

# IFRS 17 Compliance: Bridging the Gap

## Abstract

The International Accounting Standards Board (IASB) released its latest accounting standard, IFRS 17: Insurance Contracts, in May 2017, applicable to reporting periods beginning on or after January 1, 2022. IFRS 17, which replaces the existing mandate under IFRS 4, is an attempt to standardize measurement approaches and models for insurance contracts and enhance comparability of financial statements of insurers across the globe. To comply, insurers will have to significantly overhaul their financial statements and source systems.

Complying with IFRS 17 provisions for short-term contracts is especially complicated as it necessitates comparing the various measurement approaches and selecting the one best suited for the contract. Global companies will have to comply with several standards such as the US GAAP and IFRS, in turn increasing complexity. This paper compares IFRS 17 with the US GAAP from the standpoint of short-term insurance contracts to better understand the similarities and differences and overcome the challenges to creating the financial statements under each standard. The paper also delves into how automation and cloud platforms can provide an optimal and cost effective path to compliance.

## IFRS 17 versus US GAAP

Complying with IFRS 17 for short-term contracts will require insurance companies to perform detailed calculations supported by reasonable and verifiable information. Insurance companies, however, are ill-equipped to handle the change due to the limited time available for implementation, lack of clarity and understanding, difficulties in data collection and analysis, and shortage of IFRS 17 trained resources. The situation is even more complex for companies with a global footprint that will need to comply with US GAAP as well. Table 1 illustrates how the calculations and accounting requirements differ between the two standards with specific focus on short-term insurance contracts.

Area of Difference	IFRS 17	US GAAP
Scope	Impacts all entities – insurance or non-insurance companies – that issue insurance contracts.	Specific reporting and accounting guidelines are applicable to insurance companies. For non-insurance companies, any insurance contract issued is accounted for in accordance with other applicable US GAAP rules.
Grouping of contracts	Insurance contracts must be divided into the following groups: <ul style="list-style-type: none"> <li>· Onerous (loss making) contracts</li> <li>· Non-onerous contracts</li> <li>· Contracts that may become onerous subsequently.</li> </ul> These groups are further divided into sub-groups containing contracts issued within one year of each other.	Insurance contracts must be grouped according to the entity's mode of acquiring, measuring the profitability, and servicing of insurance contracts. There is currently no requirement for year-wise grouping but it is mandatory to ascertain the existence of premium deficiency, if any.
Non-financial risk adjustment	Explicit risk adjustment to address the uncertainty of timing and amount of cash flows that arise from non-financial risk.	Provision for risk of adverse deviation applicable to traditional long-duration contracts but not for short-term contracts.
Distribution of risk	Entities must determine whether the cash flows of a group of insurance contracts affect the cash flows of another group of insurance contracts. This effect, which is called 'mutualisation' of contracts, is used to measure fulfilment cash flows.	There is no concept of 'mutualisation'.
Treatment of loss making contracts	Mandates immediate recognition as loss if: <ul style="list-style-type: none"> <li>· at the date of initial recognition, the fulfilment cash flows allocated to the insurance contract are a net outflow, or</li> <li>· on subsequent measurement, value of contractual service margin (CSM) becomes nil.</li> </ul>	Requires accrual of the probable loss amount when there is a premium deficiency relating to insurance contracts.

Area of Difference	IFRS 17	US GAAP
Acquisition costs	Acquisition costs can be treated as expense in the year in which it was incurred instead of amortizing such costs.	Acquisition costs have to be deferred and amortized.
Recognition of revenue	Premiums are recognized in proportion to the period of the contract. If the insurance contract is for more than one year, the entity will have to assess whether discounting of cash flow is required.	Same approach is followed for recognizing premiums; however, discounting is not used for short duration insurance contracts.

**Table 1: IFRS 17 vs. US GAAP**

## Overview of Premium Allocation Approach

To ensure consistent measurement, provide accurate information about risks and performance, and facilitate transparent financial reporting, IFRS 17 has introduced a new measurement framework called the general measurement model (GMM) or building block approach (BBA). The premium allocation approach (PAA) is the simplified version of the GMM suitable for short-term insurance contracts. Although a simplified version, IFRS 17 compliance for short-term contracts using PAA still poses several challenges.

### Calculating eligibility

The PAA approach is used for contracts with a coverage period of one year or less. However, it may also be used for longer duration contracts if measurement under PAA provides a reasonable approximation to measurement under GMM over the life of the contract. Insurers with short-term insurance contracts longer than one year will try to qualify for PAA using this condition. However, this criteria may not be easy to prove. In many cases, proof can only be achieved through comparison with a calculation under the GMM, which is a cumbersome process and the purpose of PAA will be lost.

### Contracts becoming onerous subsequently

Under PAA, if insurance contracts become onerous after initial recognition, measurement using PAA is discontinued and substituted by GMM. This means that even if an entity only issues short-duration insurance contracts, it must still have the capability to calculate using GMM.

### Incurred claims liability calculations

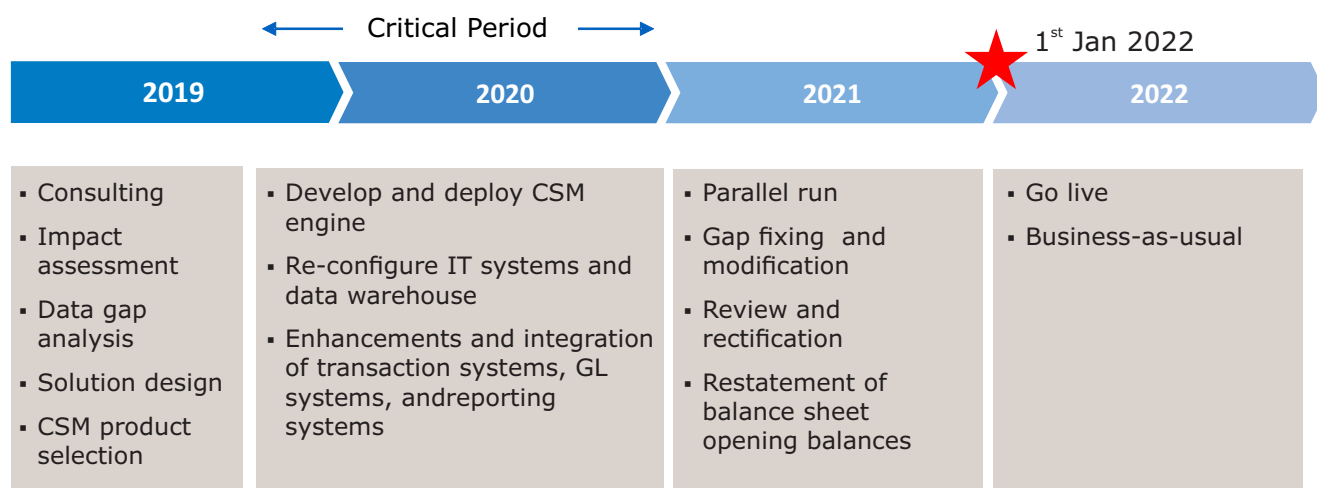
The PAA simplifies the process of calculating liability for remaining coverage. The liability for incurred claims has to be calculated using the GMM guidelines. This means that the PAA simplifies only 50% percent of the insurance contract liability calculation.

### Discounting requirements

Under the PAA, discounting adjustment is not normally required since the coverage period is usually less than one year. However, for property and casualty contracts with long claim settlement periods, a certain amount of discounting becomes necessary. For many insurers, this will entail additional calculations and accounting adjustments.

## Charting a Path to IFRS 17 Compliance

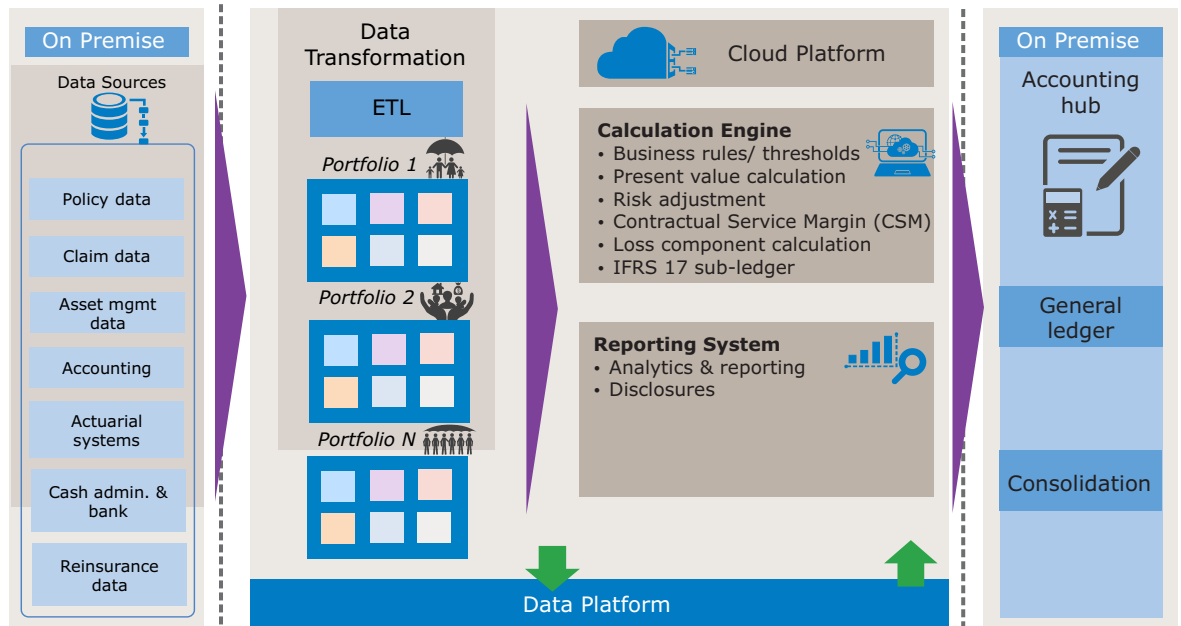
IFRS 17 compliance using the PAA and GMM approaches requires a large number of complex calculations. As a result, insurers are finding the scope of the regulation to be more extensive than anticipated making compliance all the more challenging. Given the scale, impact, and complexity of the regulation and limited time availability, insurers must lay down a clear roadmap with firm timelines for achieving key milestones (see Figure 1).



**Figure 1: Roadmap for IFRS 17 Compliance**

IFRS 17 compliance will require insurers to process large volumes of premium, claims, actuarial, and investment data as well as make numerous calculations such as fulfillment cash flows (FCF) and contractual service margin (CSM), computation of onerous contracts, recalculating FCF and CSM for every reporting period as well as calculating liability for incurred claims. We believe that the path to timely compliance lies in adopting an automated calculation engine (see Figure 2). The automation tool must have the capability to extract data from multiple sources, group insurance contracts, and store the grouped data in a data platform. This will ensure that the data can be accessed by the calculation engine for IFRS 17 computations as well as for regulatory reporting and disclosure. The configuration, deployment, and integration of the

automated calculation engine must be completed before the end of 2020 to ensure compliance before the deadline.



**Figure 2: Cloud and Automation Solution for IFRS 17 Compliance**

Keeping in mind the limited time available for IFRS 17 implementation coupled with budgetary constraints, the automated engine must be built on a cloud platform to capitalize on the inherent flexibility of cloud technologies. Insurers from across the ecosystem must consider using a common cloud platform on a shared infrastructure model which will significantly cut down IT infrastructure and application costs thereby unlocking exponential value.

Achieving IFRS 17 compliance will not be easy; insurers are likely to be constrained by a lack of in-house resources with knowledge of IFRS 17 requirements. Timely and hassle free compliance may require insurers to partner with the right vendor post a comprehensive market analysis and evaluation. The right service provider can drive compliance by helping insurers to draw up a strategy to assess the impact, identify the technology and infrastructure changes required, define an implementation roadmap, and ensure effective execution.

**About Author****Debaditya Gupta**

Debaditya Gupta heads IFRS 17 Initiatives for the ANZ region within the Finance and Reporting practice of TCS' Banking, Financial Services and Insurance business unit. He has nearly 13 years of industry experience in the areas of finance, insurance, treasury, IFRS, and US-GAAP. A Chartered Accountant by profession, he also has an MBA degree in Finance from Symbiosis University, Pune.

**Contact**

Visit the [Banking & Financial Services](#) page on [www.tcs.com](http://www.tcs.com)

Email: [bfs.marketing@tcs.com](mailto:bfs.marketing@tcs.com)

Blog: [Drive Governance](#)

Subscribe to TCS White Papers

TCS.com RSS: [http://www.tcs.com/rss\\_feeds/Pages/feed.aspx?f=w](http://www.tcs.com/rss_feeds/Pages/feed.aspx?f=w)

Feedburner: <http://feeds2.feedburner.com/tcswhitepapers>

**About Tata Consultancy Services Ltd (TCS)**

Tata Consultancy Services is an IT services, consulting and business solutions organization that delivers real results to global business, ensuring a level of certainty no other firm can match. TCS offers a consulting-led, integrated portfolio of IT and IT-enabled, infrastructure, engineering and assurance services. This is delivered through its unique Global Network Delivery Model™, recognized as the benchmark of excellence in software development. A part of the Tata Group, India's largest industrial conglomerate, TCS has a global footprint and is listed on the National Stock Exchange and Bombay Stock Exchange in India.

For more information, visit us at [www.tcs.com](http://www.tcs.com)