IFRS 17 – Insurance Contracts
Summary of standard – The East African Edition

The International Accounting Standards Board (IASB) has published a new standard, IFRS 17 'Insurance contracts'. The new standard provides a more uniform measurement and presentation approach for all insurance contracts. These requirements are designed to achieve the goal of a consistent, principle-based accounting for insurance contracts. IFRS 17 supersedes IFRS 4 Insurance Contracts and related interpretations and is effective for periods beginning on or after 1 January 2021, with earlier adoption permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial instruments have also been applied.

IFRS 17 will replace the current IFRS 4, an interim standard for insurance contracts which does not explicitly prescribe measurement of insurance contracts but allows companies to use different practices, often based on local accounting or regulatory requirements.

For instance, Kenya's insurance regulator now requires use of the market consistent Gross Premium Valuation methodology for measurement of insurance contracts but in Uganda, the Net Premium valuation methodology is still permissible. This implies that under IFRS4 standards, insurance financial statements for Uganda and Kenya are not necessarily comparable due to the different measurement methods.

Further, use of regulatory prescribed measurement methods, as is usually the case, does not necessarily address the underlying objective of financial reporting i.e. presentation of the true and fair value of the insurance contracts. This is mainly because the insurance regulators' key objective is protection of policyholders hence their overriding principle is prudence.

Background

This project began as a joint IASB-FASB project to undertake a comprehensive review of accounting for insurance contracts when the IASB added the project to its agenda in September 2001. During the past 16 years of development, the project was better known as "IFRS 4 Phase II".

The Board's objective was to develop a common, high-quality standard that will address recognition, measurement, presentation and disclosure requirements for insurance contracts. In February 2014, the FASB tentatively decided to abandon its convergence work with the IASB on insurance contracts, and instead focus its future efforts on making targeted improvements to the existing U.S. GAAP insurance accounting model.

The IASB issued a discussion paper in 2007 and the first exposure draft "ED/2010/8 Insurance Contracts" in December 2010. A second targeted revised exposure draft "ED/2013/7 Insurance Contracts" was published on 20 June 2013. The IASB finalized its deliberations in March 2016 and made the last set of amendments in February 2017 as a result of the field test activities late 2016.

Scope

An entity shall apply IFRS 17 Insurance contracts to:

- Insurance and reinsurance contracts that it issues;
- Reinsurance contracts it holds; and
- Investment contracts with discretionary participation features ("DPF") it issues, provided the entity also issues insurance contracts. DPF includes bonuses, interest declared on deposit administration business.

Changes from IFRS 4

- The requirement, that in order to apply insurance standard to investment contracts with DPF, an entity has to also issue insurance contracts.
- Introduction of the option to apply IFRS 15 (Revenue from Contracts with Customers) to fixed-fee contracts, provided certain criteria are met.

Level of aggregation

IFRS 17 requires entities to identify portfolios of insurance contracts, which comprises contracts that are subject to similar risks and are managed together. Each portfolio of insurance contracts issued shall 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, if any; and
- A group of the remaining contracts in the portfolio, if any.

In addition, an entity is not permitted to include contracts issued more than one year apart in the same group. 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.

Overview of the new accounting model

The Standard measures insurance contracts either under the General Model or a simplified version of this called the Premium Allocation Approach. The General Model is defined such that at initial recognition an entity shall measure a group of contracts at the total of;

a. The amount of fulfilment cash flows ("FCF"); comprising estimates of future cash flows, an adjustment to reflect the time value of money ("TVM") and the financial risks associated with those future cash flows and a risk adjustment for non-financial risk; and
b. The contractual service margin ("CSM").

This is the component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognize as it provides services under the insurance contracts in the group.

On subsequent measurement, the carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of the liability for remaining coverage and the liability for incurred claims. The liability for remaining coverage comprises the FCF related to future services and the CSM of the group at that date. The liability for incurred claims is measured as the FCF 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 premium allocation approach (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. Using the PAA, the liability for remaining coverage shall be initially recognised as the premiums, if any, received at initial recognition, minus any insurance acquisition cash flows.

Subsequently the carrying amount of the liability is the carrying amount at the start of the reporting period plus the premiums received in the period, minus insurance acquisition cash flows, plus amortization of acquisition cash flows, minus the amount recognised as insurance revenue for coverage provided in that period, and minus any investment component paid or transferred to the liability for incurred claims.

Presentation in the statement of financial performance

Income Statement

An entity shall disaggregate the amounts recognized in the statement(s) of financial performance into:

- **Insurance service result:** comprising insurance revenue arising from the groups of insurance contracts issued, and insurance service expenses arising from a group of insurance contracts it issues, comprising incurred claims and other incurred insurance service expenses. Revenue and insurance service expenses shall exclude any investment components.

  Income or expenses from reinsurance contracts held shall be presented separately from the expenses or income from insurance contracts issued.

- **Insurance finance income or expenses:** comprises the change in the carrying amount of the group of insurance contracts arising from:
  - the effect of the time value of money and changes in the time value of money;
  - the effect of changes in assumptions that relate to financial risk; but excluding any such changes for groups of insurance contracts with direct participating insurance contracts that would instead adjust the CSM.

Balance Sheet

An entity shall present separately in the statement of financial position the carrying amount of groups of: insurance contracts issued that are assets, insurance contracts issued that are liabilities, reinsurance contracts held that are assets and reinsurance contracts held that are liabilities.

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 also been applied.

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.

Under the modified retrospective approach, an entity shall utilize reasonable and supportable information and maximize the use of information that would have been used to apply a full retrospective approach, but need only use information available without undue cost or effort. Under this approach the use of hindsight is permitted, if that is the only practical source of information for the restatement of prior periods.

Under the fair value approach, an entity determines the CSM at the transition date as the difference between the fair value of a group of insurance contracts at that date and the FCF measured at that date. Using this approach, on transition there is no need for annual groups.

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.

Impact of IFRS17

Better information on profitability:

IFRS17 compliant financial statements will provide more information about current and future profitability of insurance contracts. Separation of insurance and financial results in the income statements will allow users of financial statements to better analyze performance of an entity's core insurance business by stripping out the impact of the volatilities from the macro-economic environment. Further, disclosure of unearned profits from the inforce contracts will allow users of financial statements to better assess future profit potential of an insurer.

Comparability: The new standard will allow better comparability of insurance financial statements across jurisdictions as well as industries.

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