

Ind AS in Focus

The Insurance Regulatory and Development Authority of India (IRDA) has issued a circular, "Implementation of Indian Accounting Standards (Ind AS)", requiring insurance companies to prepare and execute the implementation in advance of the applicability date.

This circular is issued pursuant to a press release issued by the Ministry of Corporate Affairs (MCA) on the roadmap for implementation of Ind AS by banks, non-banking finance companies (NBFCs) and insurance companies.

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The Bottom line

- The MCA issued a press release for insurance companies to prepare Ind AS based stand-alone and consolidated financial statements for FY 2018-19 with comparatives of FY 2017-18.
- The IRDA issued a circular under Section 34 of the Insurance Act, 1938, which mandates insurers to comply with Ind AS and its implementation Roadmap issued by the MCA, provides implementation guidance and casts responsibility on the Audit Committees of the Boards and the Boards of the insurers.
- All Insurers are advised to place the circular before the ensuing meeting of their Board of Directors and confirm the compliance.
- As part of the monitoring by the IRDA, the circular introduces additional reporting requirements until implementation. Accordingly insurers need to submit 'pro forma Ind AS financial statements' to the IRDA from the quarter ending 31 Dec 2016 onwards and disclose the strategy for Ind AS implementation, including the progress made, in their Annual Reports for FY 2015-16 until implementation.
- The IRDA itself has undertaken the responsibility to take steps to facilitate the implementation process and issue necessary instructions/guidance/clarifications on relevant aspects as and when required. Further, from July 2016, the IRDA shall hold periodic meetings with insurers in this regard.

This edition of Ind AS in Focus outlines the requirements of the Circular issued by the IRDA on Implementation of Ind AS for insurance companies from FY 2018-19.

For more information, please see the following websites:

www.iasplus.com

www.deloitte.com

Responsibility of the Insurer and those charged with governance

The IRDA acknowledges the fact that Ind AS implementation is likely to have significant impact on the insurers' financial reporting, systems and processes. These changes need to be planned, managed, tested and executed in advance of the implementation date, with monitoring by those charged with governance.

- The **Board of the** insurer has been cast with the ultimate responsibility of determining the Ind AS direction and strategy and overseeing the development and execution of the Ind AS implementation plan.
- The **Audit Committee of the Board** has been cast the responsibility to oversee the progress of the Ind AS implementation process and report to the Board at quarterly intervals.

What are the responsibilities of insurers?

The IRDA has mandated the following activities and reporting requirements for insurers:

Activities and reporting requirements	Timeline	Whom?
Set up a Steering Committee , headed by an official of the rank of an Executive Director (or equivalent), comprising members from cross-functional areas of the insurer to immediately initiate the implementation process. <ul style="list-style-type: none"> • Mandate of the Steering Committee • Rights and responsibility • Reporting obligation 	Immediately	
Send by email to the IRDA – the name and details of the designated official and the team.	Immediately	IRDA
Assess the impact of the Ind AS implementation on their financial position, including the adequacy of capital, taking into account the solvency regulations requirements, and present the quarterly progress reports to their Boards. It is presumed that such reports presented to the board be prepared/ approved by the Steering Committee first.	Quarterly	Board
Submit 'pro forma Ind AS financial statements' to the IRDA from the quarter ending 31 Dec 2016 onwards until implementation.	Quarterly ^{Note 1}	IRDA
Disclose the strategy for Ind AS implementation, including the progress made, in their Annual Reports for FY 2015-16 until implementation.	Annually	Stakeholders

Note 1: The pro forma Ind AS financial statements shall be filed within the time lines specified in the IRDA's circular No. IRDA /F&I /CIR /F&A /012 /01 /2010 dated 28th January, 2010.

Observation

The IRDA has asked for strict compliance with the Circular. For the successful overall implementation by the insurance industry, it has scripted a detailed implementation activities and reporting plan until implementation, identified critical steps and cast responsibility on those responsible for governance at the highest level.

The IRDA has also taken the responsibility on itself to facilitate the implementation process and issue necessary instructions/guidance/clarifications on relevant aspects as and when required. It will be holding periodic meeting with the insurance companies from July 2016 onwards.

What are the implementation challenges?

The transition to Ind AS is far more than a technical challenge of adopting a new accounting standard. It will be one of the most fundamental changes to affect the Insurance Industry for many years. The change will transform the way the insurers and markets judge performance and value, and may require a decisive shift in areas ranging from product design, asset liability management and earnings management to information systems, market communications and performance-based pay.

Beyond accounting, Ind AS has extensive disclosures requirements, which leads to extensive data mining. For example, treatment of insurance contracts; classification and measurement of financial instruments; nature and extent of its exposure to the associated risks (insurance risk, credit risk, market risk and liquidity risks) both in qualitative and quantitative terms – to reflect the way management perceives, measures and manages these risks, areas involving significant estimates and assumptions, and related sensitivities; effect of changes in assumptions used to measure insurance assets and liabilities.

The IRDA has identified critical issues that need to be factored in within the Ind AS implementation plan, which include the following:

Critical Issues	Detailed activities
Ind AS Technical Requirements	<p>Project activities</p> <ul style="list-style-type: none"> • Diagnostic analysis of differences between the current accounting framework and Ind AS • Significant accounting policy decisions impacting financial statements • Drafting accounting policies • Preparation of disclosures • Documentation • Preparation of pro forma Ind AS financial statements • Timing the changeover to Ind AS • Dry-run of accounting systems and end-to-end reporting process before the actual conversion
Systems and processes	<p>Evaluate system changes</p> <ul style="list-style-type: none"> • Assessment of processes requiring changes • Identifying issues having significant impact on information systems (including IT systems) • Developing/ strengthening data capture system, where required • Performing data analytics and data mining
Business Impact	<p>Evaluate business impact</p> <ul style="list-style-type: none"> • Profit planning and budgeting • Taxation • Capital planning • Assessing the impact on solvency margin
People	<p>Evaluation of resources</p> <ul style="list-style-type: none"> • Setting up adequate and fully dedicated internal staff for implementation • Creating comprehensive training strategy and programme

Observation

Effective Ind AS conversion would require significant input from practically every business unit and link in the decision-making and value-generating chain, including IT, HR, finance, treasury, product development, underwriting, benefits / claims payout, reinsurance, reserving, distribution, marketing and customer service. Without careful preparation, the volatility of reported results could reach unexpected levels and the level of execution risk may become unsustainable.

Ind AS is likely to increase income volatility, which certainly needs to be managed, or at least carefully explained to the stakeholders, to avoid undermining their confidence. Also, Management Information Systems may need to be revamped and economic capital and other common value-at-risk measurements reassessed as the current strategies could prove untenable.

For successful implementation, there is large amount of time commitment that insurers will have to invest as there are significant process and information challenges associated with the adoption of these standards. So, it is imperative that the implementation is done right, the first time.

Ind AS 104, Insurance Contracts

The objective of Ind AS 104 is to specify the financial reporting for insurance contracts by any entity that issues such contracts and the standard is developed with the intention of minimizing short-term system changes. It allows entity to continue to use their existing accounting policies for insurance contracts, provided that the existing policies meet certain minimum requirements set out in Ind AS 104. The key implications include segregation of products among insurance contracts and investment contracts, unbundling of deposit component from insurance contract, accounting for discretionary participation features in insurance contract, treatment of embedded derivatives in insurance contracts, liability adequacy test, treatment of deferred acquisition costs, reinstatement of reinsurance assets and liabilities, etc.

Observation

Ind AS 104 is substantially similar to IFRS 4, which is an interim standard, pending the completion of Phase II of IASB's project on insurance contracts which is expected to be completed by end of December 2016. Product classification would become an inherent part of product designing process and it would have impact on financial statements of the Company. Unbundling of contracts may result in eroding top line for insurance companies as deposit component will be accounted as deposit liability and would be accounted as per the requirements of Ind AS 109.

Ind AS 109, Financial Instruments – a big leap

The MCA has introduced Ind AS 109, an accounting standard for Financial Instruments. Ind AS 109 introduces concepts wherein the accounting of financial assets is required to be reflective of a business model – to earn contractual cash flow versus fair value change; financial assets are derecognized on transfer of risks and rewards, etc.

Use of fair value is all pervasive – from the initial recognition, i.e. transaction date, to subsequent measurements at each balance sheet dates, either for determining carrying value, impairment testing or disclosures.

Observation

Ind AS 109 is similar to IFRS 9, which is globally going to be implemented from 1st January 2018. Whereas, the Indian insurers will be implementing Ind AS 109 from 1st April 2017 ahead of its global peers and would not have any precedents of experience. Intent, business model and substance-over-form will play a big role in accounting. Thus, the insurers will take a big leap from rule-based to principles-based accounting.

Importance of Project Management

Adoption of Ind AS also presents an opportunity to insurers to recast their financial position and operating results on a globally recognised set of accounting pronouncements. This opportunity calls for a high degree of strategy in developing a framework for individual decisions. This framework should focus on the interplay between opening Ind AS equity and the potential for volatility in future earnings.

Through its circular, the IRDA has emphasized the importance of project management. A project management framework would involve managing the entire process – a holistic approach to planning and execution by ensuring that all linkages are established between systems, people and business, besides effective communication with stakeholders.

Observation

Large, complex projects inherently require a thoroughly considered strategy. Early identification of issues, careful consideration of alternatives and quick resolution are critical to a project's success. The strategy, the process and the project structure must facilitate and reinforce management's resolution of issues. Organising a major Ind AS implementation project is a demanding task. The most successful global insurers have devoted significant resources to their GAAP conversion projects – to analyse their major reporting units component by component, to compare the new accounting standards with existing reporting, to determine the appropriate accounting and to systematically obtain the information to meet the identified requirements under Ind AS. Even the first-time adoption policy choices are made with long-term implications as expected for the financial assets.

Applicability and timeline:

Insurance Companies are required to prepare Ind AS-based stand-alone and consolidated financial statements for **FY 2018-19** with comparatives of **FY 2017-18**.

The insurers shall apply Ind AS only as per the above timelines and are not permitted to adopt Ind AS earlier.

In addition, the insurers are required to submit 'pro forma Ind AS financial statements' to the IRDA from quarter ending **31 Dec 2016 onwards** until implementation. The pro forma Ind AS financial statements shall be filed within the time lines specified in the IRDA's circular No. IRDA /F&I /CIR /F&A /012 /01 /2010 dated 28th January, 2010.

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