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New insurance standard must already be applied

The new International Financial Reporting Standard 17 “Insurance Contracts”, which replaced the previous IFRS 4, has been in effect since January 2023. To implement the standard, insurance companies will need to adapt their reporting and control systems to the new requirements.

I. International Financial Reporting Standard 17 in force

A regulation implementing International Financial Reporting Standard 17 (IFRS 17) was published on 23 November 2022 in the Official Journal of the European Union. IFRS 17 “Insurance Contracts” is a new standard that went into force on 1 January 2023. It specifies the methods of recognition, presentation and disclosure of insurance contracts covered by the standard. The new standard replaced IFRS 4 “Insurance Contracts”. The main objective of the new standard is to ensure greater transparency and comparability of insurance company financial statements. One of the main components of the new standard is the annual cohorts requirement.

II. New insurance liability measurement models

IFRS 17 is an accounting standard that introduces a series of important changes to the presentation of insurance company financial data. The most significant is the introduction of new insurance liability measurement models. The general model is based on the allocation of premium and a variable fee, and is made up of three blocks: estimates of the present value of future cash flows, risk adjustment for non-financial risk and contractual service margin (GSM).

III. Insurer must determine the value of future payments

Simply put, estimates of the present value of future cash flows constitute the present value of the future cash payments that will be made or received as part of a given financial obligation. These estimates take into account the timing, nominal value and risk associated with the payments, as well as the discount rates applied to the future cash flows. In the context of measuring insurance liabilities, estimates of the present value of future cash flows are significant for determining the provision for insurance liabilities. The provision represents the amount the insurance company must have in its account to cover future liabilities resulting from insurance contracts.

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IV. Insurance service expenses must be estimated

Future insurance service expenses are costs the insurance company will have to incur in the future to fulfill its obligations under the insurance contract. Examples of such costs include claim adjustment costs, administrative and management costs, marketing costs, costs of employee wages and salaries, etc. The measurement of such costs is important due to the fact that they affect the estimates of the present value of future cash flows.

V. Contractual service margin, i.e. the profit expected from the insurance contract, must be determined

The GSM contractual service margin is one of the three insurance liability measurement components introduced by IFRS 17. It is the profit the insurance company expects to earn in the future from the given insurance contract. The contractual service margin is determined based on estimates of the future cash inflows from insurance premiums and the future insurance contract service costs.

VI. Changes in presentation

The introduction of IFRS 17 will also lead to a change in the presentation of insurance company financial data. Under the standard, the statement of financial position will only show the assets and liabilities from insurance contracts issued and the assets and liabilities from reinsurance contracts held. Any insurance related accounts will not be presented separately, but will be included in those balances.

VII. Annual cohorts will have to be prepared

One of the components of the new standard is the annual cohort requirement. Annual cohorts refer to a group of insurance policies that have been issued in a given year and will be serviced by the insurance company in the future. Each such group of policies, or cohort, is treated as a separate unit of account and managed as part of its own block, which means that the insurance liabilities for each cohort can be measured separately. Annual cohorts are of key significance in IFRS 17, as they are the basis for determining estimates of the present value of future cash flows, risk adjustment and contractual service margin for individual policy groups. It should be noted that the standard allows some contracts to be excluded from annual cohorts until the end of 2027.

VIII. Changed profit and loss account format

In addition, IFRS 17 makes changes to the format of the statement of profit and loss, by replacing the existing items, such as premiums written with completely new items, such as insurance revenue, insurance service expenses, revenue or expenses from reinsurance contracts held, income or expenses from reinsurance contracts held separately from the income or expenses from reinsurance contracts issued. The standard also requires that the financial statements of insurance companies include a detailed insurance risk assessment. This includes risk identification, measurement and control in order to calculate technical provisions. For such provisions it is necessary to recognize information on the revenue and expenses from insurance contracts, as well as information on profits or losses on insurance services. IFRS 17 imposes new requirements relating to insurance assets, including a requirement to disclose information about investments and financial instruments used by insurance companies to manage risk.

IX. Wider scope of information to be disclosed in notes

The new standard contains detailed requirements for disclosures in the notes to the financial statements. Insurance companies will have to disclose information on the reconciliation of changes in balance sheet items, the effect of changes on the estimates of the present value of future cash flows, risk adjustment and contractual service margin, and the amortization pattern of contractual service margin over time. Insurance companies will also have to provide a detailed description of their measurement methods and principles. To recap, in the context of insurance, contractual service margin refers to the difference between the insurance premium collected from the insured and the costs of operating an insurance business, such as payment of claims, administrative and other operating expenses.

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X. Changes must be made in reporting and control systems

Implementation of IFRS 17 brings with it the need to introduce a new company chart of accounts that will present financial data in multiple dimensions. The changes introduced by IFRS 17 are broad enough to require detailed disclosures in the notes, and make it necessary to adjust the presentation of data in the financial statements. In consequence, to implement the standard, insurance companies will need to adapt their reporting and control systems to the new requirements. It should be noted that the new standard introduces more complex requirements for accounting for insurance contracts, but at the same time will result in more transparent and precise disclosures in financial statements.

The information presented herein does not constitute comprehensive information or opinion. Consult your adviser before making any decisions.

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