In 1997, work started on the delivery of an international financial standard for insurance contracts. After nearly 20 years of discussion, the International Accounting Standards Board (IASB) published IFRS 17 *Insurance Contracts* in May 2017. Insurers must get started now as there is a morass of detail to be dealt with and fundamental accounting policy decisions and judgements to be made.

**Background**
IFRS 17 began as a comprehensive review of accounting for insurance contracts.

IASB completed phase one of this project when IFRS 4 *Insurance Contracts* was issued in March 2004. However, IFRS 4 was intended as an interim solution only. It allowed insurers to continue to use a variety of accounting practices for measuring insurance contract liabilities pending the completion of a comprehensive Standard. The differences in accounting practices across jurisdictions and products have made it difficult to understand and compare insurers’ financial position, performance and risk exposures. Phase two was designed to address these concerns and resulted in the issuance of IFRS 17, which replaces IFRS 4.

**Objective**
The objective of the Standard is to ensure that an entity provides relevant information that faithfully represents rights and obligations from insurance contracts it issues. IASB developed the Standard to eliminate inconsistencies and weaknesses in existing accounting practices by providing a single principle-based framework to account for all...
types of insurance contracts, including reinsurance contracts that an insurer holds. The Standard also introduces further presentation and disclosure requirements to enhance comparability between insurers.

**Scope**
An entity shall apply IFRS 17 to insurance and reinsurance contracts it issues; reinsurance contracts it holds; and investment contracts with DPF, an entity to apply the insurance standard to include the requirement that, in order to provide it also issues insurance contracts. Scope changes from IFRS 4 include the requirement that, in order to apply the insurance standard to investment contracts with DPF, an entity must also issue insurance contracts; and an option to apply IFRS 15 Revenue from Contracts with Customers to fixed-fee contracts once certain criteria are met.

**Level of aggregation**
One of the most significant challenges for insurers under the new Standard will be aggregating their insurance policies. IFRS 17 requires entities to identify portfolios of insurance contracts comprised of contracts that are subject to similar risks and are managed together. Each portfolio of insurance contracts issued should be divided into a minimum of three groups:

- A group of contracts that are onerous at initial recognition, if any;
- A group of contracts that, at initial recognition, have no significant possibility of becoming onerous subsequently, if any; and
- A group of remaining contracts in the portfolio, if any.

An entity is permitted to divide portfolios into more groups. However, groups cannot include contracts issued more than one year apart. Furthermore, if a portfolio would fall into different groups only because law or regulation constrains the entity’s practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group.

The groups are established at the inception of the contracts and not subsequently reassessed.

| Observation | The requirements for the level of aggregation of insurance contracts will be one of the most challenging aspects of implementing the new Standard. As a result, up-front planning and advanced data management will be crucial. |

| Measurement | Before describing the new measurement requirements in IFRS 17, it is useful to compare the valuation of insurance contract liabilities under IFRS 17 to the valuation under Solvency II. While there are similarities between the two frameworks, there are also fundamental differences. Terms like “risk adjustment” and “best estimate liability” will be familiar to insurers, but IFRS 17 introduces a number of new concepts – the main one being the contractual service margin (CSM). The CSM is a component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognise as it provides services under the insurance contracts in the group. |

| Figure 1 (above) is an extremely simplistic illustration of how the differences between Solvency II and IFRS 17 insurance contract liabilities might materialise. There are four broad categories of “adjustments” outlined. However, the devil is always in the detail. |

| Table 1: Simplistic example of Solvency II versus IFRS 17 insurance contract liabilities |

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<th>Solvency II technical provisions</th>
<th>SII contract boundaries</th>
<th>Risk margin</th>
<th>Discount rates</th>
<th>CSM</th>
<th>IFRS 17 insurance liabilities</th>
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<td>Risk margin</td>
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<td>Best estimate liabilities</td>
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<td>Contractual service margin</td>
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<td>PV of fulfilment cashflows</td>
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liability for incurred claims is measured as the future cash flows related to past services allocated to the group at that date. An entity may simplify the measurement of the liability for remaining coverage of a group of insurance contracts using the PAA on the condition that, at initial recognition, the entity reasonably expects that doing so would produce a reasonable approximation of the General Model, or the coverage period of each contract in the group is one year or less.

Disclosure
An entity shall disclose qualitative and quantitative information about the amounts recognised in its financial statements that arise from insurance contracts; the significant judgements, and changes in those judgements; and the nature and extent of the risks that arise from insurance contracts. There are also extensive disclosures in relation to transition.

Transition
An entity shall apply the Standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach.

At the date of initial application of the Standard, those entities already applying IFRS 9 may retrospectively re-designate and reclassify financial assets held in respect of activities connected with contracts within the scope of the Standard.

Effective date
IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments have been applied at or before the date of initial application of the Standard.

Next steps
The key task for insurers now is to make the appropriate implementation decisions and consider their next steps:

- Insurers should prepare for implementation, which is likely to be long and complex. The decision of IASB to give up to the year beginning on or after 1 January 2021 to implement IFRS 17 is an indicator of the expected demands the adoption of the Standard will have on the insurance industry. Insurers should also remember the requirements under IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to disclose prior to implementation the impact IFRS 17 will have on their financial statements;
- Insurers should decide whether they will avail of one of the voluntary options available within IFRS 4 in relation to implementing IFRS 9 – the ‘overlay approach’ or the ‘deferral approach’. IFRS 9 will be effective for periods beginning on or after 1 January 2018 unless an insurer has the option to defer its application to no later than periods beginning on or after 1 January 2021 if it qualifies as having predominantly insurance activities;
- Insurers should evaluate whether their current actuarial and accounting systems are flexible enough to be enhanced to address the new data and measurement requirements of the Standard;
- Another aspect insurers should consider is whether they have enough staff resources to manage the transition process and maintain ‘business as usual’ operations; and
- Now is the time to develop your communication strategy on the impacts of IFRS 17. Boards, senior management and investor relations teams are all responsible for engaging with the market and will benefit from early preparation. Various stakeholders will need to be educated on the implications of the new Standard.

IFRS 17 will fundamentally change accounting for the insurance industry. We have waited 20 years for the Standard and now that it is here, does the industry have the systems and resources to prepare for implementation? Investment of time and resources is an absolute necessity. Remember – start early, start small, and keep it simple.

**Changes for non-life insurance**
Existing accounting practices vary by jurisdiction. However, for most non-life insurance contracts, the major accounting change is the introduction of discounting and an explicit risk adjustment for non-financial risk in measuring the liability for incurred claims along with the more transparent reporting of any movements in these elements. Of the insurance contracts eligible to use the PAA, many are expected to be non-life insurance contracts. The PAA simplifies the General Model accounting for the liability for remaining coverage, but not for incurred claims.

**Changes for life insurance**
While existing accounting practices vary, for most life insurance contracts the most significant financial reporting changes may include:

- The introduction of a single accounting model for all insurance contracts;
- Updated assumptions rather than locked-in assumptions;
- Current value measurement guarantees and options previously not fully recognised;
- More information about the effects of financial and non-financial risk, time value of money and other estimates;
- Discount rate reflecting the characteristics of the insurance contract liability, excluding future investment spreads unless they are part of the characteristics of the contract;
- New presentation of revenue and service result; and
- Deferred acquisition costs forming part of the insurance contract’s measurement, replacing the need for separate release mechanisms.

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