise that we strictly reject the disclosure requirements of the proposed article 37A (c) and (d): whereas (c) would at least determine the implementation of the classification requirements of IFRS 9 within the entity taking the advantage of the temporary exemption, (d) determines the connection of the respective financial assets with their relevant credit risk rating grades as defined in IFRS 4. We doubt that the benefit of applying the temporary exemption justifies the additional costs caused by this parallel approach (maintaining IFRS 9 and IAS 39 sub-ledgers in order to be able to calculate the correct figures, which have to be audited).

QUESTION 5—SHOULD THE OVERLAY APPROACH AND THE TEMPORARY EXEMPTION FROM APPLYING IFRS 9 BE OPTIONAL?

As explained in paragraphs BC78–BC81, the Exposure Draft proposes that both the overlay approach and the temporary exemption from applying IFRS 9 would be optional for entities that qualify. Consistently with this approach, paragraphs BC45 and BC76 explain that an entity would be permitted to stop applying those approaches before the new insurance contracts Standard is applied.

(a) Do you agree with the proposal that the overlay approach and the temporary exemption from applying IFRS 9 should be optional? Why or why not?

(b) Do you agree with the proposal to allow entities 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 contracts Standards is applied? Why or why not?

AFRAC's comment:

(a) AFRAC agrees with the proposal to offer both the temporary exemption and the overlay approach on an optional basis.

(b) AFRAC further agrees to allowing entities to stop applying the overlay approach or the temporary exemption from applying IFRS 9 before the effective date of the new insurance contracts Standard, because no entity should be prevented from benefiting from the improvements brought by IFRS 9 when its circumstances permit it to do so.

QUESTION 6—EXPIRY DATE FOR THE TEMPORARY EXEMPTION FROM APPLYING IFRS 9

Paragraphs 20A and BC77 propose that the temporary exemption from applying IFRS 9 should expire at the start of annual reporting periods beginning on or after 1 January 2021.

Do you agree that the temporary exemption should have an expiry date? Why or why not?

Do you agree with the proposed expiry date of annual reporting periods beginning onor after 1 January 2021? If not, what expiry date would you propose and why?

AFRAC's comment:

(a) AFRAC agrees that the temporary exemption from applying IFRS 9 should have an expiry date, as this constitutes a strong incentive for all parties involved to finalise the insurance contracts Standard as quickly as possible.
(b) AFRAC also agrees that the expiry date should be for reporting periods beginning on or after 1 January 2021 or earlier, because we expect that the effective date of the new insurance contracts Standard will be no later than 1 January 2021.

Kind regards,
Romuald Bertl,
Chairman