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IFRS 17: The controversy that has not come to an end

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As the first comprehensive and truly International Financial Reporting Standard (IFRS) to set up a consistent accounting framework for all insurance contracts, IFRS 17 is the result of an initiative by the International Accounting Standards Board (IASB).

Due to insufficient time to complete the project before the mandatory implementation of IFRS in 2005, the IASB divided the project into two phases. Phase one ended in 2004 with the release of IFRS 4, while phase two was completed with the launch of IFRS 17 in 2017 to replace IFRS 4. However, due to many challenges in preparing for the application of the latter, the IASB temporarily halted it the start of IFRS 17 application until 2022.

IFRS 4 requires insurance companies to present information about insurance contracts, but does not prescribe the measurement method of such contracts. Instead, it allows companies to use local accounting requirements, or variations of those requirements, for the measurement of their insurance contracts issued. As a result, investors and analysts found it difficult to identify which groups of contracts are profit-making or loss-making, and to analyse trend information about such contracts.

Meanwhile, IFRS 17 establishes a consistent accounting framework for all insurance contracts. It introduces three evaluation models: the general model, the premium allocation approach, and the variable fee approach. Insurers are required to measure insurance contracts using the updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to the contracts. This requirement will provide transparent reporting about the financial position and risks of insurers.

IFRS 17 also requires insurers to recognise profits as it delivers insurance services, rather than when they receive premiums as current accounting practices dictate. The insurer must also provide information about insurance contract profits that they expect to recognise in the future. This information will produce metrics that can be used to evaluate the performance of insurers and how the performance changes over time.

IFRS 17 promises to improve the transparency and comparability of information. At the same time, it is considered a very costly and complex standard to apply and maintain.

IFRS 17 creates a consistent accounting framework for all insurance contracts, thus increasing the comparability of information between different insurance contracts, between insurers in different territories, and between businesses in different industries. IFRS 17, therefore, helps provide more transparent and useful information about insurance obligations and the current and future profit and loss situation of insurers.

However, the application of IFRS 17 also presents major challenges because of the complexity of this standard. The first is the impact on operations because IFRS 17 requires an insurer to track historical data on a more granular level, perform often complicated calculations, and compare this historical information against current period information. This leads to change not only in actuarial methods, but also in IT and reporting systems, as well as in the internal operating procedures of insurers.

The IT system of insurers must be strong enough to collect, store, and track data in the format and volume required by IFRS 17. Enterprises must also spend more to employ and develop people with appropriate skills for applying this standard. These changes will require a lot of time, effort, and financial investment from insurers.

Next is the impact on financial reporting due to the application of a common standard. Previously, insurers could select to apply different accounting practices and each insurer also issued different types of insurance contracts. For those reasons, IFRS 17's effects on financial reporting are expected to differ vastly between insurers. For example, short-term insurance contracts will not significantly be affected, whereas long-term ones will be greatly affected. This leads to changes in the financial statements of insurers and they need to communicate these changes to their business stakeholders.

After nearly 20 years of debate, the issuance of IFRS 17 in 2017 did not end discussions on how to account for an insurance contract. There are still many lingering questions about how to apply this standard and the impact that it will have on the financial reporting results and the consequent market assessment of an insurance company.

What's certain is that IFRS 17 is a significant challenge to the entire organisation and not just for the actuarial and finance departments. The extension of this standard to 2022 will offer insurers more time for preparations, but IFRS 17 will continue to be a challenge that should be tackled as soon as possible.■