IFRS 17 Insurance contracts

Impact on organisations that are not insurance companies

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Summary

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The standard applies to all insurance contracts no matter who issues them. So, NHS bodies will need to demonstrate that they have considered the new standard and have satisfied themselves that they have not issued any insurance contracts.

This briefing sets out how NHS bodies might want to approach the adoption of the new standard.

Executive summary

NHS bodies will be required to apply international financial reporting standard (IFRS) 17 Insurance contracts from 1 April 2025.

The standard was developed to bring consistency to the way that insurance companies account for insurance contracts. An insurance contract is a contract where the issuer agrees to take on the risk of something happening in the future that will cost money to fix or resolve, in return the policy holder pays a fee for the insurance coverage. This makes more sense when considered in relation to common examples of insurance contracts such as car insurance – the insurer takes on the risk that the policy holder will be in an accident or that their car is stolen, both of these incidents will cost money if they occur but there is a good chance that they will not occur.

The new standard does not affect accounting by insurance policy holders as they expense the fee as it is incurred. However, until now, there has been no accounting standard that sets out how the issuers of insurance contracts should account for the transaction which means that issuers have determined their own approach to income recognition and how profits are calculated. IFRS 17 standardises the approach to how insurance policies are accounted for to allow for comparability between organisations.

The standard applies to all insurance contracts no matter who issues them. So, NHS bodies will need to demonstrate that they have considered the new standard and have satisfied themselves that they have not issued any insurance contracts. This is unlikely but is not something that would have been considered or documented under the current arrangements as the accounting treatment would have been determined based on the terms of the contract and extant accounting standards. From 1 April 2025, IFRS 17 must be applied to all insurance contracts. This standard has to be adopted retrospectively so all contracts, not just ones issued after 1 April 2025 need to be considered.

This briefing sets out how NHS bodies might want to approach the adoption of the new standard.

Introduction

IFRS 17 *Insurance contracts*[1] was published by the International Accounting Standards Board (IASB) in May 2017 and subsequently amended in June 2020 and December 2021.
IFRS 17 will be adopted by HM Treasury into the *Financial reporting manual* (FReM)[2] from 1 April 2025 and it will therefore be included in the Department of Health and Social Care's Group accounting manual (GAM) for 2025/26.

How does this differ from current arrangements?

IFRS 17 sets out the principles for the recognition, measurement, presentation and disclosure of insurance contracts and replaces the previous standard, IFRS 4. IFRS 4 was always intended to be a stop gap until the IASB completed its project on insurance contracts and issued IFRS 17. The definition of an insurance contract remains largely unchanged, but IFRS 4 permitted entities to use a wide variety of accounting practices for insurance contracts.

Under the stricter requirements of IFRS 17, finance teams will have to split the profit from the insurance element of the contract from the rest of the contract income. This profit is derived from the income less the risk-adjusted present value of future pay-outs. In essence, when the issuer enters into an insurance contract then the whole contract value should not be recognised as income in year because some of this income could be returned to the policy holder if the insured event happens. The present value of the potential payment, subject to a probabilistic estimate of the event happening, should be expensed as 'insurance service expense' and recognised, in the statement of financial position, as an 'insurance contract liability'.

It is the change in accounting treatment under the new standard that means that it will be important to identify insurance contracts. Under IFRS 4, as the accounting treatment was not mandated, it was less important to identify insurance contracts. This is similar to the need to identify all leases under IFRS 16 when, prior to that, the accounting treatment for operating leases made it less important to identify them as leases.

While IFRS 17 will mostly impact insurance companies, it applies to contracts rather than organisations, so will have to be applied to any agreement that meets the definition of an insurance contract. NHS bodies are unlikely to be the issuer of an insurance contract however they cannot simply make that assumption. Finance teams will have to assure themselves that due consideration has been given to contracts that may include an insurance element. Evidence of such consideration should be maintained for presentation to auditors, to prevent challenges and issues at year end.

Once insurance contracts have been identified they will have to be revisited each year to review assumptions, including risks and probabilities of the insured event happening.

This briefing sets out the practical steps NHS bodies should be taking now as well as highlighting the issues that will need to be considered when applying the standard for the first time. The briefing focuses on identifying insurance contracts rather than working out the accounting for them. As there is not expected to be any impact on policy holders, this briefing only considers the new standard from the perspective of the insurer.

Summary of IFRS 17

The standard establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts, in the accounts of the issuer. This is intended to allow users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. IFRS 17 applies to all contracts that meet this definition, whether the issuer is an insurance company or not.

Key definitions

IFRS 17 includes the following key definitions:

Insurance contract -a contract under which one party (**the issuer**) 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.

Issuer - IFRS 17 does not define the issuer but it is the party issuing an insurance contract to the policyholder.

Insurance risk - risk other than **financial risk**, transferred from the holders of a contract to the issuer.

Significant insurance risk - insurance risk is significant if, and only if, an insurance event could cause the issuer to pay additional amounts that are significant in any single scenario. Significant insurance risk can still exist if the insured event is extremely unlikely, or even if the expected (i.e. probability-weighted) present value of the contingent cash flows is a small proportion of the expected present value of the remaining cash flows from the insurance contract.

Financial risk - gains or losses resulting from movements in interest rates, commodity prices or indices (e.g. losing money on an investment, due to changes in interest rates).

Policyholder - the party receiving the insurance contract, which agrees to compensate them if a specified uncertain future event occurs.

Insured event - an uncertain future event covered by an insurance contract that creates insurance risk.

IFRS 17, appendix A, includes a more comprehensive list of definitions. This briefing is not intended to provide a substitute for reading the full standard. It is intended to focus readers on the important considerations and highlight areas where insurance contracts may be found.

What constitutes an insurance contract?

There are many everyday examples of insurance contracts that individuals enter into in their personal lives as well as those that NHS bodies enter into. NHS finance staff are more likely to be familiar with being the policy holder rather than the issuer of an insurance contract in both their professional and personal lives.

Everyday examples of insurance contracts include roadside assistance and washing machine repair and maintenance contracts. Effectively, these are contracts for insurance against breakdowns of vehicles or equipment.
The breakdown of the vehicle or equipment is uncertain as to whether or when it will occur. When it does occur it adversely affects the customer (policy holder) and the service provider (the issuer of the contract) compensates the customer for that adverse effect. It is important to note that the risk, of the vehicle or equipment breaking down, existed before the contract to cover the risk.

HM Treasury has scoped out a number of contracts from the standard and these are listed in the section ‘contracts scoped out of IFRS 17’, below.

Impact of IFRS 17 on NHS bodies

The key question for NHS bodies is whether they have entered into any contracts where they are the issuer of an insurance contract. To determine whether a contract falls within the definition of an insurance contract under IFRS 17, NHS bodies need to ask the following questions:

- Is there a contract – an agreement between two or more parties that creates enforceable rights and obligations? Contracts can be written, oral or implied by business practices.
- Will the arrangement require the NHS body to compensate the policyholder for a specified uncertain future event? This amount should be significant in any single scenario however remote. For example, if there is a 99% chance that the risk will not materialise or, if it does, will only cost £100 in compensation but a 1% chance that the compensation will be £10m then this is a significant risk. The insured event must also cause the issuer to suffer a loss on a present value basis.
- Will that specified uncertain event adversely affect the policyholder?
- Has the NHS body accepted the transfer of significant insurance risk from the policyholder? This means that the risk must be a risk to which the policy holder was already exposed, it must not be a risk established only by the contract.

NHS contracts review

The issuer of an insurance contract will be paid for providing that insurance cover. Therefore, when developing this briefing, we have reviewed provider trust accounts consolidation (TAC) forms to identify common sources of income and consider whether IFRS 17 could apply to these contracts. Those sources of income that could include an insurance contract are considered below.

This list not exhaustive – it is intended to set out a framework for assessing whether the NHS body has issued any insurance contracts. Any contracts that generate 'other income' should be considered against IFRS 17 on a contract by contact basis.

The conclusion in each of these examples is that there is unlikely to be an insurance contract as one, or more, of the tests are not met.

NHS standard contract

The majority of NHS providers' income is for the provision of NHS healthcare under the NHS standard contract.

Does this meet the definition of an insurance contract?

HM Treasury's *IFRS 17 insurance: application guidance*[3] excludes services provided as a result of legislation and regulations. The example given in is the provision of healthcare by the NHS free at the point of delivery. This exclusion is on the basis that legislation and regulations are not contractual agreements between the government and specific individual citizens or businesses. Consequently, NHS standard contracts between commissioners and providers are not insurance contracts and they are effectively scoped out of IFRS 17.

Private patient income

Some NHS bodies provide healthcare to patients who pay for that care rather than receive it as an NHS patient.
Private patient treatment by NHS bodies funded in three ways:

- paid for directly by the patient
- paid for by an employer or a foreign government
- funded via private health insurance.

Is there are pre-existing risk?	Will that risk adversely affect the policy holder?	Is the risk transferred by the policy holder to the issuer by the contract?
There is a pre-existing risk that people will experience illness or injury that they will seek to be privately treated by an NHS body. This is basically the risk that people will get ill.	Illness or injury will, by its very nature, adversely affect the policy holder.	NHS bodies only provide private healthcare to people once they need healthcare and as long as it is being paid for in one of the three ways listed in the first column. The contract for the provisions of healthcare does not transfer the pre-existing risk to the NHS body. Therefore, this test is not met.
Once the private patient is being treated by the NHS body, there is a risk of harm as a result of that treatment. This risk only exists because of the private patient contract so this test is not met.	Harm while in NHS care would adversely affect the patient.	This risk is part of the contract for private patient treatment rather than transferred by the contract. This test is not met.

Overseas visitor income

Similarly, to private patient income, overseas visitor income is funded directly by the patient or by a foreign government.

The answers in this case are the same as for private patient income:

- NHS bodies do not contract with individuals, whether based in the UK or overseas, to provide healthcare in the event that they need it in the future.
- Instead, NHS bodies enter into arrangements to treat individuals once they have fallen ill or are in need of healthcare, provided that they can pay for this treatment if they are not entitled to free NHS care or they have chosen to pay for private healthcare.
- The contract between the NHS body and the patient is for the provision of services once the need for those services arises rather than providing insurance against a

future risk that may or not occur.

Research and development income

There are many types of research and development arrangements. Some will not be contracts, but some will be.

This example is for an arrangement where a drug company pays an NHS trust to run a clinical trial. The NHS body is contracted to administer a drug to a cohort of patients or volunteers and perform associated tests for a sum of money.

Is there are pre-existing risk?	Will that risk adversely affect the policy holder?	Is the risk transferred by the policy holder to the issuer by the contract?
There is the risk that one of the trial participants will contract the disease, particularly if the trial is being run on healthy volunteers. However, the risks only arise as a result of the trail so the requirement for the risks to be pre-existing is not met.	Contracting the disease will adversely affect the policy holder.	The risk of catching the disease is transferred to the NHS body but this is not a pre-existing.
There is a risk that the trial will fail, and the drug does not treat the illness.	If the trial fails, then the drug company will not have a product to sell which is an adverse outcome. However, they may have learned from the trial anyway.	This risk is not transferred to the NHS body as the work was to run the trial. This risk is therefore not transferred by the contract.
With any trial, there is a risk that it causes harm to the patients or volunteers. This risk only exists because of the trial and the contract to run the trial so it is not a pre-existing risk.	If the trial causes harm, this will adversely affect the drug company and, possibly, the NHS body as well as the individual concerned.	The contract is to run the trial, depending on the terms of the arrangement and the reason for the harm, the NHS body may be liable.

Contingent liabilities

The other area of the accounts that may include arrangements that meet the definition of an insurance contract is the contingent liability disclosure. Both are liabilities that will crystallise when something happens in the future.

In this context, the part of the definition of a contingent liability set out in IAS 37 *Provisions, contingent liabilities and contingent assets* [3] is:

> 'a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity'

Very few NHS bodies currently disclose contingent liabilities in their accounts and, in 2021/22, only seven NHS providers disclosed contingent liabilities of over £1m. Most of those liabilities relate to either employment tribunal cases or, more often, land sales or financing arrangements for property.

The implementation of IFRS 17 is likely to increase the scrutiny of contingent liabilities by both regulators and auditors. NHS bodies may want to review their arrangements for identifying contingent liabilities ahead of the implementation of IFRS 17. Contracts relating to land and asset sales that have contingent clauses should be reviewed.

HM Treasury's *Managing public money*[4] requires that all contingent liabilities that are novel, contentious or repercussive are approved in advance as well as those with a maximum disclosure of £3m. According to *Managing public money* (paragraph A5.4.20) public sector bodies may take on liabilities by:

- issuing guarantees, usually of loans
- writing a letter or statement of comfort
- providing an indemnity.

HM Treasury's *Contingent liability approval framework* [5] indicates that there are four types of contingent liability that government departments are most likely to enter into:

- guarantees - when an entity agrees to pay the debts of a third party if they default
- indemnities - when an entity agrees to cover costs if a certain event occurs
- legal cases - when a lawsuit is brought against the entity
- purchaser protections - where the entity provides warranties relating to asset sales.

Contingent liabilities will not all meet the definition of an insurance contract, but they should be reviewed in the context of IFRS 17 as well as IAS 37.

Contracts scoped out of IFRS 17

The IASB has stated that an entity shall not apply IFRS 17 to:

- financial guarantee contracts, for example, agreeing to make payments to a car leasing company if an employee leaves the organisation and does not return the car or keep up repayments. Effectively, this is not an insurance contract because the employer is standing as a guarantor for their employee in the event of non-payment. This differs from an insurance contract which, for example, covers the car, in the event of damage caused by an accident or natural disaster. HM Treasury has mandated that financial guarantee contracts are accounted for in accordance with using IAS 32 *Financial instruments presentation*, IFRS 7 *Financial instruments disclosures* and IFRS 9 *Financial instruments*

- warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer as they are accounted for in accordance with *IFRS 15 Revenue from contracts with customers*
- employers' assets and liabilities from employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans that are accounted for in accordance with IAS 26 *Accounting and reporting by retirement benefit plans*
- contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some licence fees, royalties, variable and other contingent lease payments)
- residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease that are accounted for in accordance with IFRS 15 *Revenue from contracts with customers* and IFRS 16 *Leases*
- contingent consideration payable or receivable in a business combination (see IFRS 3 *Business combinations)*
- insurance contracts in which the entity is the policyholder
- credit card contracts, or similar contracts that provide credit or payment arrangements
- if an entity has a contract which meets the definition of an insurance contract but is primarily intended to provide services for a fixed fee, HM Treasury has mandated the application of IFRS 15 instead of IFRS 17. An example could be a maintenance contract where the provider agrees to fix equipment after a malfunction and the fee charged for the contract is fixed rather than variable based on the work to be performed
- service contracts, for example, if NHS body A provides services to NHS body B, under an agreement which guarantees continued provision of service and offers compensation if services are not provided due to events beyond the issuing body's control. For example, the provision of a service which relies on a piece of equipment, with a guarantee that if the equipment is unavailable for reasons beyond the NHS body A's control, NHS body A will compensate NHS body B. Although this example may look like an insurance contract in the first instance, it is the contract that creates the risk that the issuer (A) will have to pay the policyholder (B). The risk of equipment failure belongs to NHS body A and has not transferred.

Treatment of reinsurance

If a parent department has agreed to cover one of its bodies' insurance contracts, so that the cost of any risk that crystallised would be passed on to the department, then the insurance risk has been transferred again. Under IFRS 17 this second transfer of risk – from the policy holder to the NHS body to the parent department – constitutes a reinsurance contract.

An entity which has purchased reinsurance would recognise both the insurance contract, as a liability and the reinsurance contract, as an asset, in its financial statements. The net impact would be zero.

How do the accounting entries for IFRS 17 differ from provisions accounting?

The accounting entries feel similar as both require the establishment of a liability based on an assessment of the likelihood of an event happening in the future. However, a provision represents a present obligation from a past event while an insurance contract liability represents a present obligation based on the probability of a specified, future event happening.

Subsidiaries

Preparers of the accounts will have to be aware of the impact of IFRS 17 on subsidiaries that trade with other NHS bodies. These subsidiaries may issue insurance contracts, for instance, a maintenance contract.

If the subsidiary is a limited company (even if wholly owned) and they prepare their accounts under UK GAAP then FRS 103 (which is based, in part, on IFRS 4) applies to insurance contracts. Such contracts would need to be identified and recognised under IFRS 17 upon consolidation of the accounts with the NHS parent body. This will be a consolidation adjustment.

Insurance contracts between the NHS body and the subsidiary would be eliminated in the group accounts on consolidation.

Transition to the new standard

The date of initial application is 1 April 2025, so the transition date is the beginning of the annual reporting period immediately preceding the date of initial application - 1 April 2024.

On transition to IFRS 17, entities must retrospectively apply the new standard to prior periods. This means that the entity must identify, measure, and recognise all their portfolios of insurance contracts as if IFRS 17 has always applied.

To improve consistency of central government annual reports and accounts and consolidation of entities within the Whole of Government Accounts, HM Treasury has mandated the adoption of both transition reliefs noted in IFRS 17 paragraph C3(a) and C28.

This means that, on transition, entities shall not:

- disclose the amount of the adjustment for each financial statement line affected (and earnings per share) for the current period and each prior period presented
- disclose previously unpublished information about claims development that occurred earlier than five years before the end of the annual reporting period in which it first applies IFRS 17.

Footnotes

1 IFRS, IFRS 17 Insurance Contracts, 2023

2 HM Treasury, Financial reporting manual, updated July 2023

3 HM Treasury, IFRS 17 Insurance contracts: application guidance, June 2023

3 IFRS Foundation, IAS 37 Provisions, contingent liabilities and contingent assets, April 2021

4 HM Treasury, Managing public money, May 2023

5 HM Treasury, Contingent liability approval framework, updated April 2023

The Healthcare Financial Management Association (HFMA) is the professional body for finance staff in healthcare. For over 70 years, it has provided independent and objective advice to its members and the wider healthcare community. It is a charitable organisation that promotes best practice and innovation in financial management and governance across the UK health economy through its local and national networks.

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110 Rochester Row, Victoria, London SW1P 1JP

HFMA
HFMA House, 4 Broad Plain, Bristol, BS2 0JP
T 0117 929 4789
E info@hfma.org.uk