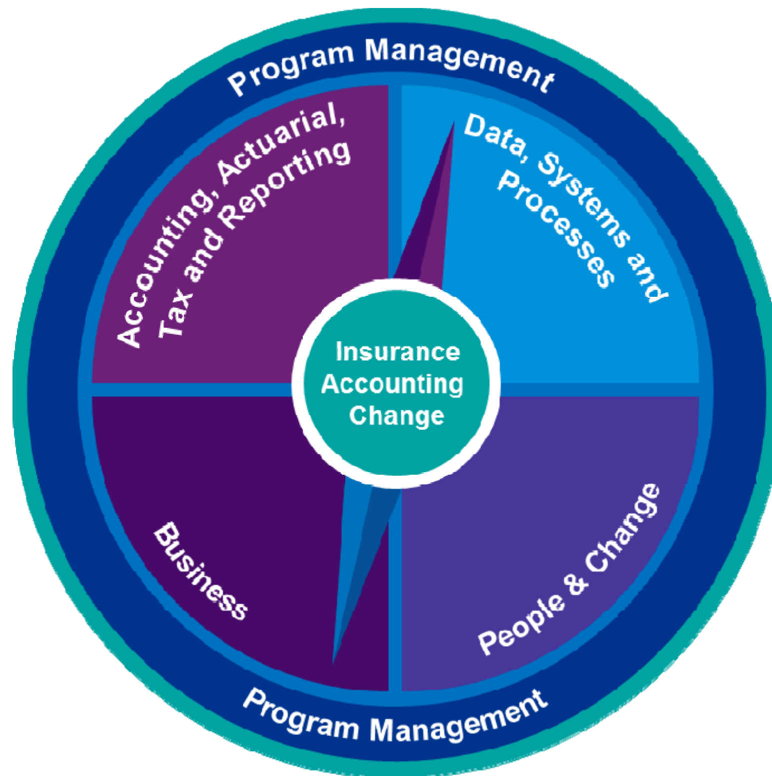
Accounting & Tax Update

CIAA Annual Conference
September 19, 2017

This session's objectives



A quick look at what's coming

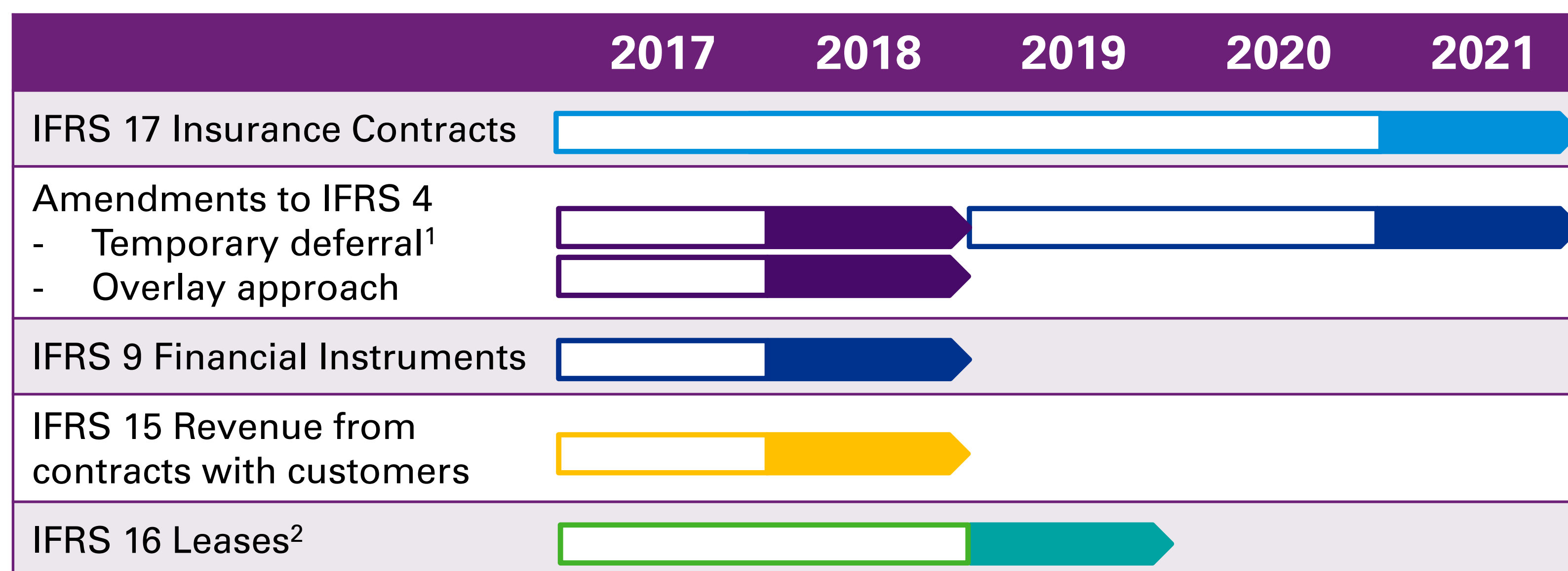
IFRS 17: In-depth

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

A quick look at what's coming

Forthcoming standards and regulations

Canadian P&C insurers have a number of accounting changes on the horizon:



1. OSFI's Advisory (March 2017) narrows the range of practice for federally regulated life insurers who meet the predominance test, but leaves the full range of practice available for P&C insurers.
2. Early application of IFRS 16 *Leases* is permitted only for companies that also apply IFRs 15 *Revenue from Contracts with Customers.*

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

A quick look at what's coming

Amendments to IFRS 4 *Insurance Contracts*

Key facts

- In September 2016, the IASB responded by releasing amendments to IFRS 4 providing two optional solutions:
  - A temporary exemption to IFRS 9; and
  - An overlay approach to presentation.
- Temporary exemption is applied at the reporting entity level, therefore there are implications where entities within a group are not eligible to apply or are eligible and choose not to apply. (see chart)
- OSFI's Advisory (March 2017) is silent on P&C insurers – leaving the full range of practice open.
- The amendments are effective for reporting periods beginning on or after January 1, 2018

Case Study: Applying the temporary exemption within a group

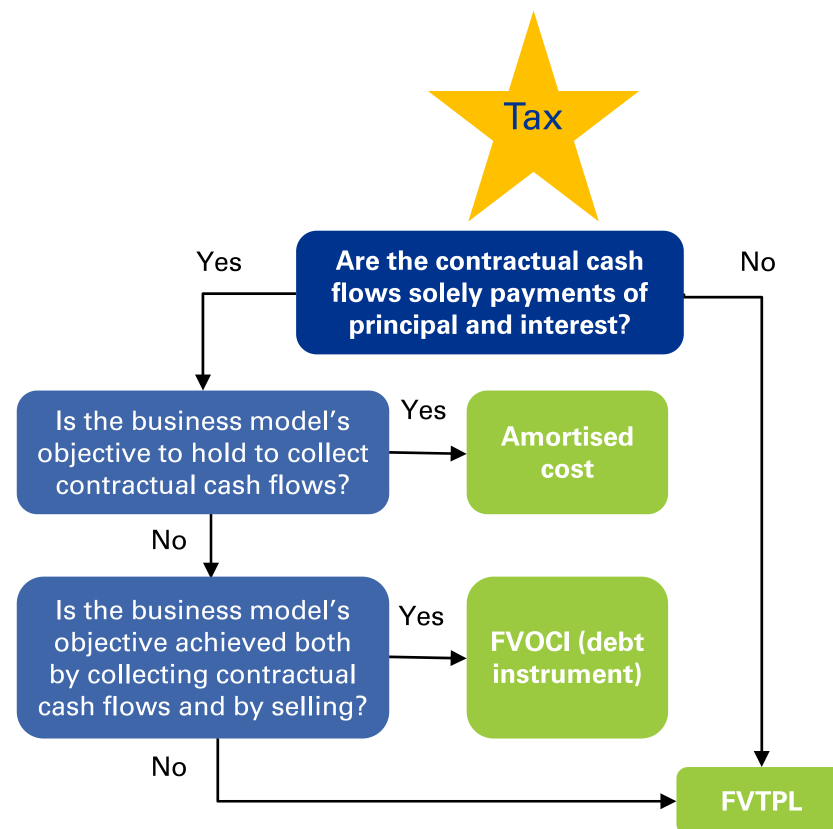
Facts and Circumstances		Considerations
Parent	Activities are considered predominantly connected with insurance and qualifies for the temporary exemption.	-Eligible to apply the temporary exemption in its consolidated financial statements -Costs and complexities of multiple reporting bases for subsidiaries which are not eligible.
Sub 1	Issues stand-alone financial statements and its activities are not 'predominantly connected with insurance'	-Has to apply IFRS 9 in its stand-alone financial statements. -If A elects to apply the temporary exemption, then will report its results applying IAS 39 for group reporting purposes
Sub 2	Does not issue stand-alone financial statements and its activities are 'predominantly connected with insurance'.	-Provides information to A consistent with A's accounting policies for group reporting purposes.

What to think about today

- Costs and complexities of each option, including:
  - Number of reporting bases (by entity)
  - Understandability and comparability with peers
  - Amount and timing of resources to implement IFRS 9 or the Amendments
- Required disclosure (within annual and quarterly statements) under each option:
  - Standards issued but not yet effective (IAS 8)
  - IFRS 4 amendments, note: there are differing disclosures requirements for each amendment; and
  - IFRS 9, as for some entities, this may be easier than operationalizing the Amendments
- Interaction of IFRS 9 with IFRS 17

A quick look at what's coming

IFRS 9 Financial Instruments



Key facts

- The IASB's IFRS 9 *Financial instruments* includes:
  - Revised guidance on the classification and measurement of financial instruments;
  - A new expected credit loss model for calculating impairment; and
  - Supplements the general hedge accounting requirements published in 2013.
- The standard will be **effective for annual periods beginning on or after January 1, 2018**, unless an entity chooses to adopt one of the Amendments to IFRS 4 (previous slide).
- OSFI has issued an exposure draft to amend guideline D-10 in response to IFRS 9

What to think about today

- Interaction with IFRS 17, including:
  - Current and future designation of assets held to back insurance contract liabilities;
  - Current and future designation of surplus assets.
- System and process changes to implement IFRS 9 classification guidance, including identification of assets which do not meet the SPPI test
- Where financial assets are classified as amortised cost or FVOCI, implementation of the ECL model for calculating impairment, including any simplifications (e.g. low credit risk)
- If adopting in 2018, new disclosures, including those required for transition and going forward
- If adopting the Amendments to IFRS 4, disclosures required for standards issued but are not yet effective (IAS 8)

KPMG

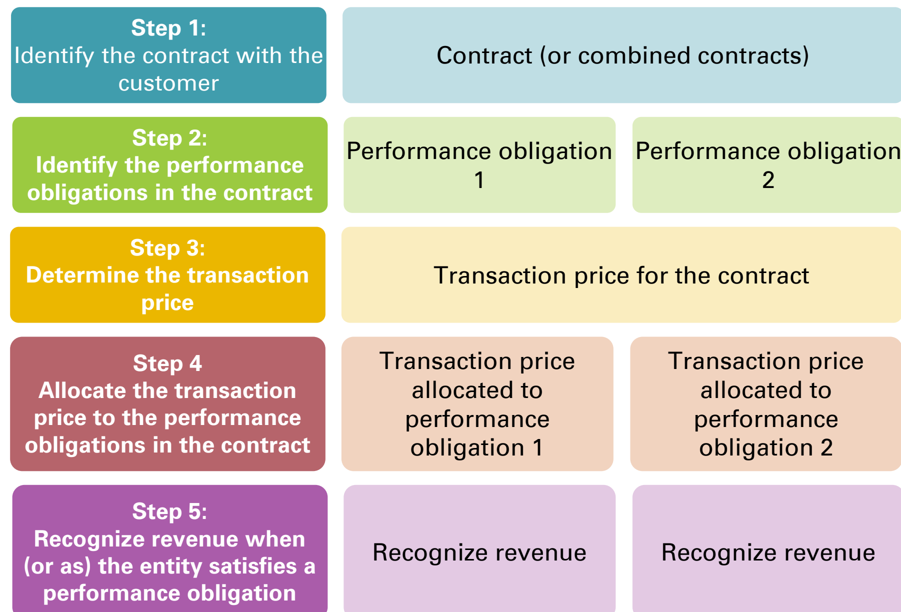
© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

A quick look at what's coming

IFRS 15 *Revenue from contracts with customers*

IFRS 15 Highlights

- The new standard replaces substantially all of the current revenue recognition guidance in both IFRS and US GAAP, excluding contracts that are out of scope.
- The model features a contract-based five-step analysis of transactions to determine whether and how much and when revenue is recognized.
- A contract with a customer may be partially in the scope of the new standard and partially in the scope of other accounting guidance.
- The standard will be effective for annual periods beginning on or after January 1, 2018.



What to think about today

- What is the impact on non-insurance operations (e.g. insurance broking, claims handling, custody services, etc.), including:
  - unbundling of performance obligations to provide goods or non-insurance services from insurance contracts;
  - timing of revenue recognition for up-front fees;
  - deferral and amortisation of costs for non-insurance contracts or components; and
  - measurement and timing of recognition for variable consideration.
- Disclosures required for standards issued but are not yet effective (IAS 8), including consideration of OSC's recent non-authoritative guidance

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

A quick look at what's coming

IFRS 16 *Leases*

Key facts

— Dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases is gone, IFRS 16 requires organisations to bring most leases on-balance sheet, recognising new assets and liabilities.

— Leases will now be accounted for as if the organization had borrowed funds to purchase an interest in the leased asset

— Practical expedients relating to leases of low value items and short term leases may reduce compliance costs and ease the burden of implementation

— Effective for annual reporting periods beginning on or after January 1, 2019.

Balance sheet

Asset

= 'Right-of-use' of underlying asset

Liability

= Obligation to make lease payments

P&L

Lease expense

+ Depreciation

+ Interest

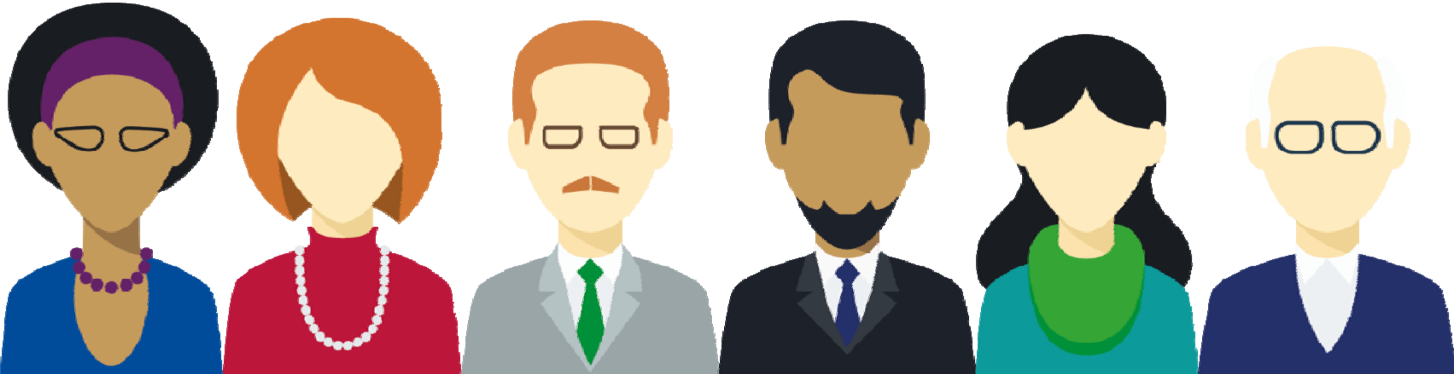
What to think about today

- Generating an inventory of leases, classifying each under the new model and determining whether the practical expedients are relevant
- Calculating the impact on capital and forecasting the likely impact on KPIs (e.g. EBITDA) as leases will no longer be charged to profit on a straight-line basis over the life of a lease, they will be reflected as depreciation and interest
- Bringing operating leases on-balance sheet will make lessees appear more asset-rich but also more heavily indebted, which may affect debt covenants or regulatory capital (MCT).
- Disclosures required for standards issued but are not yet effective (IAS 8), including consideration of OSC's recent non-authoritative guidance

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Questions?



KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

IFRS 17: In Depth

Why is this important?

- **It will give users of insurers' financial statements a whole new perspective.**
- **Potential for greater volatility in financial results and equity.**
- **May result in more than just accounting changes.**

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

The changes could significantly affect insurers'…

Profitability patterns

Volatility of financial results and equity

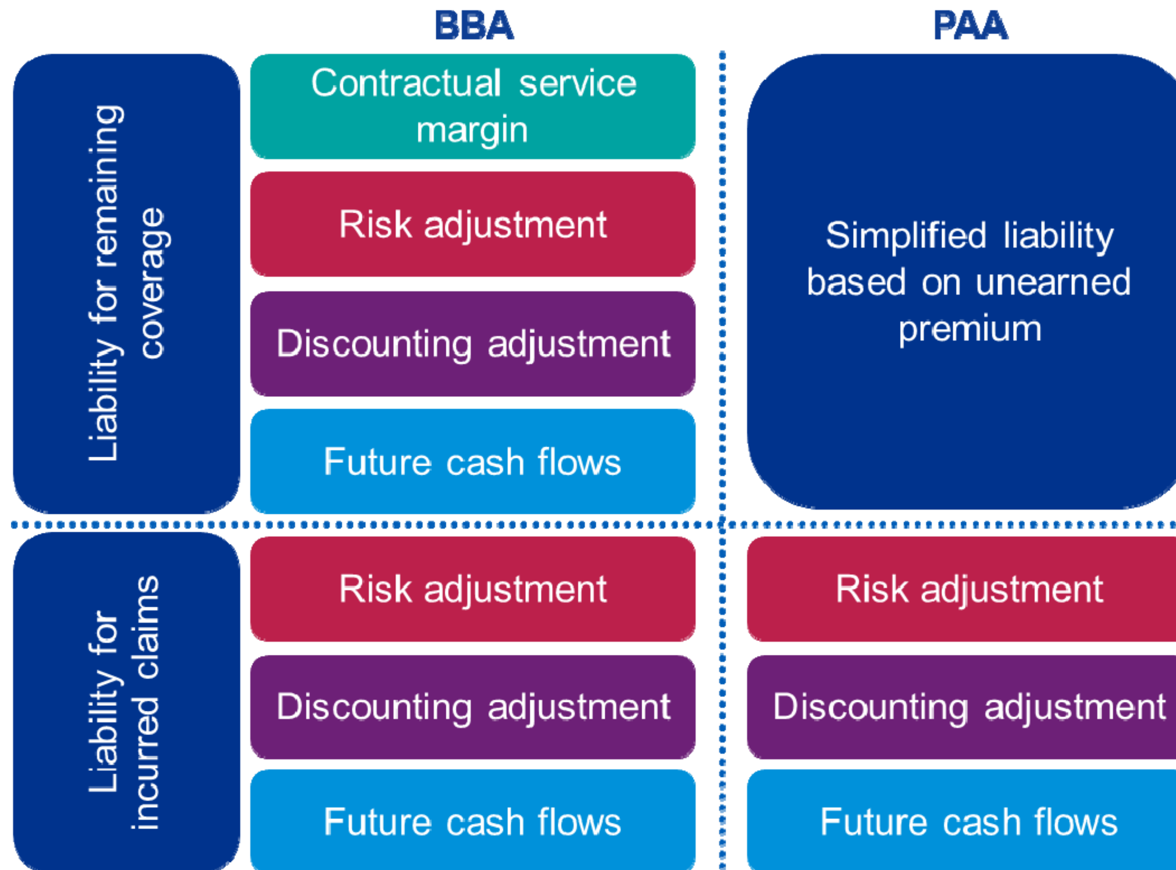
Level of transparency about profit drivers

Equity levels

The magnitude of the accounting change for life and non-life insurers will be different

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Measurement model



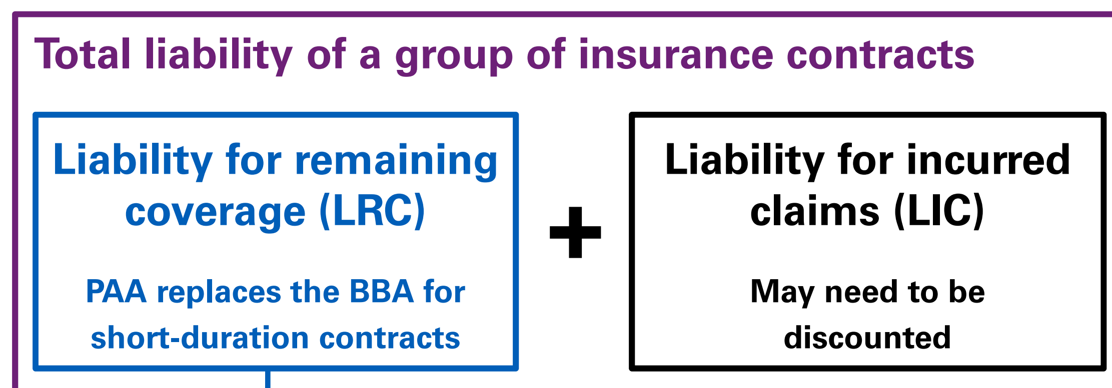
* The use of the Premium Allocation Approach (PAA) permits not discounting the claims liability if those cash flows are expected to be paid or received in 1 year or less.

KPMG

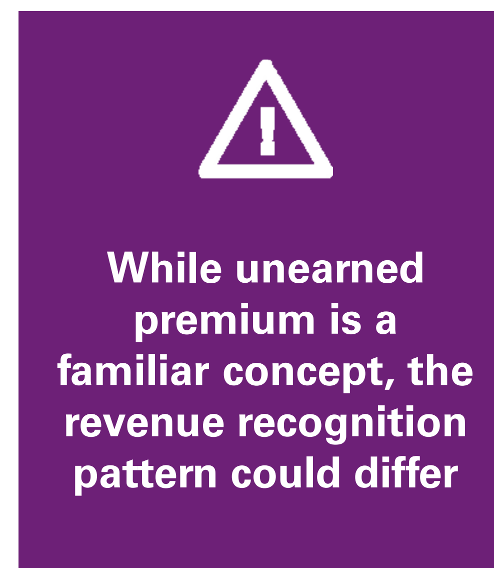
© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Premium allocation approach (PAA)

The PAA is an optional, simplified model for measuring the LRC



Premium is recognised over time as revenue unless release of risk follows a different pattern



© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Significant policy decisions for P&C insurers

Accounting for non-life insurers may have similarities to current practice but major impacts may arise around…

Qualifying for the PAA

Presentation of insurance finance income or expense in profit or loss or in OCI

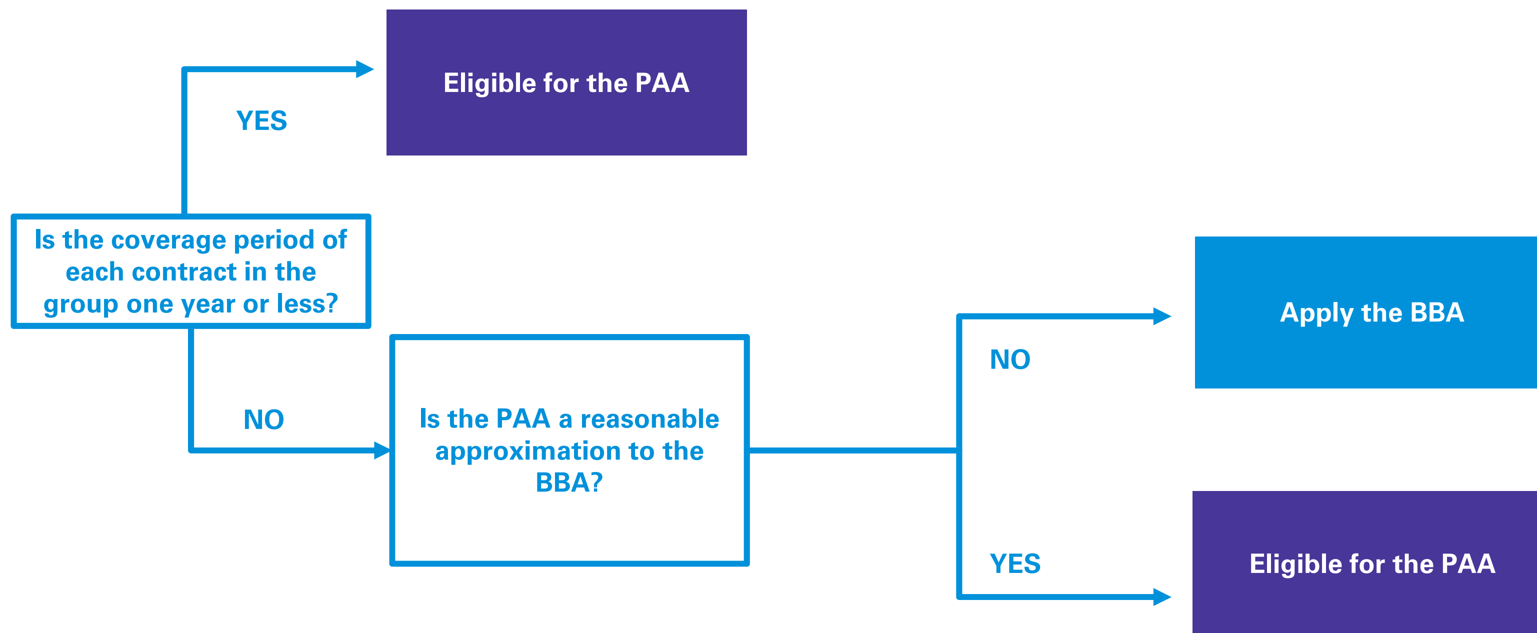
Level of Aggregation (Onerous contracts)

Recognising insurance revenue

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

When can the PAA be applied?



KPMG
© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

What does it look like?

Insurers can choose whether to present the effect of changes in financial risk in profit & loss, or partially in profit & loss and partially in OCI:

IFRS 4	
Premiums	X
Investment income	X
Incurred claims	(X)
Change in insurance contract liabilities	(X)
Profit or loss	**X**
Other comprehensive income	X
Comprehensive income	**X**

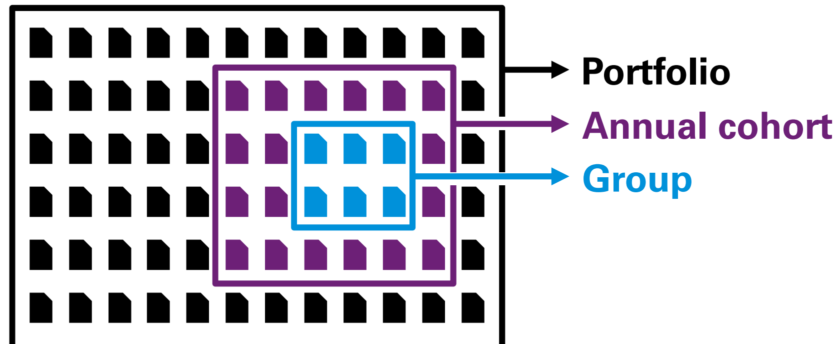
IFRS 17	
Insurance revenue	X
Incurred service expenses	(X)
Insurance service result	**X**
Investment result	X
Insurance finance expenses	(X)
Net finance result	**X**
Profit or loss	**X**
Other comprehensive income	**X**
Comprehensive income	**X**

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Level of aggregation (BBA)

The CSM is determined for groups of insurance contracts



Insurers will need to account for their business performance at a more granular level

IFRS 17 limits offsetting of onerous contracts against profitable ones

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Level of aggregation (PAA)

The requirements are consistent with those under the BBA.

HOWEVER:

- **It is assumed that no contracts in the portfolio are onerous at initial recognition unless facts and circumstances indicate so.**

- **Whether contracts have no significant possibility of becoming onerous subsequently is based on the likelihood of changes in applicable facts and circumstances.**

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Recognising insurance revenue under the PAA

Insurance revenue is derived from the expected premium receipts.

The allocation to each period of coverage is based on the passage of time.

HOWEVER, if the pattern of release of risk significantly differs from the passage of time, the allocation is based on the expected timing of incurred insurance service expenses.

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

For reinsurance contracts held…

The GMM and PAA still apply, with modifications.

Reinsurance contracts held are accounted for separately from the underlying direct contract(s).

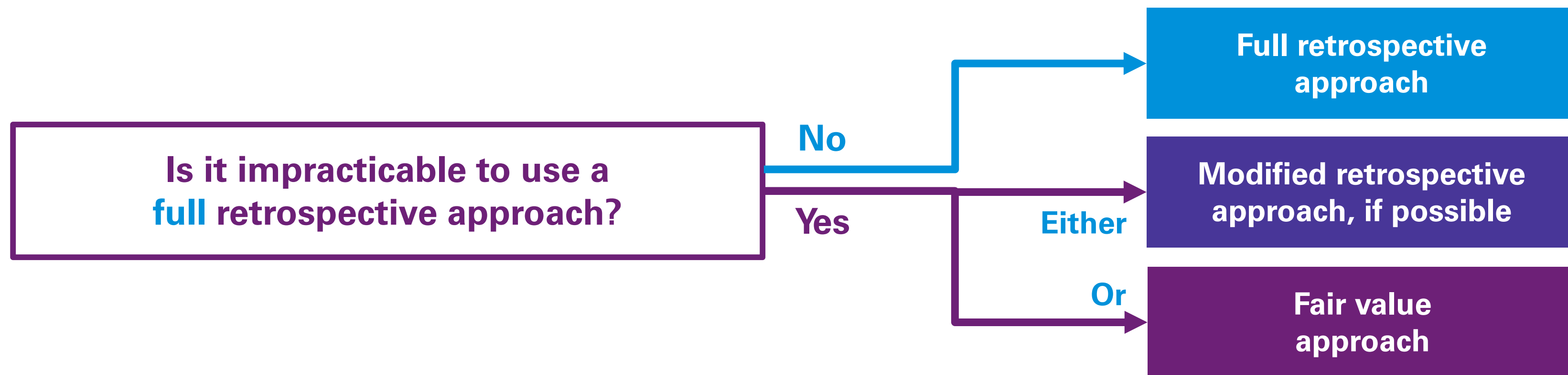
Reinsurance gain or loss is recognised as reinsurance services are received.

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Full retrospective approach is required…

… but expedients can be used

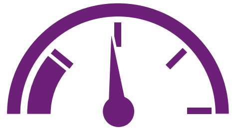


A company can apply different approaches for different groups

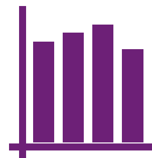
KPMG
© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Disclosures

Information should be disclosed at a level of granularity that helps users assess the effects contracts have on…



Financial position



Financial performance

Cash flows

New disclosures relate to expected profitability and attributes of new business

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Other tax considerations

- **DAC & inclusion of certain elements of overhead costs**
- **Current P&C reserve deduction is at 95% --> should it be consistent with Life reserve deduction at 100%**
- **Canadian Investment Fund (CIF) for branches**
  - Calculation of CRL
  - Impact of time value of money on UPR (if applicable)
- **Ontario CMT**
- **Premium tax**
- **Provincial allocation**

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Next steps

Fundamental operational challenges lie ahead and there isn't much time

Entities can start by…

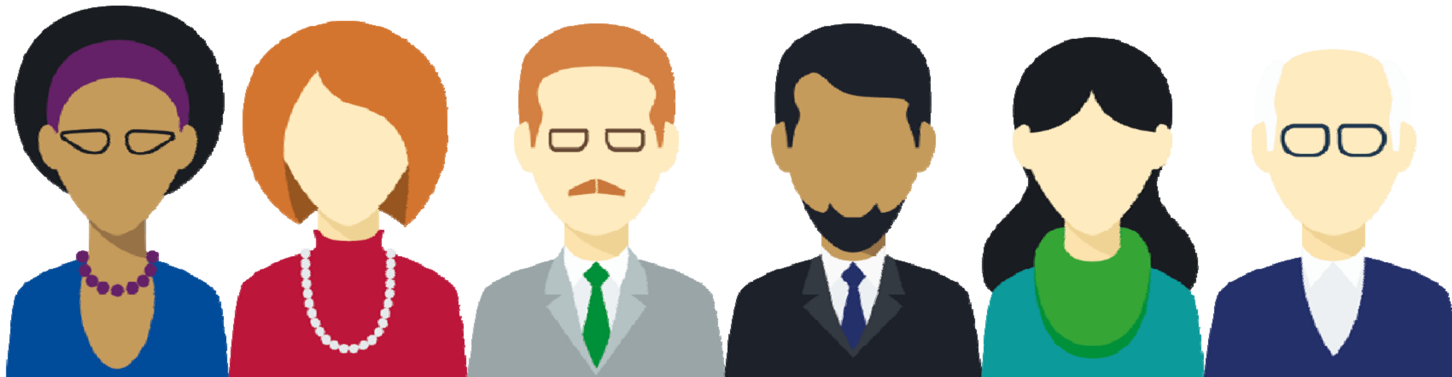
- ☑ Completing an initial assessment
- ☑ Reviewing their contracts
- ☑ Planning accounting policy decisions
- ☑ Determine their needs for systems, processes and resources

Effective date

KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

What are your peers doing?



KPMG

© 2017 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

kpmg.ca

© 2016 KPMG LLP, a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.