Volume **XVII**/2021 ISSN 2344-102X
Issue (XXVII) / **October** 2021 ISSN-L 2344-102X

# EXHAUSTIVE IMPACT OF IFRS 17 IN THE CONTEXT OF THE ACCOUNTING OF INSURANCE CONTRACTS

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**Abstract**
*IFRS 17 "Insurance Contracts" represents a new stage in the interpretation and accounting of Insurance Contracts. The need to apply this Standard is imperative in the context of the continuous development of the Insurance field, both nationally and internationally. Given the fact that IFRS 17 "Insurance Contracts" replaces the implemented standard IFRS 4 "Insurance Contracts", we tried to identify the particularities and innovative elements that are brought with the implementation of the new standard. One of the limitations of the study is that the standard is not yet widely applied, so we have less information on its applicability. At the same time, it stimulates us to carry out a larger study that would serve as a support for the entities that are to implement IFRS 17 "Insurance Contracts". The topicality of the subject is determined first of all that this standard has a mandatory character of application and a new vision on the accounting methods of the Insurance Contracts.*

**Keywords:** *insurance contracts; international financial reporting standards (IFRS); service contract margin (SCM); audit*

**JEL Classification:** *M40, M41*

## I. INTRODUCTION

The insurance services market is a sector that is indispensable in the current period, with a continuous evolution at a global level. Given the fact that at the international level the entities have the obligation that both the accounting and the preparation of the Financial Statements be carried out in accordance with IFRS, the Republic of Moldova has adopted national legislation so that public interest entities, including insurance companies, apply IFRS.

The elaboration of the new IFRS 17 "Insurance Contracts" to replace the current standard, which was in fact conceived from the outset as an interim one, namely IFRS 4 "Insurance Contracts", is also the subject of the present study. Given the fact that the obligation to implement the new IFRS 17 "Insurance Contracts" is established starting with January 1, 2023, there is room for interpretations, analysis and optimal identification of the method and the transition period. The rules that will be the basis for the implementation of the new IFRS 17 "Insurance Contracts" are to be established.

The first step is to see the changes to be made by the entities that will apply the new standard, by comparing the two standards. The underlying principles are set out in the Accounting Policies issued by the entity under IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" which specify that when an IFRS specifically applies to a transaction, other event or other conditions, the accounting policy applied or the accounting policies of that item must be determined by applying that IAS. In the context of the above, the reporting of the insurance contracts they issue and the reinsurance contracts they currently hold is carried out in accordance with the provisions of IFRS 4 "Insurance Contracts", as well as the reporting of financial instruments is specified by this standard, namely those issued with a discretionary participation feature. At the same time, IFRS 7 “Financial Instruments: Disclosures” required the disclosure of information about financial instruments, including financial instruments that have such characteristics.

*The purpose* of this study is to determine the new elements found in IFRS 17 “Insurance Contracts” and the difficulties in their implementation. To achieve the goal, as a *methodological support of the investigation* served the universal method of researching matter, phenomena, processes - the dialectical method of knowledge with its components: analysis, synthesis, induction and deduction, and methods inherent in economic disciplines: observation, comparison, selection, grouping, scientific abstraction. The research was performed based on the provisions of IFRSs, as well as specialized bibliographic sources.

## II. LITERATURE REVIEW

Taking into account the fact that the implementation of the new standard IFRS 17 “Insurance Contracts” is to be performed starting with January 1, 2023, we tried to perform an analysis to determine how approached this topic was in the literature. For this research we turned to the Web of Science in the period 2017 - 2021 entitled "Insurance Contracts" or "IFRS 17". Based on the selected data, we found that during the period, 9 articles were developed that included the indicated keywords. To determine the interconnection between keywords, we downloaded the information related to the Title, year of publication, keywords from the o Web of Science site (se Figure 1). Through the VosViewer software we mapped the keywords thus mapping the clusters, links and distances between them, being presented the network of interconnections between them.

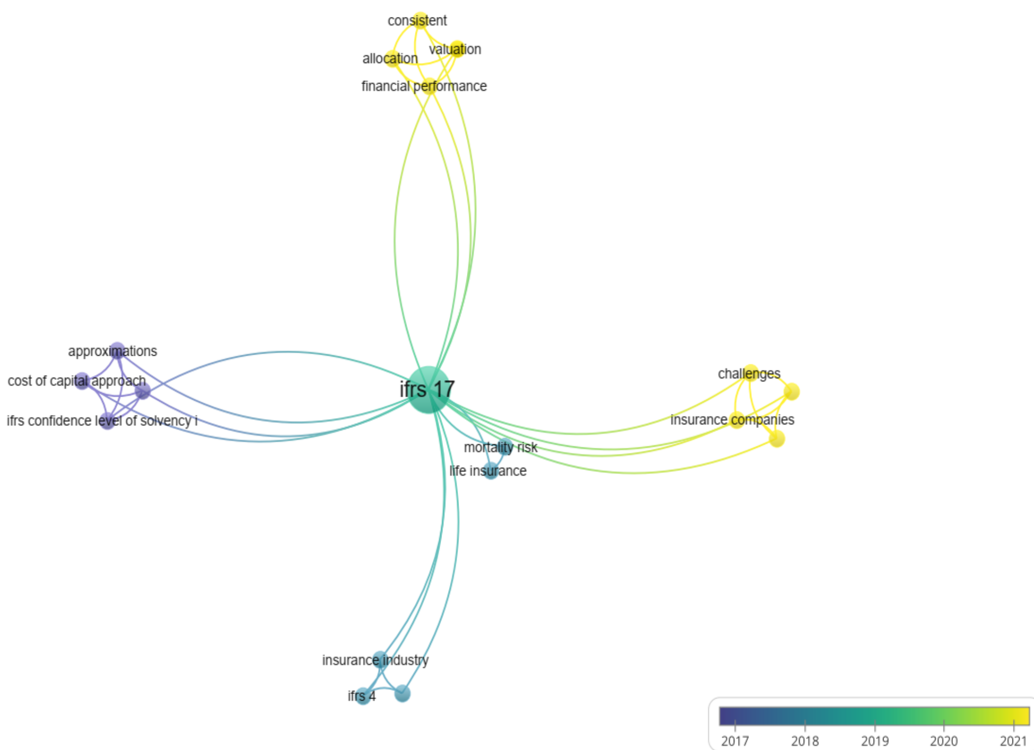


**Figure 1 – Keyword map grouped into clusters**
Source: Elaborated by the authors based on VosViewer

Based on the information downloaded from the Web of Science platform, the keyword map was sketched using VosViewer, which is shown in Figure 1. It comprises five clusters, differentiated by colors. The size of the clusters shows the number of works that contain the keyword. The branches between the clusters differ in length and color and show the appearance of keywords in publications depending on the year of publication. We can see that in 2021 the keywords appear more often in the literature, which is appreciated positively. At the same time, the small number of published articles offers the possibility to research this segment in more detail.

Following the information analyzed on the official pages of the National Commission for Financial Markets of the Republic of Moldova (CNPF) and the Romanian Financial Supervisory Authority (ASF), which represent the Authorities regulating the activity of the participants on the Insurance Market, we can conclude that the insurance activity is constantly increasing. In the diagrams below we can see that both non-life and life insurance have a growing trend.

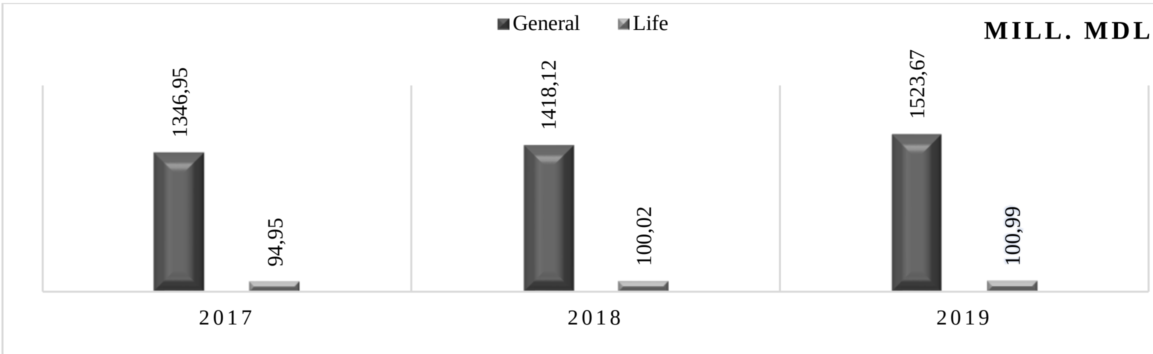


**Figure 2 – Evolution of Gross Written Premiums on the market in R.M.**
Source: Elaborated by the authors based on www.cnpf.md

We note that in the Republic of Moldova general insurance contracts have a faster growth trend compared to life insurance contracts. Thus, in 2019 compared to 2018, the value of general insurance contracts increased by 7.44%, and the value of life insurance contracts - by 0.97%. In Figure 2 we can see the evolution of Insurance Contracts in Romania.

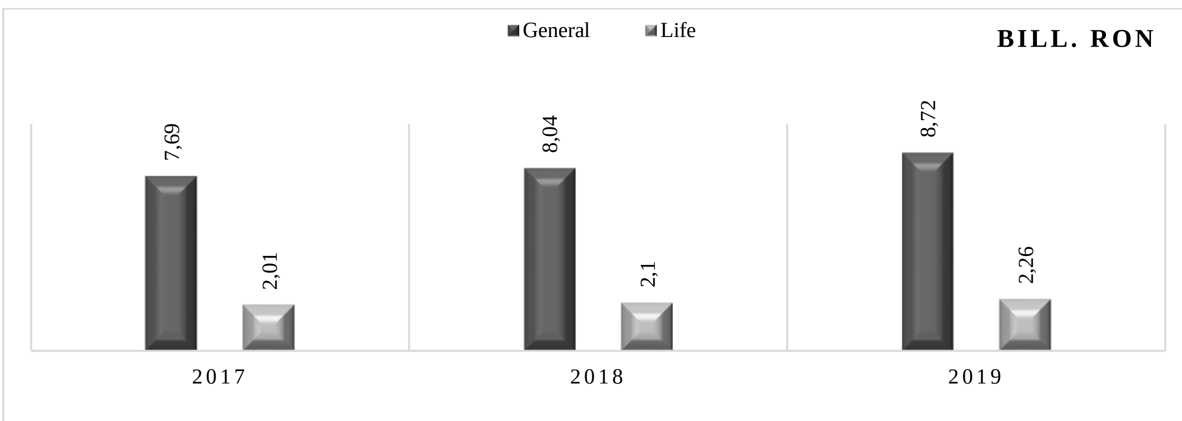


**Figure 3 –Evolution of Gross Written Premiums on the Romanian market**
Source: Elaborated by the authors based on www.asfromania.*ro*

From the data presented above we see that the trend of faster growth of general insurance contracts compared to life insurance contracts is maintained in Romania. We also see that the value of general insurance contracts increased in 2019 compared to 2017 by 8.45%, and the value of life contracts - by 7.61%. Therefore, the most accurate and appropriate evidence is essential in the development of this market segment, and information on transactions or other events and the conditions for their application must contain information that is as relevant and reliable as possible.

Currently, the record of insurance contracts is performed on the basis of IFRS 4 “Insurance Contracts” which was issued in March 2004 and is applicable for the period starting from January 1, 2005, or thereafter until January 1, 2023 when will be replaced by IFRS 17 "Insurance Contracts".

IFRS 4 “Insurance Contracts” is the first Guide issued by the IASB on Accounting for Insurance Contracts and was issued because there was an urgent need to improve the methods of presenting Insurance Contracts and some practices for timely recognition and measurement, thus, this standard has been applied by listed companies throughout Europe and elsewhere since 2005. Therefore, IFRS 4 “Insurance Contracts” provides guidance on how to financially report insurance contracts to any entity that issues such contracts (described in this IFRS as an insurer), whether the entity is treated as an insurance company for legal and regulatory purposes. It also covers financial instruments issued by any entity that have a discretionary participation feature. It does not apply to the assets and liabilities of an entity that do not arise from insurance contracts or financial instruments with discretionary participation characteristics.

IFRS 4 "Insurance Contracts" being only a "transit" standard, is to be replaced by IFRS 17 "Insurance Contracts", which comes with a new breath, with much better defined and outlined procedures to be granted to both users internal and external, higher security, a clearer perception of risks, profitability and financial positions of insurance companies.

Given the fact that IFRS 17 has gone through a long period of formulation, analysis, study all these efforts have led to the creation of a much broader and more well-defined Standard. Below we have formulated a chronology of the main changes that IFRS 17 has gone through until this stage.

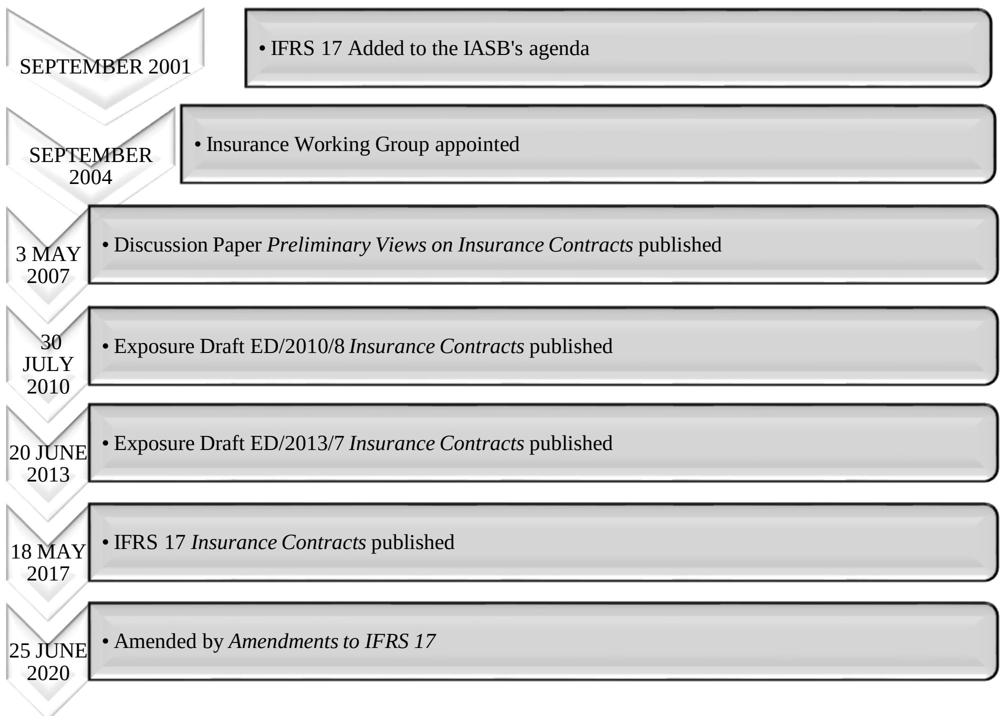


**Figure 4 –History of the evolution of IFRS 17 amendments from the initiation stage to the present**

Source: Elaborated by the authors

On 25 June 2020 the amendments included the postponement of the date of entry into force of the standard, being valid for annual periods beginning on or after 1 January 2023, although it was initially approved on 1 January 2021. Also, on 19 July 2021 Accounting Regulatory Committee (ARC), voted in favor of the approval of IFRS 17 "Insurance Contracts" and for its implementation in the European Union. Final approval is expected in the fourth quarter of 2021.

In accordance with IFRS 17 “Insurance Contracts”, the principles for the recognition, measurement, presentation and disclosure of insurance contracts in the standard are established. The objective of IFRS 17 “Insurance Contracts” is to ensure that an entity provides relevant information that accurately represents these contracts. This information provides users of financial statements with a basis for assessing the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

At the initial stage, the application criteria must be considered, an entity must apply IFRS 17 "Insurance Contracts" if:

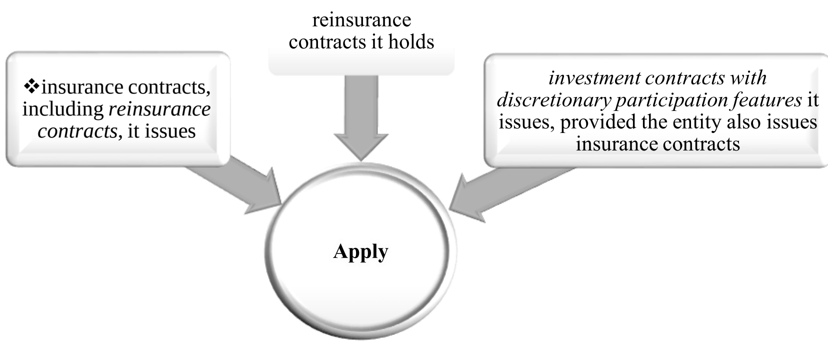


**Figure 5 – Criteria for the application of IFRS 17**
Source: Elaborated by the authors

At the same time, we must keep in mind that some contracts meet the definition of an insurance contract, but have as their main purpose the provision of services for a fixed fee. Such issued contracts fall within the scope of the standard, unless the entity chooses to apply IFRS 15 "Revenue from contracts with customers" and to comply with the following conditions (Grosu & Socoliuc, 2016):

a) the entity does not reflect an assessment of the risk associated with an individual customer in determining the contract price with that customer;

b) the contract with the client must be performed primarily by providing a service, rather than by making cash payments to the client; and

c) the insurance risk assumed by the contract comes primarily from the use of the services by the client, rather than from the uncertainty regarding the cost of the respective services.

As it is specified in IFRS 17 "Insurance Contracts", the recognition by an entity of a group of insurance contracts that it issues takes place taking into account the primary event that takes place, among the criteria set out in Figure 6.

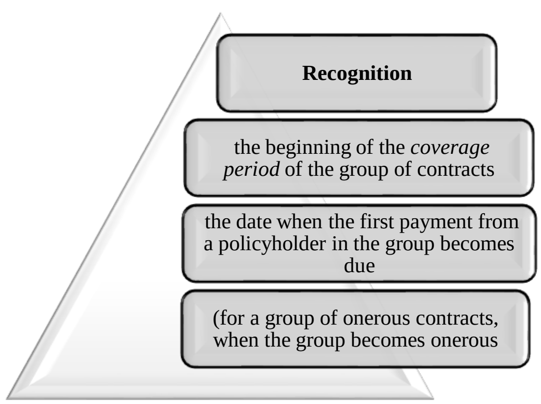


**Figure 6 – Criteria for the recognition of insurance contracts**
Source: Elaborated by the authors

At the same time as applying the above criteria to initial recognition, an entity shall measure a group of insurance contracts as a total of:

• (a) free cash flows ("FCF"), which include:

• (i) estimates of future cash flows;

• (ii) an adjustment to reflect the time value of money ("TVM") and the financial risks associated with future cash flows;

• (iii) a risk adjustment for non-financial risk.

• (b) service contract margin ("SCM"), which represents the uncollected profit of the group of insurance contracts, which the entity will calculate upon recognition and which is subsequently released during the term of the contract in a systematic manner, which best reflects the remaining transfer of future services provided under the contract. The approach is one of the main challenges of implementing the new IFRS given that it is a new concept. Through this approach, the profit is uniformly recognized for the entire duration of the insurance contract. And the SCM cannot have negative values, given the fact that losses from unprofitable contracts are immediately recorded in the profit and loss statement.

The standard states that the entity shall include all future cash flows within the limits of each group contract (Cosmulese & Grosu, 2019). Under the new IFRS, the entity can estimate future cash flows at a higher level of aggregation and then allocate the resulting cash flows to individual groups of contracts.

An entity may simplify the method of recognizing insurance contracts by applying the Premium Allocation Approach (PAA) method if:

• (a) the entity reasonably expects that some simplifications will have an impact on the remaining value of insurance contracts, which will not substantially differentiate in case of applying the standard model;

• (b) the period of coverage of each group insurance contract is not more than one year.

Another very important and complex stage for the application of IFRS 17 "Insurance Contracts" is the transition period. Given the major effect expected with the application of the new standard and the multitude of changes that will occur, it is very important that entities use the transition period as rationally as possible, so that: on the one hand, the applied valuation models to reflect as accurately as possible the financial situation, and on the other hand, to be prepared to implement IFRS 17 "Insurance Contracts" on January 1, 2023.

The principles set out in IFRS 17 applicable during the transition period are set out below:

- An entity shall apply the standard in a retrospective way, unless it is impracticable, in which case the entities have the option to use either the modified retrospective approach or the fair value approach.
- In the modified retrospective approach, an entity shall use reasonable and acceptable information and maximize the use of information that would have been used to apply a complete retrospective approach, but shall use only available information without undue cost or effort. According to this approach, the use of the retrospective is allowed, if it is the only practical source of information for the restatement of previous periods.
- According to the fair value approach, an entity determines the Service Contractual Margin (SCM) on the transition date as the difference between the fair value of a group of insurance contracts on that date and the Free Cash Flow (FCF) measured on that date. Using this approach, no annual groups are needed for the transition.
- On the date of initial application of the standard, those entities that already apply IFRS 9 may retrospectively designate and reclassify financial assets held in respect of activities related to contracts within the scope of the standard.
- Entities may choose not to revalue IFRS 9 compared to any difference between the prior carrying amount of these financial assets and the carrying amount on the date of the initial application recognized in opening capital on the date of the initial application. Any restatements of prior periods must reflect all the requirements of IFRS 9.

## III. Results Of The Study

Although IFRS 17 is to be widely applied as of January 1, 2023, a deeper study of it will reduce the efforts made by the entity. We must bear in mind that IFRS 17 imposes or recommends the following rules:

1. Separation from insurance contracts of: a) the specified built-in derivative instruments; b) the direct investment components; c) the distinct execution obligations.

2. Separate presentation of: a) the insurance income; b) the expenses with insurance services; c) the financial expenses related to insurances.

3. From the evaluations performed to result: a) the valuation of the debt related to the remaining to be executed obligation, according to IFRS 15 "Revenues from contracts with customers"; b) the evaluation of the debt for the compensations incurred in accordance with IAS 37 "Provisions, contingent liabilities and contingent assets".

Based on the analyzed information, we can define that the main differences between the current applied IFRS 4 and its successor IFRS 17 will lead to the following changes in the balance sheet:

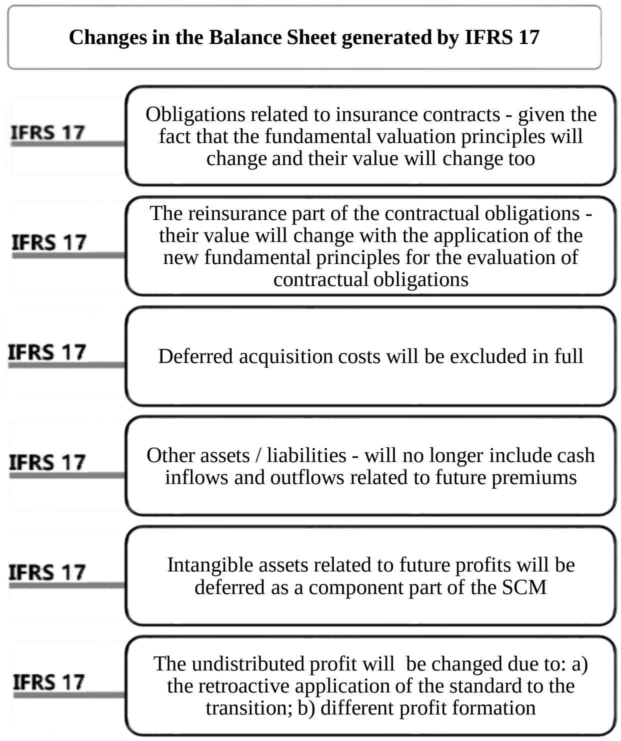


**Figure 7 – Significant changes generated by IFRS 17**

Source: Elaborated by the authors

Top management and stakeholders will need to consider the impact that the new standard will have on the company's profits, as well as the aspects related to the choice of methods used in the valuation of obligations, as they will affect how future profits will be released over time, which in turn will have an impact on the decision-making process (Erhan, Socoliuc, Mihaila & Grosu, 2015; Grosu & Maihala, 2019). Therefore, insurance companies need to be clear about how the accounting, financial and investment elements will be affected with the application of the new IFRS 17 and how they will present these changes to investors.

## IV. CONCLUSIONS

The implementation of IFRS 17 will replace the multitude of current approaches with an unified approach, which will provide investors and other external users with comparable and up-to-date information, while helping them to better understand the risk, profitability and financial position of the insurer.

The publication of IFRS 17 "Insurance Contracts" marks an unique change in the accounting of insurance policies. The new regulations aim to bring more transparency to financial reporting in an industry whose accounts have often been labeled as non-transparent and, at the same time, complicated. A single accounting language for insurers should improve comparability in countries where national practices are not currently uniformly applied.

Substantial efforts will be required to implement IFRS 17 "Insurance Contracts". The assessment of insurance liabilities will reflect the market interest rate and the impact on the guaranteed benefits of policyholders. Revenues from insurance policies will be systematically reported during the contractual period. The profit for the remaining coverage period will be explicitly reported as a component of insurance liabilities.

This effort will most likely generate major implementation costs for many insurers, similar to those in the European Union with the adoption of the Solvency-II regulations estimated by the European Commission to be between € 3-4 billion for EU insurers.

At the same time, the benefits that will arise as a result of the implementation of the new standard prevail over time over the implementation costs. Its application will influence not only the financial, actuarial and systems development areas of insurance companies, but also the design and distribution of insurance products, incentive and remuneration policies for intermediaries, budgeting and forecasting methodologies, tax treatment, etc. Thus, in order to ensure the profitability and efficiency of the management systems implemented within the insurance companies, it is necessary to align the governance and control systems with the new financial reporting requirements, in parallel with the requirements of the prudential framework. In this regard, the IASB recommends that insurance companies use the transition period as rationally as possible, so that from 1 January 2023 they are able to comply with all IFRS 17 requirements so that the valuation models adopted reflect as accurately as possible the specifics of the entity's activity.

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