IFRS 17

Insurance Contracts

Darrel Scott

May 2023

National Bank of Ukraine

THE WORLD BANK
IBRD • IDA | WORLD BANK GROUP

Швеція
Sverige

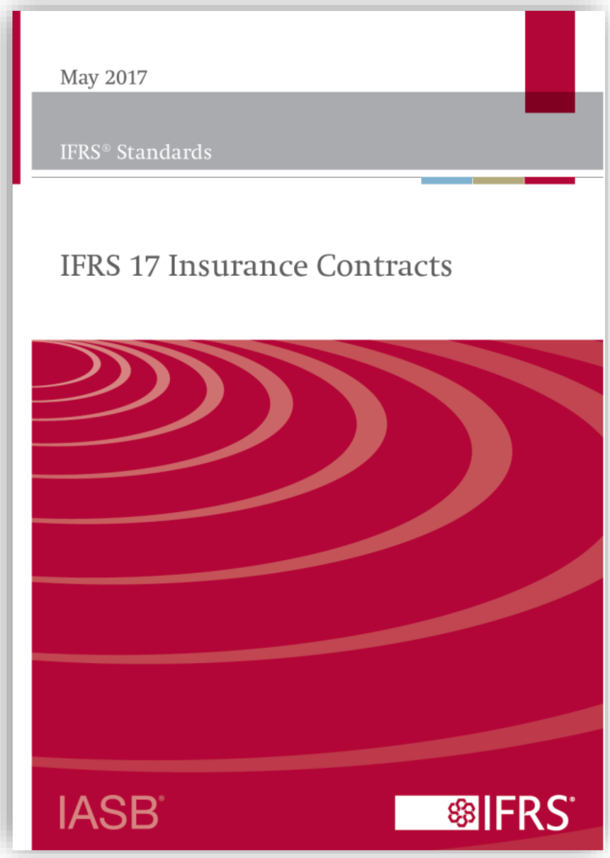
Disclaimer

The International Accounting Standards Board® (IASB), the IFRS Foundation, the authors and the publishers do not accept responsibility for any loss caused by acting or refraining from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

Introduction
IFRS 17 Insurance Contracts



- IFRS 17
  - replaces an interim Standard—IFRS 4
  - requires consistent accounting for all insurance contracts based on a current measurement model
  - will provide useful information about profitability of insurance contracts
- Effective 2023
  - one year restated comparative information
  - early application permitted

Programme

IFRS 17 Programme

Session 1	Recap: Core model and premium allocation approach (PAA)
Session 2	PAA with comparison to unearned premium
Session 3	Challenges in applying PAA
Session 4	Disclosure and presentation requirement
Session 5	Transition, transition presentations and disclosures
Session 6	Audit reports and compliance with IFRS
Session 7	

Compliance with IFRS

Fair presentation

» Financial statements must present fairly the financial position, financial performance and cash flows of an entity

» Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses

» The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation

IAS 1.15

Statement of compliance

- An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes
- An entity shall not describe financial statements as complying with IFRSs unless they comply with all the requirements of IFRSs

IAS 1.16

Principles of presentation

Overall principles

Fair presentation

Financial statements **fairly present** the financial position, financial performance and cash flows of an entity

- Fair presentation is a faithful representation of an economic phenomena (ie complete, neutral and free from error)
- Application of IFRS with additional disclosures when necessary is *presumed* to result in a fair presentation
- In the extremely rare circumstance when compliance with a requirement would be so misleading as to conflict with the objective of financial reporting, an entity may deviate from it

IAS 1.19

Going concern

Financial statements are prepared on a going concern basis

- An entity is a going concern **unless** management intend to liquidate the entity or to cease trading, or have no realistic alternative to liquidation in the foreseeable future.
- When preparing financial statements, management must assess the ability of the reporting entity to continue as a going concern.

Conceptual framework 3.9, IAS 1.25 AND 26

Accrual basis

Financial statements are prepared applying the <u>accrual basis</u>...

- An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.
- An entity recognises items as assets, liabilities, equity, income and expenses when they satisfy the definitions and recognition criteria for those elements in the *Conceptual Framework*

IAS 1.27 and 28

Materiality and aggregation

Present separately each material class of similar items.

Present separately material items of a **dissimilar nature or function**

- Aggregation is the presentation of condensed and classified data
- If an item is not individually material, it is aggregated with other items
- Entity decides how it aggregates information
  - must not reduce understandability by obscuring material information with immaterial information or
  - **Not** aggregate material items that have different natures or functions.
- An entity need not provide a specific disclosure required by an IFRS **if** the information resulting from that disclosure is not material.

IAS 1.29 to 31

Offsetting

An entity **shall not offset** assets and liabilities or income and expenses, unless required or permitted by an IFRS

- An entity reports separately both assets and liabilities, and income and expenses
- Offsetting detracts from the ability of users both to understand the transactions, other events and conditions

IAS 1.32 and 33

Comparability and consistency

Present **comparative information** for all amounts reported
Retain the presentation and classification from one period to the next

- Present comparative information in respect of the preceding period for all amounts reported
- Include comparative information for narrative and descriptive information if relevant to understanding current period
- Retain the presentation and classification unless:
  - Warranted by a significant change in nature of entity's operations
  - an IFRS requires a change

IAS 1.38, 38A and 45

Accounting policies, accounting estimates and errors

Accounting policies

Accounting policies are <u>specific principles, bases, conventions</u>, rules and practices applied by an entity in preparing and presenting financial statements

- Accounting policies are designed to provide information capable of making a difference in the decisions made by users (ie relevant) that can be faithfully represented—complete, neutral and free from error
- An entity can voluntarily change an accounting policy **<u>only if</u>** the change results in the financial statements providing reliable and more relevant information
- A change in accounting policy is applied retrospectively

IAS 8.5, 8 to 10

Applying accounting policies

- An entity **need not** apply its accounting policies when the effect of applying them is immaterial
  - an entity specific application of the materiality aspect of relevance
- It **is not** a change in accounting policy to apply for the first time a new or previously undisclosed accounting policy to transactions, other events or conditions that:
  - did not previously occur (or occurred but were immaterial); or
  - that differ in substance from those previously occurring

IAS 8.8 and 16

Accounting estimates

- Many items in financial statements cannot be measured with precision but can only be estimated
- Estimation involves judgements based on the latest available, reliable information
- Use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability
- An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience

IAS 8.32 - 34

Change in accounting estimate

Changes in <u>accounting estimates</u> result from new information or new developments

- An estimate may need revision if:
  - changes occur in circumstances on which estimate was based; or
  - as a result of new information or more experience
- By its nature, the revision of an estimate:
  - does **<u>not</u>** relate to prior periods; and
  - is not correction of an error
- A change in estimate is applied prospectively

IAS 8.5 and 34

Change in estimate vs change in accounting policy

- Generally, a change in measurement basis applied is:
  - a change in accounting policy;
  - **not** a change in accounting estimate.
- When it is difficult to distinguish a change in accounting policy from a change in accounting estimate, the change is treated as a change in accounting estimate
  - Note: a changes in measurement bases can also be transfers from a change in the purpose to which the asset is put or a change in circumstance

IAS 8.35

Prior period errors

Prior period errors are omissions from, and misstatements in, the entity's financial statements

- For one or more prior periods arising from failure to, or misuse of, reliable information that:
  - was available when financial statements for those periods were authorised for issue; and
  - could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements
- A prior period error is **corrected retrospectively**

IAS 8.5

Errors

- Errors can arise in respect of the recognition, measurements, presentation or disclosure of elements of financial statements.
- Financial statements do not comply with IFRS if they contain either:
  - material errors (errors that could affect a user's decision made on the basis of the financial info); or
  - immaterial errors **made intentionally** to achieve a particular presentation of an entity's financial position, financial performance or cash flows
- Current period errors must be fixed to **achieve compliance**

IAS 8.41

Applying changes retrospectively

- Impracticability exception
  - a practical expedient (rule)
  - anti-abuse—prohibits the use of hindsight when applying a new accounting policy to, or correcting amounts for, a prior period
- Transitional provisions when applying for the first time new and amended Standards and Interpretations
  - the IASB's application of the cost constraint

IAS 8.5, 50.53

Principles of disclosure

Principles of disclosure

Faithful representation is complete, neutral and free from error

- Financial reports show economic phenomena in **words & numbers**.
- **Complete depiction** includes all information necessary for a user to understand phenomenon being depicted, including all necessary descriptions and explanations….
- May entail explanations of significant facts about quality and nature of items, factors and circumstances that might affect that quality and nature, and process used to determine numerical depiction
- Information material to understanding financial statements should be disclosed even if no IFRS requires it

Conceptual Framework 2.12 to 2.14, IAS 1.18 and IAS 1.31

Principles of disclosure

- Notes (to the financial statements)
  - contain information in addition to that in the primary statements
  - provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for recognition
  - disclose information required (explicitly or implicitly) not presented elsewhere in the financial statements
  - An entity **cannot rectify inappropriate accounting policies** either by disclosure of the accounting policies used or by notes or explanatory material

IAS 1.16 and 1.18

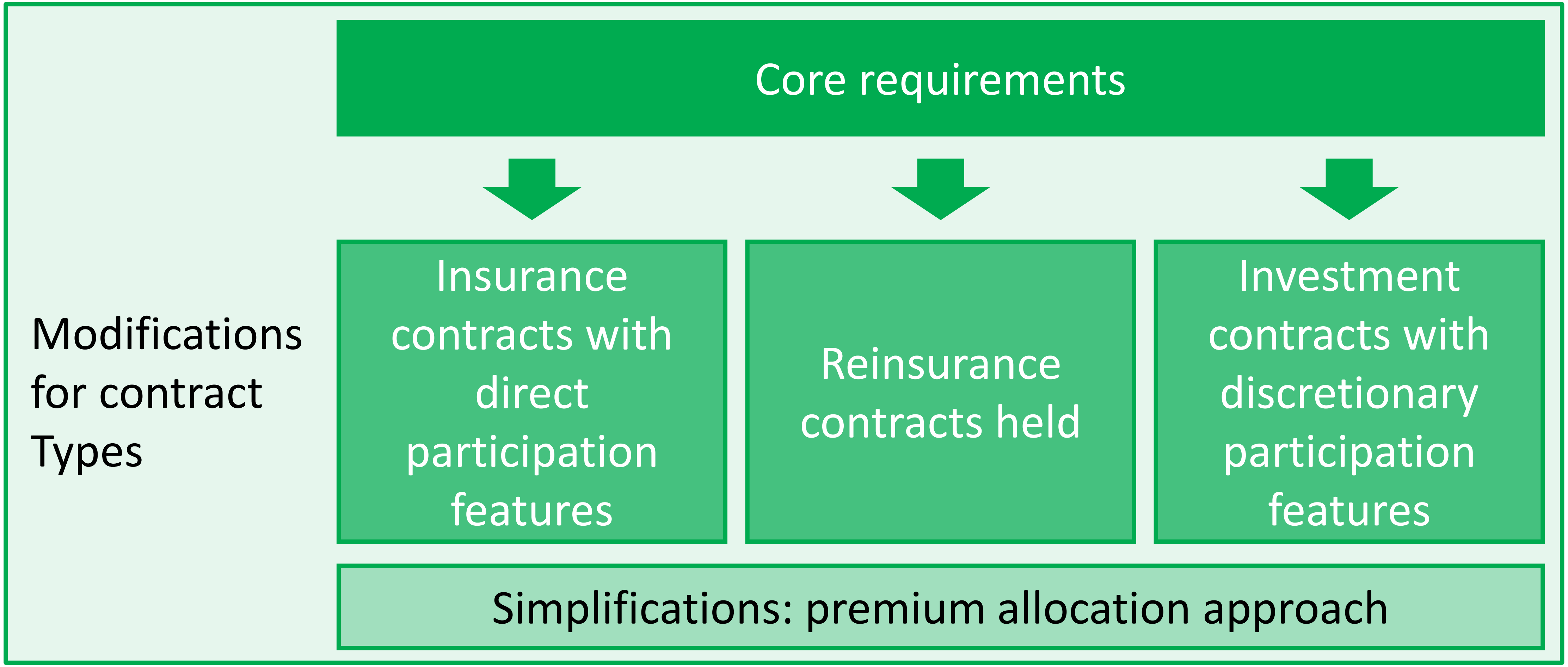
Principles of disclosure

- Notes (to the financial statements)
  - present information about basis of preparation and specific accounting policies used
  - disclose significant judgements management has made in applying the entity's accounting policies (apart from estimates)
  - disclose information about major sources of estimation uncertainty

IAS 1.16 and 1.18

What are the primary IFRS 17 requirements

Core Requirements
Snapshot of IFRS 17 Approaches



IFRS 17 models

Core
Liability for remaining coverage

PV future cash flows	Risk adjustment	Unearned profit

+

Core
Liability for Incurred claims

PV future cash flows	Risk adjustment

=

IFRS 17 liability

Premium allocation
Liability for remaining coverage

- » No split required
- » Cash flows based, limited forecasting
- » Other practical expedients

+

Premium allocation
Liability for incurred claims

- » Consistent with core
- » Practical expedient for discount rate

=

IFRS 17 liability

Ukraine
Entities currently applying UPR

Automatically qualify for PAA

- Reuse much data and finance systems
- Can likely use existing groups/ings

Challenges

- Onerous contracts
  - Facts and circumstances
- Liability for incurred claims
  - But have expedients
  - Typically short term

Do not automatically qualify

- May be able to consider materiality
- May be able to use actuarial data

Challenges

- Eligibility test
- Applying the GMM model
  - Grouping more challenging
  - Actuarial data
  - CSM engine/process
  - Interest/risk/cash flow data

Challenges applying IFRS 17
Entity specific

Tight timelines

- Effective date has already passed,
- 8 months to 1st yearend
- Systems need to accommodate reporting cycle

Integrated models and processes

Integration of:
- accounting and actuarial systems
- Procurement systems
- Client and pricing systems

Technology

- Integration of existing systems
- New systems for CSM, some cash flow management

Data

Significant data
- generation,
- management and
- validation requirements

Challenges applying IFRS 17
IFRS 17 specific

Choices

IFRS 17 includes choices
- Simplified model
- OCI
- Practical expedients

Contract grouping

Grouping differs from most IFRS 4:
- Portfolio level
- Profitability
- Annual cohort

Estimations

- Future cash flows
- Risk and risk run off
- Updated interest rate yield curve
- Contract group run-off

Measurement

- Future contract performance
- Insurance liability
- CSM release pattern
- Calculations

Challenges with compliance

Challenges to adopting IFRS 17

Competing projects

Regulatory reform, financial accounting reform, data protection and fintech

Quality of data

Sourcing robust and verifiable data

Cultural integration

Integrating actuarial and accounting culture

Conservatism

Many insurers maintained conservative reserves that have proven hard to release

Group accounting

Difference in accounting at subsidiary level challenge group wide projects

Timelines

Many insurers have struggled to meet deadlines

Unique Ukrainian Challenges
Effects of Russian invasion

Current status of implementation

Implementation unavoidably delayed by the events

Quality of data

Significant change in veracity and reliability of historical data

Legal uncertainty

Uncertainty as to status of contracts and claims

IBNR Claims

Delay in reporting claims unprecedented and unpredictable

Recoveries

Source and quantum of recoveries uncertain

Going concern

Level of known, expected & potential claims challenge solvency

What are the alternatives

Objectives

- To provide useful, reliable and timeous information to
  - Regulators
  - Other stakeholders including policyholders
- Maximise verifiability and usefulness of audit process
- Minimise wasted effort
- Note: Even in highly uncertain circumstances, insurer can value add the information they provide:
  - Insider knowledge
  - Sensitivity analysis

Reliability of data

Example	High ⟸ Degree of reliability ⟹ Low	
UPR to PAA	Application of existing UPR methodology with remapping	Estimates of LIC/onerous
UPR to GMM	Application of existing UPR data with reworking – shorter timeframe	Estimates of forward looking data, LIC and onerous contracts
Life to GMM[1]	Use of existing actuarial data for determination of FCF/BEL, including risk margin	CSM process, uncertain estimates
Life to GMM[2]	Use of existing forecasts	CSM engine, uncertain estimates, uncertain measurements, limited understanding of own data

[1] Sophisticated actuarial approach/Solvency II

[2] Limited or no actuarial skills/data

Possible alternatives

Full compliance with IFRS 17	Partial compliance with IFRS 17	No compliance with IFRS 17
• Insurers with international, IFRS 17 compliant owners • Listed insurers • Insurers currently applying UPR, eligible for PAA	• Insurers with international, IFRS 17 compliant owners • Listed insurers • Insurers currently applying UPR, eligible for PAA	• Domestic life insurers • UPR insurers required to apply GMM with long dated contracts

Types of audit opinion

- Unqualified opinion: auditors are satisfied with insurer's financial reporting
- Limited scope opinion: auditors are not able to perform all the procedures they considered necessary
- Qualified opinion: the auditors are unable to obtain evidence in support of a specific assertion or measurement in the financial statements
- Adverse opinion: auditors disagree with an assertion or measurement in the financial statements
- Disclaimer of opinion: the auditors are unable to express an opinion

Collectively referred to as qualified opinions

Alternatives
Full compliance with IFRS 17

Stay regulatory sanctions for audit qualifications

Insurers

- Use existing information and data to apply IFRS 17 (especially UPR)
- Obtain new data, and build new processes required processes
- Estimate uncertain future data using ‘best endeavours’
- Explicitly disclose data uncertainty and areas requiring judgement

Auditors

- All else being equal, will issue an unqualified report for compliance with IFRS 17
- May qualify for data uncertainty/ inability to obtain evidence

Alternatives
Full compliance with IFRS 17

Stay regulatory sanctions for audit qualifications

Advantages	Disadvantages

• Adhere to IFRS 17
• Unqualified audit provide robust, comparable information
• Limited future changes as new information becomes available
• Enhanced comparability with international entities
• Consolidation
	• Significant effort required at a time of limited resources
	• Qualifications may none-the-less occur:
	    • Going concern
	    • Uncertainty
	• Some redo may be required once situation stabilises

Alternatives
Partial compliance with IFRS 17

Stay regulatory sanctions for audit qualifications

Insurers

- Use existing information and data to apply IFRS 17
- Obtain new data, and build new processes as 'far as possible'
- Estimate other data & measurement using 'best endeavours'
- Explicitly disclose data weaknesses and areas requiring judgement

Auditors

- All else being equal, will not qualify areas of compliance with IFRS 17
- May qualify for uncertainty/inability to obtain evidence:
    - Entire AFS if pervasive
    - Otherwise ringfenced areas

Alternatives
Partial compliance with IFRS 17

Stay regulatory sanctions for audit qualifications

Advantages	Disadvantages
• Adhere closely to IFRS 17 • Unqualified sections provide robust, comparable information • Limited future changes as new information becomes available • Enhanced comparability with international entities • Continuous adherence to IFRS	• Significant effort required at a time of limited resources • Qualifications detract from usefulness • Some redo may be required once situation stabilises • If entire AFS qualified, then detracts from usefulness and effort

Alternatives
No compliance with IFRS 17 (comply with IFRS 4)

Stay regulatory sanctions for audit qualifications

Insurers apply IFRS 4	Auditors
• Suspend compliance with IFRS • Provide information based on existing systems, processes and data • Explicitly state that financial statements are not compliant with 2023 IFRS • Provide available disclosures for effects of IFRS 17	• Will qualify for non-compliance with IFRS • However, ideally won’t qualify for adherence to accounting basis (IFRS 4) • May qualify for data uncertainty/ inability to obtain evidence

Alternatives
No compliance with IFRS 17 (comply with IFRS 4)

Stay regulatory sanctions for audit qualifications

Advantages	Disadvantages
• Some usefulness of AFS retained • Regulators and other stakeholders continue to use and rely on AFS • Comparable with the past • Limits wasted effort • Audit qualifications can probably be ringfenced	• Qualifications detract from usefulness • Will none-the-less require a full transition at some point in the future (postpones effort) • Limited comparability with peers in and outside Ukraine • May have to apply IFRS 1 in future

What are the repercussions

Application before ready

- Potential to harm the credibility of industry in Ukraine
  - there will be errors in the financial statements,
  - some which may be identified in the reporting period by auditors, and
  - others that may only be identified in later years
- Poor reporting may reduce trust at a crucial time
- There may still be insufficient information available to quantify the extent of error
- Result will be AFS prepared at high cost, but with limited benefit
- Insurers may have to reissue the financial statements

Non-application if ready

- Potential to harm the credibility of industry in Ukraine
  - Industry/entity non-compliant at a crucial time
- Wasted effort that will need to be revisited/redone at a future time
- Potentially need to reissue financials at a later date, or
- May be required to apply IFRS 1 unnecessarily, or alternatively to 'track the effects' of IFRS 17
- Consolidation complications

Supervision

- Prudential supervision typically relies to at least some extent on audited financial statements
- Unreliable financial statements, or financial statements that are significantly qualified or disclaimed may not be able to be used as a reasonable basis for prudential proposes
- Financial statements prepared under different bases will complicate supervision
- This may impair the supervisory process at an important time for the sector

First Time adoption

First Time adoption after a break

Insurer that did not state unreserved compliance with IFRS in most recent AFS

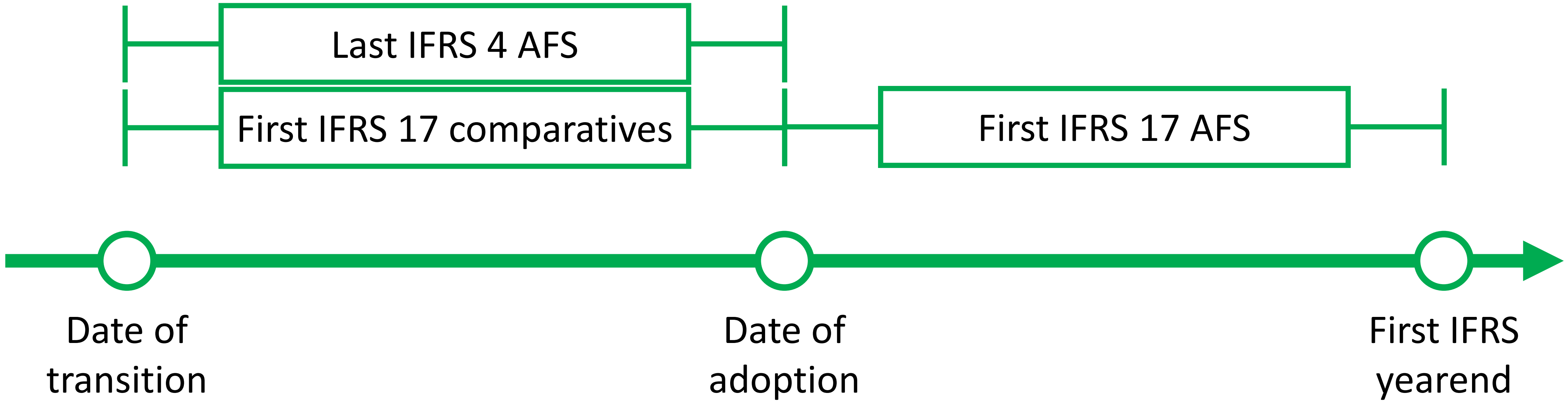
Either

Apply IFRS 1	**Or**	Apply IFRSs retrospectively in accordance with IAS 8

Fully retrospective, except:
• Mandatory exceptions, eg
  • Estimates
  • Derecognition of FIs
  • IFRS 17 transition
• Optional exceptions
		Fully retrospective to effective date of IFRS 17:
		• IFRS transition relief ends 1 Jan 2022/23 as though adopted on time
		• Plus all IFRS 1 disclosures

IFRS 1.4A and 4B

Time line



- Opening IFRS balance Sheet
- Retrospective application unless exempt

- Balance sheet and income statement for comparative period

- First set of IFRS compliant AFS (with comparatives)
- Polices compliant with requirements at this date

Disclosure
Explanation

- Explain how transition affected financial position, financial performance and cash flows, including reconciliations between previous GAAP and IFRS for:
  - Change in equity at transition date and date of last GAAP financials
  - Differences in total comprehensive income for most recent comparative
  - Changes in impairments of non financial assets
- Any errors under previous GAAP should clearly distinguished
- Disclose if the insurer **did not** previously present financial statements
- Explanations what specific recognition and measurement exemptions permitted under IFRS 1 have been applied

IFRS 1.23 to 28

Thank you