wcb Workers' Compensation Board – Alberta

Briefing Note

FINANCIAL REPORTING ISSUES

IFRS 17 *Insurance Contracts*

Contract Boundary

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DISCLAIMER

The analysis and conclusions in this briefing note are those of the author and do not necessarily represent the views of all accountants and actuaries engaged in this issue.

The discussion in this note of the long contract boundary reflects the author's high-level understanding of this view as presented in the document *Application of IFRS 17 for Workers Compensation Boards in Canada (including Auto Insurance Schemes with Similar Characteristics* by Conrad Ferguson, FCIA. Because the analysis and conclusions on both the short and long contract boundary reflect an accounting, not an actuarial, interpretation of IFRS 17 requirements on a preliminary basis only, this paper should not be relied upon as a final position on the technical characterization for either view.

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Executive Summary

This briefing note focuses primarily on the application of IFRS 17 to the contract boundary with respect to eligibility to apply the simplified measurement model (premium allocation approach, PAA). The key issue focuses on the practical ability of WCBs to reassess (i.e., fully reprice) insurance risks in their respective portfolios as at each reassessment date, in that some of those jurisdictions may have a statutory limitation on any annual increase in premium rates. This paper examines the application of IFRS 17 p.34(b) with respect to the intent and meaning of "*practical ability to reassess risk*" as a precondition to ending the insurer's "substantive obligation to provide [insurance] services", and whether or not the pricing constraint is effective. Satisfaction of the requirements of p.34(b) establishes the contract boundary as short, qualifying the entity to apply the PAA to the liability for remaining coverage (LRC), if any. Inability to comply with p.34(b) would require the entity to treat the contract as having a long contract boundary, to determine the remaining periods for which it is constructively obligated to provide insurance service, and to apply a CSM for those funding components that the entity expects to include in future premiums. Under the long contract boundary, the proposed financial reporting is unsatisfactory, and perhaps not even implementable.

Key risks for WCBs in applying the long contract boundary stem mainly from actuarial implementation of an unfamiliar measurement framework, involving potentially substantive changes in methods, assumptions, and systems with respect to valuations, and to how experience studies might be conducted. Another risk is that the financial statements will likely not be acceptable to those charged with governance, in that they will not be useful for evaluating WCBs' fiduciary performance and funding-related decision making. Because the proposed accounting treatments are also inconsistent with IFRS principles, there is a risk of auditor modification and/or a qualified opinion.

To overcome these hurdles, establishing the correct contract boundary ensures that all relevant cash flows are captured and <u>known</u> material risks inherent in the contract are accurately reflected in the technical provisions and capital requirements. In theory, the contract boundary would end at the point where a reliable estimate of rights and obligations can be made that reflects the terms and conditions of the contract. The short contract boundary will meet these criteria. Although some elements of the long contract boundary may be relevant for some WCBs depending on the specific features of their legislation, funded position, and funding practices, the short contract boundary faithfully captures the current statutory and economic reality of the WCB business model, is well understood by WCBs and their stakeholders, and produces financial information that best meets their governance, fiduciary, and decision making needs. Financial information flowing from the long contract boundary would not meet the criteria of reliable measurement and information utility.

Further research, analysis, and deliberation will be required to align WCB legislation with the definition of an insurance contract and the nature of the risk, if any, that is transferred from employers to WCBs. This step is critical to the conclusions and application of the contract boundary. Given the diversity in their respective legislation and funding practices, a "one size fits all" approach does not work for WCBs. Determination of the contract boundary should be based on all factors relevant to the individual entity, including its legislation, funded status, fiscal capacity, and practical constraints that could affect its ability to fully reprice risk. Because such determination requires extensive use of judgment, it is reasonable to accept that different conclusions on the contract boundary may be appropriate. IFRS 17 contains significant actuarial content, thus giving the views of the actuarial community disproportionate weight; ultimately, however, the final determination of the contract boundary is an accounting decision flowing from an accounting standard.

Background

The actuarial joint task force[1] on IFRS 17 has proposed two possible interpretations of the contract boundary as it relates to Canadian workers' compensation entities (WCBs, jurisdictions, Boards). Counter to the short contract boundary that WCB accountants have concluded on, some actuaries consider that the contract boundary could be long or even indefinite, based on WCBs' ability to charge additional premiums to achieve full funding over an indeterminate number of years into the future. Arguably, certain features of WCBs, such as monopoly power, compulsory coverage and premiums, inability to terminate coverage, ability to charge additional premiums or levies for both insured losses and funding shortfalls, also suggest that the insurance arrangement may be long, i.e., featuring a multi-year, and perhaps indefinite, contract boundary.

Contract Boundary in the WCB Context

WCBs are typically organized as statutory corporations operating as board-governed trust agencies, with injured workers (and in limited circumstances, employers) as the beneficiaries. The fundamental insurance relationship is established through public policy enshrined in and governed by statute rather than by contract. Several features highlight some important differences between WCB and commercial insurance contracts:

1. WCB coverage is not based on profit-seeking underwriting in a competitive market, but on a not-for-profit funding or full cost recovery model as a monopoly insurer.
2. Policyholder behavior is irrelevant as there are no options for renewing coverage or switching insurers (other than to self-insure, if eligible).
3. Instead of individual contracts with policyholders, WCB legislation sets out the rights and obligations applicable to all policyholders, along with entitlement of injured workers to benefits. From time to time, amendments to legislation may substantively change the scope, nature, and magnitude of the related obligations, and rarely, the core business and/or funding model.
4. The lack of a specified contract term requires significant use of judgment in assessing the relevant facts and circumstances of the insurance arrangements to determine the correct contract boundary.

In practice, the objective of a contract boundary is to identify and attribute the relevant cash flows for a particular insurance contract, mainly for underwriting and performance reporting purposes. A secondary, but equally important, objective is to segregate profitable from lossmaking (i.e., onerous) contracts to allow users to assess current and future profitability of an insurance contract portfolio. While these objectives also apply to WCBs and other public sector insurers, they would apply quite differently due to the factors identified above, with significant challenges in applying the contract boundary in the WCB context.

Key Positions of the Short Contract Boundary

Cash flows within the contract boundary reflect the following rights and obligations of WCBs during the period:

1. *Ability to compel payment of premiums*

Under WCB legislation, employers are mandated to register with the Board upon commencing operations in the jurisdiction and to pay the assessed premiums, including an obligation to pay additional premiums or levies to achieve full funding of the system. Legislation provides WCBs with certain powers to enforce payment, including provision of security to cover payment, withholding of clearances, suspending operations, liens on property, or seizure of debtor assets. At the same time, WCBs have a statutory obligation to provide employer coverage and pay benefits, irrespective of insurable risk, default on premiums, or insolvency. Neither employers nor WCB have the ability to opt out of coverage; only when the employer has ceased operations or no longer has workers covered in that jurisdiction will coverage end.

[1] Committee on Workers' Compensation (CWC) and the International Insurance Accounting Committee (IIAC) of the Canadian Institute of Actuaries (CIA)

Because the obligation to pay premiums and to provide coverage exists in each reporting period, the contract boundary would appear to be long. Notwithstanding, IFRS 17 considers certain rights of an entity that may overcome the presumption of an open-ended contract boundary, as discussed in the following section.

2. *Ability to end substantive obligations under existing contract*

Even though legislation imposes certain rights and obligations on the parties, IFRS 17 requires an assessment to ensure that these rights are practically enforceable at each reporting date. For WCBs, substantive obligations to insured employers include standby coverage for workplace injuries, and paying benefits when an insured event occurs. These obligations have commercial substance because of the potentially significant economic impact on the employer should a severe injury claim or a number of claims arise, with a corresponding insurance risk that could be material for WCBs.

An entity's substantive obligation to provide services ends (along with the corresponding the contract boundary) when it has the practical ability to reprice risks at the portfolio level. WCBs have such practical ability if there are no enforceable constraints - for example, a statutory cap on premium increases. Once approved, the repricing applies to all policyholders. However, if WCBs can unilaterally reassess risk, but for reasons such as economic hardship, reputational, political, or other stakeholder concerns, choose to charge a lower amount for the same coverage, that would not be considered a practical constraint. Under their legislation, WCBs have full autonomy in establishing coverage pricing based on the funding needs of the system. Whether or not statutory or practical constraints on reassessing and/or repricing risk exist, judgment is required to assess whether those constraints are substantive given the terms of the legislation and the prevailing circumstances.

Implications of repricing constraints

For certain WCBs, the governing legislation may constrain the escalation of premium rates each year. A hard cap may explicitly prohibit increases above a certain threshold, while a soft cap may contain language to soften the impact of a rate increase. Unlike those jurisdictions without such constraints, who are able to fully reprice risk but choose not to do so because of adverse reputational impact, stakeholder resistance, or availability of funding surplus, those WCBs with substantive pricing constraints cannot fully reprice risks at the annual reassessment date, unless the price escalation falls below the rate ceiling. If not economically significant, it may be possible to argue that the pricing constraint is not substantive, and the ability to reprice risk is therefore effective. Another important consideration is whether the constraint may be waived through regulation, or requires a legislative amendment. The test of repricing effectiveness should confirm whether the constraints are temporary or permanent at that date. In other words, the degree of difficulty in overriding the constraint is determinative of 'practical ability'. This point is important because changing economic and political circumstances specific to WCBs could result in different conclusions over time.

For WCBs that ***do not*** have a statutory limit on rate increases to fully reprice risk or where the constraints are not substantive, the ability to reprice risk at the annual reassessment date or absorb losses for a limited period effectively operate within a short contract boundary. Substantively, the ability to reassess risk represents the ability to unilaterally change the contract and reset the contract boundary. Conversely, the inability to fully reassess risk would result in continuation of the substantive obligation to provide coverage at the prevailing price, with the contract potentially becoming onerous in the short term. One consequence is that the contract would extend beyond one year, until such time as the pricing fully reflects the risk of the portfolio. Existence of a substantive pricing constraint, or inability to end a substantive obligation to provide service, could prolong the contract boundary for an indeterminate period. Therefore, those WCBs with statutory and/or financial constraints that require funding shortfalls to be recovered over a significantly longer period may need to adopt a long contract boundary to incorporate those future funding cash flows, to the extent that they are both measurable and within the scope of IFRS 17.

To summarize, the contract boundary would likely depend on the economic circumstances that allow full reassessment of risk, degree of political influence over the timing and magnitude of rate increases, and/or and the fiscal capacity to absorb short-term losses through its funding surplus.

3. *Faithful representation of the WCB business model*

To be useful, financial information must not only report relevant events and transactions, but to be reliable, it must also faithfully represent the substance of those events and transactions. To that end, the current financial statements of WCBs faithfully depict certain statutory provisions and business practices (grandfathered by IFRS 4) indicative of a short contract boundary:

- In applying IFRS 4, WCBs concluded that the contract boundary was one year. WCBs' auditors and actuaries confirmed this position. The underlying business model has not changed materially since then
- WCB legislation prescribes the assessment and payment of premiums on an annual basis
- Coverage is provided on a continuing basis (i.e., it does not need to be renewed), but the overall risk and claims experience of the book of business (i.e., portfolio) is reassessed and reflected in annual premiums
- Claims experience, assumptions, and cash flow estimates underlying actuarial valuation of insurance liabilities are reviewed and updated on an annual basis
- WCB currently applies a premium recognition method (unearned premium reserve, fully amortized over the premium year) that is essentially similar to the premium allocation approach, reflecting the statutory assessment of premiums on an annual basis, such that its business processes (rate-setting, cost tracking, liability valuation, and performance reporting) are also structured to follow a one year operating cycle.

The business processes and related analytics, and the financial statements that report them, which have been established over many decades, are well understood by both WCB and its stakeholders. While individual factors are not, in isolation, determinative of a short contract boundary, together they present a persuasive body of evidence supporting an annual business cycle. The fact that many WCBs can reassess and reprice insurance risk on an annual basis leads to the conclusion that the contract boundary may be short, and that the short contract boundary aligns well with their current business and rate-setting model.

Implications for the Short Contract Boundary

The major benefit of confirming the short contract boundary for WCBs is the ability to apply the *simplified* or *premium allocation approach* (PAA) as the measurement model for the liability for remaining coverage (LRC). Given that the PAA is essentially similar to the earned premium method currently used as a proxy for the LRC, WCBs would likely meet the requirements for applying the PAA. Since WCBs do not provide multi-year coverage with up front premiums, they would not have any LRC at the reporting date. In theory, the PAA would apply to the LRC for both internal and external interim reporting, but in practice, only those jurisdictions that issue external interim statements would need to apply the PAA. The majority of WCBs will apply the PAA to their internal financial statements only, as the LRC is fully amortized by the end of the reporting period.

Of particular interest to WCBs, the Australian Accounting Standards Board issued a Discussion Paper[2] on the application of IFRS 17 to public sector insurance entities, in which it concluded that, by virtue of annual premium rates based on actuarial review, the contract boundary is one year and the *simplified or premium allocation*

[2] Australian Accounting Standards Board, Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (November 2017), E22, IE55

approach (PAA) could apply for workers' compensation. That said, a detailed comparison of the respective legislation and coverages would be required to confirm that this recommendation is also appropriate for WCBs.

Key Positions of the Long Contract Boundary

The following sections discuss the key arguments from Conrad Ferguson's paper (*Ferguson*)[3], based on IFRS 17 guidance and WCB insurance characteristics, for concluding that the contract boundary is long.

WCB legislation is broadly within the scope of IFRS 17

The IFRS 17 definition of an insurance contract remains unchanged from IFRS 4. In adopting IFRS 4, WCBs concluded that their statutory insurance model constitutes an insurance contract. WCB legislation meets the definition of an insurance contract through an enforceable agreement that establishes the insured risks (uncertain future events) to be assumed and the benefits payable to beneficiaries (injured workers), as well as the rights and obligations of the insurer and insured within the insurance relationship. For WCBs, there is significant transfer of insurance risk from employers, i.e., claims involve material losses for the employer if not insured, for which risk WCBs receive compensation in the form of premiums.

WCB legislation carries certain implications for the long contract boundary. Legislation specifies only an effective date, but not an end date; therefore, the end date is when legislation/contract is repealed (derecognized) or superseded (substantively modified). Judgment is required to make this determination. While the *contract term* is open-ended, the *contract boundary* is not; rather, it depends on certain rights of the parties, such as the right to reprice risk and the ability of either party to terminate coverage.

Policyholder is the 'employer collective'

IFRS 17 defines a *policyholder* "*as a party that has a right to compensation under an insurance contract if an insured event occurs*." By extension, this definition implies that the policyholder is the party that transfers insurance risk to WCB.

Interpretations and conclusions following this guidance underlying the long contract boundary position:

- Under the principle of collective liability, responsibility for funding of insured losses rests with all employers, not individual employers
- Since WCBs do not issue individual contracts, the policyholder must be interpreted as employers collectively. Unfortunately, both WCB legislation and IFRS 17 are silent with respect to the concept of an undefined collective as a party (policyholder) to the (group) contract
- The statutory power to compel payment of premiums is enforceable against individual employers, not collectively. By analogy, the collective does not have a right to compensation as it is not a party to the contract
- Ascribing independent existence to the employer collective as separate from the system may be problematic because it would effectively make the employer collective a self-insurer, thus putting WCB (i.e., as a service agent) outside the scope of IFRS 17 (and into IFRS 15). To compound the problem, the employer collective cannot be a reporting entity because it is not recognized by statute

A key concern is whether the 'employer collective' meets the definition of a policyholder that can be identified and has legal existence, an important concept because contractual rights and obligations can only be enforced against a natural person or a legal entity as a party to the contract. IFRS 17 measures an entity's rights and

[3] Conrad Ferguson, *Application of IFRS 17 for Workers Compensation Boards in Canada (including Auto Insurance Schemes with Similar Characteristics*, February 2019 (unpublished discussion paper)

obligations related to a portfolio of identifiable contracts as at the reporting date. Under the long contract boundary, there is a presumption that these pre-existing rights and obligations automatically roll over to a 'new' collective that changes its composition every year. That presumption presents a conceptual hurdle because IFRS measurement is predicated on specifically identifiable policyholders and contracts, i.e., there is a one-to-one correspondence at each level of aggregation. Consequently, analogizing from an identifiable group of policyholders to an indeterminable collective, and imputing statutory rights and obligations to it, represents an interpretation of IFRS 17 that may not have been intended by the IASB.

WCBs have the ability to compel payment of premiums

The ability to compel payment of premiums includes the power to order a defaulting employer to stop hiring workers until premiums are fully paid. Notwithstanding WCBs' ability to compel payment of premiums, WCBs' substantive obligation to provide services does not end because legislation imposes coverage irrespective of unpaid premiums, while employers cannot terminate coverage as long as there are active workers.

The ability to compel payment of premiums is enforceable against identifiable employers in the current reporting period, implying that it exists only up to the end of the reporting period. The guidance is not explicit that this right is enforceable beyond the reporting period, because changing circumstances require a reassessment in each reporting period. On the other hand, WCBs' obligation to provide services cannot be terminated at any time.

For commercial insurers, the contract boundary is finite. For WCBs, it would appear to be indefinite, but the interpretive challenge is analogizing from the well-understood context of commercial insurance in IFRS 17 guidance to what is arguably a foreign fact pattern that was not contemplated by the IASB. There is a general principle in accounting that analogizing is appropriate only when fact patterns are substantially similar.

WCBs may *have the ability to reassess risk at the portfolio level, but cannot end their substantive obligation to provide service*

As discussed in the analysis of this issue in the context of the short contract boundary, the ability to reassess risk (and increase premiums) hinges on the meaning of 'practical'. IFRS 17 carefully set out conditions to ensure that such right has commercial substance, i.e., the estimate is economically reasonable and practically realizable within a determinable time horizon. Unfortunately, the long contract boundary view does not consider how the practical ability to fully reprice would apply in the WCB context.

If both conditions in p.34(b) were met, the outcome would be a short contract boundary, due to the implied right of the policyholder to accept or terminate the amended contract. Substantively, this represents extinguishment of the existing contract and its replacement with a new one, resulting in a new contract boundary. Regardless, WCBs cannot terminate coverage due to its statutory obligation to provide coverage unconditionally, nor do employers have the ability to unilaterally terminate coverage. Effectively, the statutory compulsion for both parties to maintain coverage overrides the ability to reprice; hence the contract boundary is long because the existing contract continues to apply.

Right to charge future premiums to cover funding shortfalls

Ferguson states that "…*when funding shortfalls occur using the funding policy measurement basis, the WCBs, according to the Acts that created them and their funding policies, will include a surcharge in the premium rates to recover from such shortfalls. The employers have no choice in the matter...*"[4] Given this right to recover funding shortfalls through future premiums, *Ferguson*[5] raises the question of whether this right could be interpreted as "*non-cancellable and enforceable mechanisms" that "return all significant insurance risk to the policyholder".* The

[4] *Ferguson*, pg.24

[5] *Ferguson*, Appendix 1, pgs.41 - 43

proposals raise an important concern as to whether the author is interpreting IFRS 17 guidance, which is clearly focused on financial statement objectives, under a funding perspective.

Basis for conclusion on this interpretation of WCBs' right to charge future premiums to cover funding shortfalls:

- WCBs' ability to compel payment of premiums is explicitly established in legislation, along with specific powers of enforcement. This power underlies the requirement for full funding of the system. For many WCBs, this requirement is implied in legislation, but in some instances, it is explicitly set out in regulations or in funding policy, whether through incremental premiums or direct levies
- Under the long contract boundary, the ability to "return insurance risk back to policyholders"[6] through the right to charge future premiums to recover *insured losses* has been interpreted as potentially taking WCB coverage out of IFRS 17. This right implies that WCBs do not assume significant insurance risk. If this view is upheld, then WCBs are simply agents in administering what is effectively a self-insurance program, which does not accord with the economic reality of workers' compensation
- Although ultimate responsibility to cover funding shortfalls rests with the employer collective, it is the individual employers who make the payments. However, there is no clear linkage between future premium adjustments to "enforceable mechanisms that return insurance risk to policyholders"; that is, *Ferguson* neglects to demonstrate that funding shortfalls represent insurance risk. Absent insurance risk, the unintended consequence of WCB legislation falling outside the scope of IFRS 17. WCBs had previously assessed and asserted that its coverage was an insurance contract within the scope of IFRS 4, with the B26 and B27 guidance being unchanged from IFRS 4
- Under IFRS 17 p.B11, ***insurance risk is** the risk the entity accepts from the policyholder. This means the entity must accept, from the policyholder,* ***a risk to which the policyholder was already exposed****. Any new risk created by the contract for the entity or the policyholder is not insurance risk* [emphases added]. P.B11 makes it clear that the obligation to fund the system is not insurance risk because it is not a pre-existing risk that policyholders transfer to WCB. Since p.B27(b) does not apply, WCBs' insurance arrangements are within the scope of IFRS 17.

In the WCB context, 'premium' (i.e., funding) shortfalls arise from a combination of adverse claims experience, under recovery of administrative costs, and investment losses. However, insured losses under IFRS 17 for non-life insurers include claims and some administrative losses, but not investment losses. Essentially, the long contract boundary is conflating insured losses with funding deficits. The broad power to recover funding shortfalls (i.e., imposing a funding levy) devolves from government by virtue of WCB's agency status, which is clearly not the same right contemplated by IFRS 17 as arising from contract. As such, the cash flows arising from this right may be financial or levy-like in nature, rather than insurance. Rather, it is the funding right, not the insurance arrangement, which should be scoped out of IFRS 17. It is therefore critically important to segregate future cash flows that are funding related, from those related to insured losses within the contract boundary under IFRS 17.

Recognition of future premium adjustments to achieve full funding (assets = liabilities)

Although the technical accounting details of the long contract boundary have yet to be developed, the proposed financial statement outcome[7] is that assets equal liabilities at all times, predicated on the presumption that WCBs have the right to charge sufficient premiums, or return excess premiums, to achieve full funding. To focus

[6] IFRS 17 p.B27(b)
[7] Ferguson, pg. 35 - 40

discussion on the key reporting implications of the long contract boundary, *Ferguson* incorporates the following simplifying assumptions:

- Estimating the present value of future premium adjustments is irrelevant because assets will always equal liabilities, i.e., liabilities will be adjusted to the asset amount (or an asset recognized to reflect future premiums)
- Disregards entity-specific funding policy in assuming full funding is always achieved at a target 100% funding level, which may not be the actuarial or the prudent view of sufficiency funding
- Does not consider practical constraints with respect to timing and amounts of future premium adjustments related to funding, both inflows (surcharges, levies) and outflows (rebates, surplus distributions)

Three alternative valuation and presentation approaches are considered in applying the long contract boundary:

Proposal # 1 Strict interpretation of IFRS 17

The present value of future premium adjustments, assumed to be the difference between assets at fair value and liabilities at fulfillment value, is not recognized as a separate asset, but offset against liabilities

Under this conception of the long contract boundary, WCBs have an inalienable right to charge employers sufficient future premiums to achieve full funding, and by analogy, to return surplus funding to employers. The present value of the amount is the difference between assets and liabilities at the reporting date. This position assumes a sufficiently long time horizon and no practical constraints against recovering funding shortfalls. That said, the proposed financial statement outcome is inconsistent with the reporting objectives of IFRS 17.

Concluding that the amount of future funding cash flows would equate assets to liabilities is arguably a simplistic interpretation of IFRS 17 without practical applicability. As such, the resulting financial statements would not pass the tests of faithful representation (legal form over economic substance) and relevance and reliability of financial information under IFRS, and would not likely be acceptable to auditors and stakeholders, primarily the WCBs board, management, and respective governments.

View # 2 Actuarial overlay on the strict interpretation

Imposes an actuarial limit on the present value of future premium adjustments, determined as "the difference between the present value of fulfillment outflows using the IFRS 17 discount rate and the same value using a going concern discount rate", i.e., a best estimate return on assets. The difference is presented as a 'capital' item, i.e., a component of funded position

Applies the same accounting treatment as View # 1, but introduces the notion of an actuarial limit on the amount of the future premiums, considering that the conceptual value may be economically meaningless. However, it is unclear how the proposal concluded that difference in discount rates would be a conceptually useful proxy for the present value of future premiums. Finally, presentation of the amount as a capital item would not be permitted under accounting principles – only net income and transactions with owners may be reported in equity.

This alternative compounds the conceptual challenges of applying View # 1 by introducing a hypothetical value to constrain liabilities, but one without any correlation to the future premium cash flows. For the reasons given in both conclusions, the proposed presentation will also not be implementable.

View # 3 Balance sheet presentation

Report IFRS 17 liabilities at their gross amount, with the present value of future premium adjustments presented as an offset to retained surplus in funded position

This proposal is conceptually reasonable, and may be acceptable for governance and fiduciary purposes, in that it presents the 'real' amount for both the liabilities and the funding premiums on an IFRS 17 basis. Once again, the proposed balance sheet presentation would not be permitted under IFRS principles, as explained below.

The proposed presentation as retained surplus or deficit (or funded position) transactions would be permitted only if those funding amounts are segregated from premium revenue and characterized as funding transactions outside the scope of IFRS 17. If included in premium revenue, they must flow into funded position as operating surplus, and may not be presented in a separate category of funded position. If segregated as funding items, the inflows would be characterized as direct capital contributions, while outflows represent distributions of excess surplus. That said, this presentation could also be contentious because capital transactions relate to 'owners' of WCB, which employers are technically not. A case will have to be made that this treatment would be less misleading than income statement presentation. However, presentation and disclosure alone cannot rectify inappropriate application of accounting principles.

Implications of the Long Contract Boundary

In all three reporting scenarios, the conceptualization of the long contract boundary may be taking a funding perspective of the entity and attempting to impose it on financial reporting objectives. Because the long contract boundary outcomes are incompatible with the financial reporting objectives of IFRS 17, the unintended consequence is the financial statements under the long contract boundary are not relevant or reliable for stakeholder needs.

The following subsections raise important issues and concerns for further consideration of the long contract boundary debate.

Issues related to interpretation and application of IFRS 17

- Funding is treated as a feature of the insurance contract because it is implied in legislation. Insurance contracts also contain components such as investment and financial services and products (e.g., asset management, financial guarantees) that must be unbundled and accounted for under other IFRSs. Funding power of WCBs, which is not an insurance feature, essentially devolves from the power of government to impose a levy (i.e., non-reciprocal transfer of resources), which WCBs hold by virtue of being government agencies. As substantively different from the right to compel payment of premiums that is within the scope of the contract, levy power should be viewed as outside the scope of IFRS 17
- IFRS 17 p.34 clearly states that the contract boundary encompasses cash flows that arise from rights and obligations that exist as at the reporting date, to the extent that such rights and obligations are practically enforceable. To be enforceable, a structured funding plan must be in place, whether imposed by regulation or funding policy, such that the amount and timing of the related cash flows are known with a high degree of certainty to enable reliable measurement. Absent such a realistic, enforceable, and transparent funding structure, the cash flows are contingent in nature and may not be recognized, only disclosed
- Transfer of insurance risk is at the individual contract level, not the portfolio or entity level. In return for transferring risk to WCB, employers assume an obligation to fund current costs and losses of prior years. Depending on the magnitude of prior year losses, it is clearly unrealistic to assume that current employers will be able or willing to fund that amount; as clearly, some of the obligation will transfer to future employers. Consequently, the long contract boundary raises a practical difficulty with the notion of the 'employer collective'. Analogizing from an individual policyholder to an 'employer collective' weakens the position because it posits an undefined 'party' that that has no basis in WCB legislation, IFRS 17, or fact. Consequently, the right to compel payment of future premiums may be conceptually possible, but not practically enforceable. IFRS 17 directs the entity to ignore contractual features without commercial and/or economic substance

- Future premiums may be charged to cover losses, but as contemplated under the long contract boundary, such losses may include both investment and operating losses, not only underwriting or insured losses. Under IFRS 17 p.B66(d), cash flows that cannot be directly attributable to the insurance portfolio are not within the contract boundary. Past funding losses are therefore not within the scope of IFRS 17, and must be accounted for under another standard (e.g., IFRS 9, IFRIC 21, or IAS 37)
- Barring application of the PAA, the general measurement model must be applied for future cash flows. An unintended consequence, if that amount were to be characterized as a funding component included in future premiums, is that it could be considered a contractual service margin (CSM) in accordance with the general measurement model, in that they represent a margin in excess of full cost recovery.

Stakeholder concerns

Stakeholders rely on WCBs' financial statements primarily for governance purposes, to evaluate fiduciary performance, and to monitor the long-term financial sustainability of the system. Because the financial statements based on the long contract boundary do not reflect the existing business model and economic reality of WCBs, they will not be useful or reliable in meeting those objectives. The major concern is the cost benefit tradeoff in implementing a requirement that results in minimal information utility.

Conclusion

Given the diversity in their respective legislation and funding practices, a "one size fits all" approach does not work for WCBs. Determination of the contract boundary should be based on all factors relevant to the individual entity, including its legislation, funded status, fiscal capacity, and practical constraints that could affect its ability to fully reprice risk. Because such determination requires extensive use of judgment, it is reasonable to accept that different conclusions on the contract boundary may be appropriate. IFRS 17 contains significant actuarial content, thus giving the views of the actuarial community disproportionate weight; ultimately, however, the final determination of the contract boundary is an accounting decision flowing from an accounting standard.