Impacts of IFRS 17 to insurance companies in Finland

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Abstract

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Insurance companies are facing a considerable change in accounting practices as a consequence of the implementation of IFRS 17. IFRS 17 is effective from the 1st of January, and it will bring fundamental changes to insurance accounting. The standard will replace the older standard guiding insurance accounting, the IFRS 4. Currently, a comprehensive standard for insurance accounting does not exist, as IFRS 4 was designed as an interim standard, which was meant to stay in practice until the publishment of its successor.

The new standard will bring changes to, inter alia, the measurement and recognition of insurance contracts, which are the main focus points in this thesis. In addition, the impact to profit and loss statement is evaluated due to the nature of the measurement models, which introduce the Contractual Service Margin (CSM), a term introduced by IFRS 17.

Implementation of the research has been carried out in two phases. First, the research focused on pinponting the main differences in the measurement and recognition through an example of a Finnish company, who has prepared their financial statement under IFRS 4. The profit and loss statement has then been compared and explained through examples, allowing the reader to understand the magnitude of the change. Second, the research aimed to find the common concerns companies have about the standard and evaluate whether or not companies see IFRS 17 as an improvement. The second phase of the research was performed through a qualitative research and in particular, a content analysis. Content analysis allowed the research to be performed to a vast, international target group, including stock companies from all over the world, leading to a very broad range of opinions. Comment letter were adressed to the exposure draft published by the IASB. The comment letters of the target group were analysed to find similarities and differences in opinions.

The research shows that companies have a significant amount of concerns related to the standard. Opinions on whether or not the IFRS 17 is an improvement to the current standard and will improve comparability are very divided. The common areas of concern were related to measurement during transition and the level of aggregation. Typical to exposure drafts, the IASB presented questions for companies to address. However, the feedback was not limited to the questions as companies had concerns in other areas as well.

Regarding comparability, the research came to a conclusion that while the current version of the standard may not increase comparability next year, or even the year after, the universal standard will eventually increase comparability in the financial statements of insurance companies.

Keywords
IFRS 17, insurance, IFRS 4

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1 Introduction

IFRS standards are high-quality, globally followed accounting standards, which define how companies prepare financial statements. The standards are developed by the IASB, which is a part of the non-profit organization, IFRS Foundation (IFRS Foundation s.a.a.)

Changes in accounting are typical to the IFRS standards, as new standards and amendments to older standards are published at occasional intervals, depending on the need of an update (IFRS Foundation s.a.c). In May 2017, the International Accounting Standard Board issued a new standard, IFRS 17. IFRS 17 is an accounting standard which will be effective from January 2023 onwards and will be replacing the old standard, IFRS 4. The objective of IFRS 17 is to standardize insurance accounting to increase comparability of insurance companies' financial statements. Originally, IFRS 17, was supposed to be effective from January 2021. However, as the new standard brings significant changes to many insurers, the effective date has been postponed to January 2023, giving insurers more time to align their systems and processes with IFRS 17 (IFRS Foundation s.a.e & IFRS Foundation 2017b, 2.)

To reach its objective, IFRS 17 introduces measurement models along with recognition requirements, which are also implemented in the transition phase of the standard. The standard will impact all companies selling insurance contracts, reinsurance contracts and contracts with additional, non-insurance related payments, provided that the entity also underwrites insurance contracts (International Financial Reporting Standard 17 paragraph 3 & IFRS Foundation s.a.e.) Therefore, this research will examine the change in insurance accounting from the perspective of insurance companies and aims to find the concerns companies see in the upcoming change, as well as evaluate whether or not companies believe that IFRS 17 will increase comparability of financial statements. Additionally, the measurement models under IFRS 17 are compared to the current method to pinpoint what changes does the standard bring with it.

Research material used in the theoretical framework, starting from the second chapter of this thesis, mainly consists of the IFRS 17 standard and publishments from companies impacted by the standard. The research methods are introduced in the fifth chapter and results in the sixth chapter of this thesis. First, examples are provided of the measurement models and the results of the examples are then compared to an existing financial statement of a Finnish company. Furthermore, comment letters addressed to IASB regarding the amended exposure draft are analysed, to examine what concerns companies have about the standard and do they believe that the new standard will increase comparability.

Insurance companies are large contributors to financial market. European insurance companies produce a yearly income of 1 100 billion euros and have invested nearly 8 400 billion euros in the European economy. Thus, the coverage area of the standard is large, and minimal growth in the industry can impact positively in the economy (European Comission s.a..) Therefore, it is beneficial to examine the changes from the insurer's perspective.

1.1 Research question

The objective of this thesis is to examine the impact of IFRS 17 to insurance companies in Finland by comparing the current standard to the new standard, and by analysing the feedback the standard has received to this day. In addition, the thesis will evaluate whether or not, will IFRS 17 will reach its goal to increase comparability among insurance companies.

The research question can therefore be formulated as follows:

- How will IFRS 17 impact the financial reporting of insurers in Finland and comparability of financial statements in the industry?

Based on the research question, the investigative questions are formed as following:

- IQ1: How is the measurement different between IFRS 4 and IFRS 17?
- IQ2: What are the main concerns of entities impacted by the standard, regarding measurement and recognition?
- IQ3: What is the common expectation among companies, regarding the effects to comparability?

This thesis has been demarcated to focus on the measurement and recognition under IFRS 17. Additionally, due to the nature of the measurement models introduced by the standard, the impact to profit and loss statement is included.

Table 1. Overlay matrix

Investigative questions	Theoretical framework	Research methods and data	Results (chapter)
IQ 1: How is the measurement different between IFRS 4 and IFRS 17?	2.2, 4.3	Measurement example cases. Comparative analysis of the results.	6.1

IQ2: What are the main concerns of entities impacted by the standard, regarding measurement and recognition?	4	Comment letter analysis of target group companies	6.2
IQ 3: What is the common expectation among companies, regarding the effects to comparability?	3.2, 3.3	Comment letter analysis of target group companies	6.3

1.2 Benefits

The entity who mainly benefits of this thesis is the commissioning company, Taloushallinta Uniikki Oy. With clients from the field of insurance, the topic is very timely for the company. In addition, similarly to IFRS 4, IFRS 17 requires companies to use consistent accounting policies, which may result to generalization of IFRS 17 within group companies (IFRS Foundation 2017a, 34). Being informative about the changes brought by the standard, gives the commissioning company a competitive advantage.

Although more indirectly, this thesis will also provide information for insurance companies affected by the new standard. As the IFRS standards are international, and the topic is focused on changes which are yet to happen, this thesis can be helpful for listed insurance companies, and also for those companies looking to be listed after January 2023.

Lastly, writing this thesis adds value to the writer personally, as an employee in the field of auditing. Given the size of the clients that larger audit companies work with, IFRS standards are widely used. Therefore, knowledge about IFRS in general will be beneficial. The topic is also very much focused on the writer’s personal interests.

1.3 Key concepts

Accounting mismatch: Accounting mismatches occur when items with the same risk are treated differently. For example, assets are measured at fair value, while liabilities at an amortized cost (Deloitte 2005, 2).

Financing component: A component arising when a policyholder himself, or through a third party makes payments in advance (PwC s.a., 1).

Group of insurance contracts: Group of insurance contracts is the outcome from the division from an insurance portfolio. This division is mandatory under IFRS 17 (International Financial Reporting Standard 17 Appendix A).

Portfolio of insurance contracts: Insurance contracts with similar risks and therefore are managed together (International Financial Reporting Standard 17 Appendix A). For instance, life insurance and property insurance are managed in different portfolios.

Unbundling: The process of separating a component which is not related to insurance from an insurance contract (Deloitte 2020, 41).

Underlying items: A contract may include a component or a variable, which determines how much is paid to a policyholder (International Financial Reporting Standard 17 Appendix A). For example, stocks and bonds or types of underlying items.

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2 Insurance industry

Insurance plays a significant role in today's economy, and it exists for individuals to transfer, or minimize potential risks through contracts (IFRS Foundation 2017, 3). The coverage of potential risks for individuals and companies increases financial stability and therefore, insurance companies, and insurance contracts, are important for the financial market. Furthermore, insurers are closely linked to banks, and issues in the insurance industry often reflects to the banking industry. Indeed, insurance companies are a large contributor to the financial markets as the premiums from clients are often invested. European insurance companies produce a yearly income of 1 100 billion euros and have invested nearly 8 400 billion euros in the European economy (European Commission s.a. & ECB 2009.)

Typically, insurance companies can be divided into two types of companies, either stock insurance companies or mutual insurance companies. Globally, these are the most common structures, and while other structures do exist, they are far rarer. The difference between stock and mutual insurance companies is in the ownership structure: stock insurance companies are owned by the shareholders, while mutual companies are owned by the policyholders, meaning the customers of the insurance company (Braun, Schmeiser & Rymaszewski 2013.)

2.1 Insurance contracts

An insurance contract can be simply defined as a contract between the insurer and the insured party under which the insured party will pay the insurer a specific amount, in exchange for coverage of potential loss in the future. The terms of payment are negotiated in the contract, but premiums are often paid monthly (European Commission s.a..)

Buying and selling insurance contracts is under governance of national laws (European Commission s.a.b). Different legal environments have different laws concerning insurance contracts, meaning that one insurer typically cannot sell the exact same insurance contract in multiple European countries. Instead, the insurance contract needs to be modified to fit the target countries' laws and regulations. This is also an issue the European Commission is aiming to change in the future (European Commission s.a.b.) For example, in Finland, insurance is regulated by insurance company law (Vakuutusyhtiölaki) which regulates, inter alia, founding an insurance company and preparation financial statements and law on the provision of insurance contracts (Laki vakuutusten tarjoamisesta), encompassing laws about selling insurance (Sosiaali- ja Terveysminiseriö s.a.).

Individuals and companies pay premiums in exchange for insurance. The premiums are typically paid in advance and are calculated based on historical data of similar contracts. Furthermore, the type of the insurance contract varies based on the contract type. Generally, insurance contracts are broadly divided into two categories: life and non-life. Non-life insurance, also known as general insurance, covers businesses, cars, houses, and other material products. Life insurance, on the other hand, covers diseases, life and other conditions related to health of an individual. The nature of life and non-life insurance contracts is somewhat different. Between these two insurance types, the major differences are in the areas of contract duration, and the predictability of the contract. Life insurance contracts are long-term contracts, which potentially last for decades while non-life contracts are shorter in length. In addition, life insurance types are also easier to forecast, as the amount of claims are often stated in the contract, while in non-life, the claims are indefinable (Insurance Information Institute s.a.a.) For example, the claims occurred from a car crash may vary depending on the calibre of the crash.

According to the data published by Insurance Europe (2020, 17, 24 & 34), the received premiums and paid claims have been substantially greater for life insurance than for non-life during the last two years. In table 2, life and health insurance are included in life insurance, and property and casual insurance are included in non-life insurance.

Table 2. Premiums received and claims paid in Europe 2020 (adapted from Insurance Europe 2020, 17, 24 & 34)

Premiums received		
	2019	**2020**
Life insurance	909	766
Non-life insurance	411	419

Claims paid		
	2019	**2020**
Life insurance	782	723
Non-life insurance	260	272

Despite the broad division, life and non-life insurance categories both encompass various different kinds of insurance contracts. In addition, different contracts also exist for different entities. For example, companies in Finland are usually obligated to have pension insurance, which, by law, is the only mandatory insurance in Finland and insures an entrepreneur in case of disease or disability. However, on some occasions, insurance may indeed be required. For example, motor vehicles need to be insured by both, companies and individuals, and property owners often require a home insurance from tenants. Aside from motor vehicle and home insurance, the most common insurances in Finland fall under the life insurance category: travel insurances contracts covering injury are owned by 51% of population, leisure-time accident insurance by 46% and life insurance by 31% of the population (Finance Finland 2020, 2.)

2.2 Insurance accounting

As mentioned earlier, insurance companies typically receive premiums in advance; those premiums are usually invested to gain interest. However, the invested assets need to be available as insurance companies need to be able to pay potential claims to policyholders rather quickly, meaning that long-term investments cannot be considered. Therefore, the premiums are usually invested in stocks and bonds, which can be liquidated promptly. Indeed, the majority of insurance companies' assets typically consists of liquid assets, as holding large amounts of premiums in a bank account would not be very efficient. Therefore, the profits typically consist of earned premiums, and profits from investments (Insurance Information Institute s.a.a).

As for liabilities, insurance companies have reserves for obligations to policyholders in their balance sheets, which is generally the largest liability. Unearned premium reserve is considered as unearned revenue and therefore is presented on the liability side of the financial statement (Insurance Information Institute s.a..) For example, consider that an accident insurance contract is issued, dated for 10 years, and having a monthly premium of 10 euros. The total value of the unearned premium would therefore be 1200 euros. After one month, the unearned premium would be 1190 euros, and so on. These kind of reserves are called liabilities for unexpired insurance coverages, and in theory, the amount is equal to the amount the insurer would owe the policyholder for the remaining coverage of the contract. Loss reserves, on the other hand, are reserves that have already incurred; the amount of loss reserves is estimated, and the values are based on history of similar contracts and experience (Insurance Information Institute s.a.a.)

As an example, consider a simple scenario where insurer, receiving a premium from a customer, invests the premium to generate investment income. The accounting would be performed as shown in Figure 1.

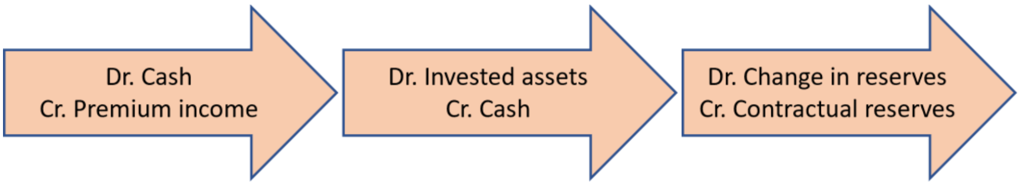

Figure 1. Accounting entries 1 (adapted from Saha, A. 2011)

If the insurer incurs claims from the contracts, the accounting entries would be performed as presented in Figure 2.

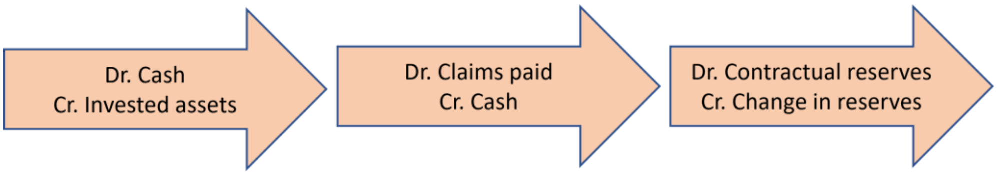
Dr. Cash
Cr. Invested assets
Dr. Claims paid
Cr. Cash
Dr. Contractual reserves
Cr. Change in reserves

Figure 2. Accounting entries 2 (adapted from Saha, A. 2011)

As shown by figures 1 & 2, the reserves need to be updated in whenever a contract is underwritten. Conversely, when claims are paid to the policyholder, those reserves are released. In the example above, contractual reserves represent the unearned premium reserves and the loss reserves. The reserves are liabilities, and since the insurer is liable for all expenses that may incur during the duration of the contract, the whole premium in only earned when the contract has expired (Outreville 1998).

3 International Financial Reporting Standards

International Financial Reporting Standards, or the IFRS, are set by International Accounting Standards Board, operating within a non-profit organization known as the IFRS Foundation. All standards are designed and developed by the International Accounting Standards Board and define how companies prepare their financial statements on an international level (IFRS Foundation s.a.a.)

3.1 Overview of the IFRS

Currently, 159 countries have adopted the IFRS to some extent and in out of those 159 countries, 146 require the use of IFRS standard for most or all listed companies or financial institutions (IFRS Foundation 2022). Therefore, more countries have adopted the standards than not. In Europe, the IFRS Consolidated Financial Statements have been prepared beginning from the fiscal year 2005 (Deloitte s.a.a). As the European Union adopted the IAS Regulation 1606/2002 in July 2002, which was entered into force in September (EU Monitor s.a.), this gave companies a little over two years to prepare for the change. The IAS Regulation required European companies listed in the EU securities markets the prepare their consolidated financial statements according to the IFRS (Deloitte s.a.a.)

The IFRS-standards are applied together with the International Accounting Standards, or the IAS. As the first IFRS-standard, IFRS 1, was issued in 2003, companies previously followed the IAS-standards as guidelines how to prepare financial statements. However in the present, many of the IAS-standards have been replaced by the IFRS-standards. To this day, a total of 17 IFRS-standards and 41 IAS-standards have been issued and 24 of the 41 issued IAS-standards are still in use, due to the fact that some have been withdrawn and some have been replaced by the newer IFRS-standards (Deloitte s.a.b.) Together, these standards define how financial statements of listed companies are prepared.

Different standards manage different accounts in the financial statement. However, general rules about preparation and presentation are included in the IAS 1 Preparation of Financial Statements. The IAS 1 defines the minimum required content and how the financial statements should be structured. It defines guidelines for accounting principles and requires a preparation of a complete set of financial statements (Deloitte s.a.c.) According to IAS 1, the complete set of financial statements includes:

- A statement of financial position
- A statement of profit and loss and other comprehensive income
- A statement in changes in equity

- A statement of cash flows
- Notes
- Comparative information (IFRS Foundation s.a.b.)

Together, these requirements provide information about a company's assets, liabilities, equity, income and expenses, contributions and distributions to owners and cash flows (Deloitte s.a.b.) However, this kind of division is still very broad, which creates a role for other accounting standards. While the IAS 1 provides guidelines how financial statement is to be prepared, other standards then define accounting principles for certain individual accounts (Halonen & al. 2017,1). For example, IFRS 16 provides accounting principles for leases, and IFRS 17 provides accounting principles for insurance contracts.

One central fact to note about the IFRS is that the standards are principle-based. As the standards are universal, rule-based regulations, being very inflexible, would be difficult to implement as regulations and legal systems are different in every country. A principle-based approach, on the other hand, offers more flexibility which leads to different interpretations on similar accounting practices. Therefore, a principle-based approach aims at reasonable valuation, enough to be comparable. However, some standards do offer clear guidance, in which cases they can be considered more rule-based than principle-based (Forgeas 2008.) For example, the forementioned IFRS 1 can be considered very rule based as it clearly states the minimum requirements to be included in financial statements.

Generally, the IFRS standards are only relevant to public companies, who are required to follow these guidelines in the preparation of financial statements. The IFRS standards require public companies to prepare financial statements in a true and fair manner, according to the variety of IFRS-standards. However, as stated in Chapter 7, Section 3 of Accounting Act (1336/1997), companies not obligated to prepare IFRS financial statements are also free to do so, provided that the financial statements are audited by certified auditors. That being said, as IFRS standards can be very complex, preparation of IFRS financial statements voluntarily would not make much sense.

3.2 Benefits of IFRS

A third of financial transactions today are cross-border transactions, and the number is expected to grow further in the future. Along with the increase of cross-border transactions, investors are also looking for investment opportunities internationally. Therefore, global markets need global accounting standards for companies to be comparable. The aim of the IFRS is to have a common accounting policy among companies, making global comparison easier and more transparent. The benefits, as stated by the IFRS Foundation, are transparency, accountability, and efficiency. These benefits will provide investors and other stakeholders reliable information about companies with a true and fair valuation of the companies' financial position (IFRS Foundation s.a.d.)

Globalization, along with global investments, have increased the demand of comparability of financial information (Yip & Young 2012, 1767). Comparability is indeed an important aspect of financial statements. After all, the primary objective of financial reporting is to provide useful information to entities, such as investors and issuers of loan. Previous literature shows that comparability of financial information is also beneficial to companies due to global investing. Better comparability reduces information risk, which occurs when users of financial statements do not fully comprehend the information presented in financial statements. The same basis in accounting allows investors to compare financial statements of foreign companies, and therefore, investments can be made more efficiently (Barth 2013.)

3.3 Issuing or amending a standard

IFRS standards are intermittently created, and older standards are being developed. Every five years, the International Accounting Standards Board performs a comprehensive review of the standards and the current situation to identify and evaluate the need of updates, and to develop the project work plan (IFRS Foundation s.a.c.)

If a new standard needs to be issued, or an older standard needs an amendment, the process will follow the Due Process Handbook, a public document which acts as a contract between IFRS Foundation and its stakeholders. The Due Process Handbook is based on three principles: transparency, full and fair consultation, and accountability. It serves as a standard-setting manual which provides steps for issuing a new standard (IFRS Foundation 2020a.)

The whole standard-setting process is public, and people from all over the world can participate in the Board's meetings and read papers related to any projects. The process of issuing a new standard typically starts with a research phase, where possible issues are identified, and possible solutions are suggested. These ideas are published in a Discussion Paper in order to gather feedback. Not all ideas are accepted, and based on the feedback, the Board defines which standards proceed to the standard setting phase (IFRS Foundation s.a.c.)

During the standard setting phase, a draft of the new standard is created and published. This is called an Exposure Draft, and people from all over the world, from companies to individuals, are able to give feedback on the draft. The feedback is typically received as Comment Letters, and the IFRS Foundation participates in meetings and events to discuss the received feedback. Afterwards, and if necessary, modifications and refinements are made before the new standard, or an amendment to an older standard, is issued. Every standard has an effective date, which gives time for countries to authorize the use of the new standard, and also for companies to prepare for new requirements (IFRS Foundation s.a.c.)

After a new standard is issued, the IFRS Foundation ensures that the standard is working as it was intended. If there are any issues with the standard, the IFRS Interpretations Committee may create an IFRIC Interpretation of the Standard or propose an amendment, in which case the process will again follow the Due Process Handbook (IFRS Foundation s.a.c.)

4 Differences between IFRS 4 and IFRS 17

4.1 IFRS 4

IFRS 4 is the current standard which defines the accounting for insurance contracts and was designed as an interim standard meant to be in place until the release of IFRS 17. The standard was first issued 31st of March in 2004 and the effective date was set on the 1st of January 2005. IFRS 4 was only a temporary solution for accounting of insurance contracts and therefore, the project concerning the changes to insurance accounting was introduced in two phases (Deloitte s.a.f & IFRS Foundation s.a.f.) To understand why, it is worthwhile to observe the brief history of the standard.

Before the second millennium, the entity setting accounting standards was known as the International Accounting Standards Committee, or the IASC. It was formed in 1973 by several different accounting bodies of different countries. However, in 1997, the IASC formed a Strategy Working Party to reorganize its structure and strategy. Concerning this change, a discussion paper was published in 1998 and final recommendations in 1999. All members of the IASC approved the recommendations by May 2000, resulting in a new financial standard setting entity, the IASB, as it is known today. The IASB operated under International Accounting Standards Committee Foundation, or the IASCF, now known as the IFRS Foundation (Deloitte s.a.d & Deloitte s.a.e.)

The IASB continued the work of the IASC, including the project of insurance contracts, which had already been started in 1998 by the IASC. However, as mentioned earlier, the European Union adopted the IFRS as reporting standards for listed companies in July 2002 by the regulation 1606/2002, which was set to be effective from the beginning of 2005. The IASB realized that the project could not be completed completely by 2005, and therefore the project was divided into two phases, the first phase being the issuance of IFRS 4 and the second phase being the issuance of IFRS 17 (Deloitte s.a.e).

4.2 Key features of IFRS 4

The introduction paragraph IN2 of IFRS 4 states the standard is a stepping stone to the second phase of the project. Furthermore, an article published by the IASB (2017) explicitly stated that a comprehensive standard for insurance contracts does not exist. The objective of IFRS 4 was, according to the standard (International Financial Reporting Standard 4 paragraph 1), to improve accounting it the field of insurance until the second phase of the project on insurance contracts is completed, and to require insurers disclose more information about insurance contracts.

IFRS 4 was issued in so that insurance companies were allowed to continue their accounting practices, but with more disclosure from future cash flows of insurance contracts (IASB 2017, 1.) Indeed, issuance of IFRS 4 did not have a significant effect on transparency or comparability of financial statements in the insurance industry, as the changes were somewhat minimal. However, paragraph 4 of IFRS 4 did introduce some exceptions and changes to existing accounting policies at that time:

- It forbids provisions for claims from contracts which were not in existence at the end of the period.
- It required adequacy testing for insurance liabilities and impairment testing for assets.
- It required insurers to keep liabilities in their balance sheets until they are cancelled or expire.
- It forbids offsetting insurance liabilities against related reinsurance, meaning cancelling mutual debts between two parties (Martinez 2018).

Furthermore, according to paragraph IN5 of IFRS 4, an entity may not introduce certain practices but could keep using those practices involving them. These practices included:

- Measuring undiscounted liabilities.
- Using non-uniformed accounting policies within the same group company.
- Measuring future investments at an amount exceeding fair value compared to market value of similar services.

However, paragraph 22 of IFRS 4 states that entities were not permitted to change their accounting policies if it would make their financial statements less relevant or less reliable, and according to paragraph 26, if insurance contracts are measured with sufficient cautiousness, accounting policies do not need to be changed. The used accounting policies needed also to be disclosed according to paragraph 36. This implies that basically, IFRS 4 prohibited insurance companies from performing certain actions and required disclosure of more information, taking the first step to a more comparable accounting policy. However, it still allowed companies to use a variety of previous accounting policies. During the years this standard has been effective, many different accounting models have been used and have also evolved. These accounting models are based on regulations and circumstances of different countries, which, in time, have led to very different accounting policies. (IASB 2017, 9).

4.3 IFRS 17

The International Accounting Standards Board published a new standard, the IFRS 17 Insurance Contracts, in May 2017, which replaces IFRS 4. Originally, the effective date of the new standard was set to be on the 1st of January 2021. However, the IASB saw that deferring the effective date would allow insurers to implement IFRS 17 simultaneously, and therefore would benefit the stakeholders and insurers. The effective date was postponed by two years, to the 1st of January 2023, meaning that the new standard will be effective for periods beginning on the day, or after the day the new standard is to be effective (IFRS Foundation 2020b.) However, earlier adaption is allowed if IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers are applied (IFRS Foundation s.a.e).

First chapter of IFRS 17 defines its objective as:

> The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows (International Financial Reporting Standard 17 paragraph 1)

Therefore, IFRS 17 intends to bring transparency and comparability among insurance companies; IFRS 4 allowed a variety of different accounting policies concerning insurance contracts, making comparison difficult. IFRS 17, however, defines one accounting policy for all insurance contracts and presents foundational changes to accounting in measuring liabilities and profit recognition (Deloitte 2020, 40-41.)

Concerning the transition, paragraph C3 of IFRS 17 states that the standard is applied retrospectively, meaning that it is applied as it had always been effective. The same paragraph also presents requirements to apply the retrospective approach. These requirements include measure all current groups of insurance contracts under the requirements of IFRS 17, derecognise any balances that would not exist under IFRS 17 and recognising any net differences from the forementioned requirements in equity. If those criteria cannot be met, the standard also presents a modified retrospective approach for those who see the retrospective approach impracticable. Paragraph C6 of IFRS 17 defines the objective of retrospective approach as:

> ''The objective of the modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort.'' (International Financial Reporting Standard 17 paragraph C6)

Therefore, companies have some room for judgement whether or not apply the retrospective approach. Furthermore, if a company cannot achieve necessary information for the modified retrospective approach, a fair value approach is also permitted (International Financial Standard 17 paragraph C5).

IFRS 17 will undeniably have the largest impact on insurance companies, as the standard is changing the way insurance companies will measure insurance contracts and present their financial information. While the standard does apply to all insurance contracts, typically, insurance contracts are not offered outside the insurance industry (IFRS Foundation 2017a, 2.) Other potential impacts of the standard are auditors, who most likely will have to educate themselves about the standard, and investors, to whom the upcoming change will hopefully be beneficial to, in regard to better comparison of financial statements leading to safer investment opportunities.

4.3.1 Main features of IFRS 17

The aim of IFRS 17 is aligned with the aim of the IFRS Foundation, to improve comparability of financial information. The scope of the standard is on insurance contracts, reinsurance contracts and investment contracts with discretionary participation features, meaning contracts with additional, non-insurance related payments. These contracts are only within the scope of IFRS 17 if the entity also issues insurance contracts (International Financial Reporting Standard 17 paragraph 3)

The standard defines an insurance contract as follows:

> ‘’A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder’’ (International Financial Reporting Standard 17 Appendix A).

A reinsurance contract, however, is defined as:

> ‘’An insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts).’’ (International Financial Reporting Standard 17 Appendix A)

To clarify, a reinsurance contract is an insurance contract that insurance companies buy to reduce risk. For example, if a company is insuring one entity from natural disasters, and when one may occur, the insurance claims may rise very high. Therefore, by insuring the insurance contract with other insurance companies, the risk is shared. Simply put, reinsurance acts as an insurance for insurance companies (Insurance Information Institute s.a.b.)

While the IFRS 17 applies to all insurance contracts, an insurance contract may, however, have components which do not fit into the scope of an insurance contract. Therefore, companies need to separate these components from the contract and apply either IFRS 9 or IFRS 15 standards, depending on the components. In addition, a company applying IFRS 17 need to identify, measure, and manage separately contracts with similar risks. The main factor of division is whether or not an insurance contract is onerous (IFRS Foundation, s.a.d, 6.) IAS 37 (2018) defines onerous contract as:

''A contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.'' (IFRS Foundation 2018, 1)

In simple terms, onerous contract is a contract that is not profitable. For example, imagine an accident insurance contract with a consumer. The consumer has an accident during the time of the contract, and the insurance company will have to cover expenses caused by the accident. If the expenses are greater than what the consumer is paying for in total, the contract is considered onerous.

According to IFRS 17, portfolio of insurance contracts need to be divided into three different categories: group of contracts that are onerous, group of contracts with a slight possibility of becoming onerous, and lastly, group of all the remaining insurance contracts. These categories are measured together and may also be divided further, for example, by profitability or possibility of becoming onerous. However, the standard only requires division into the three forementioned categories (International Financial Reporting Standard 17 paragraph 16.) Different contracts have different risks, and therefore need to be managed separately. As a simple example, it is more likely for the insurer to have to cover expenses risen from a car insurance than life insurance. Therefore, those contracts need to be in different groups and measured separately for financial statements to be more comparable. Furthermore, groups of contracts need to be recognized either in the beginning of the coverage period, when the first payment from a policyholder is due, or the contract becomes onerous (International Financial Reporting Standard 17 paragraph 25).

4.3.2 Valuation methods

Perhaps the most relevant change concerning the upcoming standard lies in the valuation methods. The old standard allowed a variety of different accounting policies, while the new standard provides three different measurement models. These methods include the General Measurement Model (GMA), the Variable Fee Approach (VFA), and the Premium Allocation Approach (PAA) and are all used for different kinds of contracts. (Deloitte 2020, 41-43.) Furthermore, insurance contracts often include non-insurance related components. According to IFRS 17, these components need to be separated from the contract and accounted according to the standard under which it belongs. For example, insurance contract including an investment component will need to be accounted for under the IFRS 9 Financial Instruments (International Financial Reporting Standard 17 paragraph 10 & 11.) This process is also known as unbundling (Deloitte 2020, 41). The choice of measurement model depends on the details of the contract; each of these methods will be elaborated separately in the following chapters.

The General Measurement Model, also called the Building Block Approach, is the basic model of valuation. For many contracts, this model is the only option and if a company chooses to use other valuation methods, the reasons need to be justified. As mentioned, the General Measurement Model is sometimes referred to as the Building Block Approach, because the measurement process of a group of insurance contracts consists of different blocks which are used to calculate the Contractual Service Margin (CSM), a term introduced in the IFRS 17 standard, which defines it as the following:

> A component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognise as it provides insurance contract services under the insurance contracts in the group. (International Financial Reporting Standard 17 Appendix A)

The CSM is the key component of the GMA and in simple terms, is the expected profit received from the group of insurance contracts. The expected profit will be allocated to each year based on the calculated CSM, which is calculated when the contract is made. At initial recognition, entities are to measure insurance groups of contracts at the total of fulfilment cash flows and the contractual service margin. The fulfilment cash flows consist of estimates of future cash flows adjusted by the time value of money and risk adjustment (IFRS Foundation s.a.d, 10.) The calculation will be elaborated further in the upcoming chapters and is presented in Figure 3.

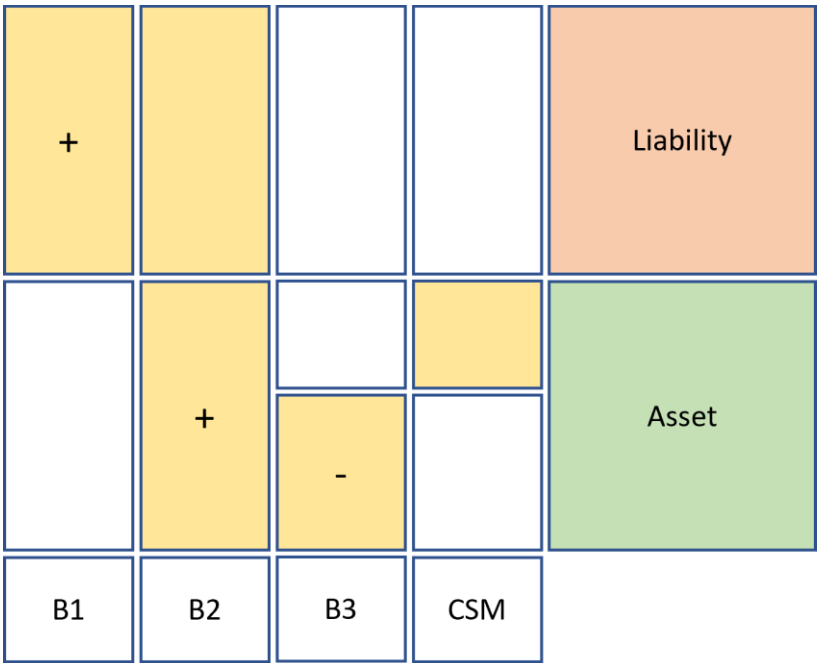

Figure 3. Building Block Approach (adapted from Blijlevens & Beijering 2016)

The term, Building Block Approach, is based on different blocks, which sum up into the Contractual Service Margin. It calculates the present value of future cash flows while taking risk liability into account.

As seen in the figure 3, the measurement model is divided into three different blocks. However, block 1 can be further divided into two blocks, meaning that the cash inflows and outflows represent block 1. Inflows can include premiums, which are very typical for insurance contracts and outflows may include operational costs or claims. Time value of money represents block 2, and equals to the expected, discounted future cash flows and inflows and outflows of block 1. Therefore, block 1 calculates the difference is expected inflows and outflows of the contract, and in block 2, it is discounted, or adjusted by the time value of money. Insurance contracts bear a risk, and therefore block 3 is needed, which represents the uncertainty of the contract. This sums up to the Contractual Service Margin, or the expected profit of the contract. The profit will be recognized in the profit and loss statement according to the length of the contract (Blijlevens & Beijering 2016.) If the CSM turns out to be negative, the losses are recognized in the profit and loss statement immediately (Burton 2017).

Blocks 1-3, or the fulfilment cash flows, are re-evaluated at each reporting date. Since the risk adjustment is based on estimates, changes in the fulfilment cash flows affect the CSM. Concerning the discount rate, when adjusting the CSM, the same discount rate is used as at initial recognition. Generally, the changes in the discount rates are recognized in the profit and loss statement. However, IFRS 17 offers insurers to either recognize changes in the market discount rates, either in the profit and loss statement, or the other comprehensive income statement (KPMG 2020, 2-3). The changes in market discount rates are referred to insurance finance incomes or expenses under IFRS 17 (International Financial Reporting Standard 17 paragraph 41).

The second valuation method is the Variable Fee Approach, and it is used in certain types of contracts. The principles are the same as in the General Model, with the exception that this valuation method reflects a possible investment profit for the insurer. Indeed, the Variable Fee Approach is generally only used in investment related contracts, or as introduced by IFRS 17, direct participation contracts. The standard clearly what qualifies as a contract with direct participation features, and all of the criteria need to be met for an insurance contract to be measured using the Variable Fee Approach:

> An insurance contract for which, at inception:
> (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;
> (b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and
> (c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.''
> (International Financial Reporting Standard 17 Appendix A)

Therefore, when the insurer shares the profit received from a potential investment with the policyholder, the contract falls under the definition of direct participating contract. For insurance contracts with direct participation features, the variable fee, or simply the potential return from an investment, needs to be deducted from the expected cash flows (International Financial Reporting Standard 17 paragraph B104). As the variable fee does not offer future service to the policyholder, it would otherwise affect the measurement of the contract (International Financial Reporting Standard 17 paragraph B112).

Similarly to the General Measurement Model, the CSM needs to be adjusted at the reporting date. However, to reflect the changes in the variable fee, the CSM is adjusted using the current discount rate (Society of Actuaries 2018, 7). Nevertheless, according to chapter B115 of IFRS 17, the risk mitigation option of allows companies to recognize changes in the financial risk in the profit and loss statement, provided that the company has a documented strategy for mitigating risks occurring from insurance contracts. Otherwise the VFA is similar to the GMM, and therefore it can be seen as a modified version of the GMM, which takes investment-related services into account.

The last of the valuation methods is the Premium Allocation Approach (PAA) and unlike the previous methods, companies are not obligated to follow this approach but are allowed to. The PAA is comparable to how insurance companies are currently measuring insurance contracts, which also eases the transition for eligible companies. It is a simplified method of measurement, which is why a company may opt to this approach. (PwC 2017, 32). However, similarly to the VFA, the PAA also presents some requirements before that valuation method to be used. For a group of insurance contracts to be valued under the PAA, it needs to fulfil one of two different criteria. First, each contract in the group cannot exceed the duration of one year or second, the measurement would not differ substantially from the measurement under the GMM (International Financial Reporting Standard 17 paragraph 53.) However, contracts meeting with the aforementioned criteria, can also be measured using the GMM, resulting in more consistency in entity’s accounting principles.

When measuring insurance contracts using the PAA, companies are not required to calculate the CSM. This measurement model presents guidelines how to measure liability for remaining coverages, meaning claims of existing insurance contract that have not occurred (International Financial Reporting Standard 17 paragraph 55) These guidelines are presented below in table 3.

Table 3. Measurement under PAA (International Financial Reporting Standard 17 paragraph 55)

Initial recognition	
+	Premiums
-	Insurance acquisition cash flows
+/-	Derecognition of assets recognized from insurance acquisition cash flows

Carrying amount at the end of reporting period	
+	Premiums
-	Insurance acquisition cash flows
+	Potential expense from amortization of acquisition cash flows
+	Adjustment to financing component
-	Amount recognized as revenue
-	Investment component

As seen in table 3, measurement under the PAA is more straight-forward, when compared to the previous measurement models. Furthermore, the PAA does offer some additional reliefs and alternatives in certain situations. Similar to other measurement models, if insurance contracts have a non-insurance component and exceeds the contract duration criteria of one-year, the liability of remaining coverage has to reflect the time value of money. However, if the duration of the contract is less than a year, discounting is not required. In addition, for contracts with coverage period under the one-year limit, entities may choose to recognize insurance acquisition cash flows as expenses (International Financial Reporting Standard 17 paragraph 59), meaning that those expenses are recognized in the profit and loss statement.

4.3.3 Summary of differences

There are a number of differences between IFRS 4 and IFRS 17. More precisely, IFRS 17 introduces more encompassing guidelines of accounting for insurance contracts, which were not present in IFRS 4. In general, IFRS 17 offers more detail and consistency in revenue recognition and liability valuation (Deloitte 2020, 3).

Some main features of differences between IFRS 4 and IFRS 17 are listed in table 4 below:

Table 4. Main differences between IFRS 4 & IFRS 17 (IFRS Foundation 2017b)

IFRS 4	IFRS 17
Multiple accounting policies for all insurance contracts.	Similar accounting policy for all insurance contracts.
Not comparable with other insurance companies in different countries and companies in different industries.	Better comparability within the same and different industries.
Revenue includes premium and may include and investment component.	Investment components are unbundled and upfront recognition is not permitted.
Estimates of discount rates are not updated.	Estimates updated in each reporting period.
Discount rates are based on estimates.	Discount rates are based on cash flow of each contract.

IFRS 17 aims to solve a variety of issues with the changes and requirements brought by the standard. For example, under IFRS 4, profit could be recognized in the profit and loss statement as premium income, and revenue may have included an investment component, as unbundling under 10 of IFRS 4 was permitted but not required (International Financial Reporting Standard 4 paragraph 10). In addition, IFRS 4 allowed multiple accounting policies depending on the jurisdiction of different countries, whereas IFRS 17 introduces three measurement models. In addition, IFRS 4 does not introduce guidelines how discount rate is determined.

While IFRS 4 does offer some guidelines in insurance accounting, it also states that if insurance contracts are measured with sufficient cautiousness, accounting policies do not need to be changed:

> An insurer need not change its accounting policies for insurance contracts to eliminate excessive prudence. However, if an insurer already measures its insurance contracts with sufficient prudence, it shall not introduce additional prudence (International Financial Accounting Standard 4 paragraph 24)

Furthermore, introducing accounting policies where liabilities are undiscounted is prohibited. However, the standard lacks clarification of what sufficient prudence is. Therefore, these parts of the standard can be interpreted simply as, continuing the accounting policies where liabilities are not discounted is allowed, while introducing new policies where liabilities are not discounted is not allowed. This also applies to using non-uniform accounting policies within a group company and cancelling mutual debts between companies, provided that these accounting policies had been practised before the implementation of IFRS 4. However, unlike its predecessor, IFRS 17 does tackle this, and many other issues, through different requirements in measurement and recognition of insurance contracts.

The changes in insurance accounting aim to improve comparability among insurance companies, as well as improve comparability among companies from other industries. The recognition of upfront premiums as revenue is not allowed under IFRS 17, but rather the expected profit is recognized consistently as the service is provided to the policyholder through the CSM. Therefore, revenue recognition is more consistent and consequently, more comparable with other industries.

5 Empirical analysis on the impacts of IFRS 17

The objective of this research is to examine, how the upcoming standard, IFRS 17, will impact the measurement of insurance contracts. The research part of this thesis will be implemented in two different parts. First, to answer investigative question 1, hypothetical examples of the new measurement models, and how the results are recognized in the profit and loss statement, are presented in chapter 7.1. Furthermore, those results are presented in a similar way to a current profit and loss statement of a Finnish company, and then converted into a IFRS 17 version, providing a visual example how the presentation in the profit and loss statement is different under IFRS 4 and IFRS 17.

Second, to answer investigative questions 2 and 3, analysis of comment letters received by the IASB regarding the exposure draft will be presented in chapter 6.2 & 6.3. The IASB has received comment letters on three separate occasions. First, the public were free to give feedback after the publication of the exposure draft in July 2010 and second, after the revised exposure draft published in June 2013 (IFRS Foundation s.a.g). Finally, the standard was amended more recently in June 2019, which gave entities a third change to give feedback on the standard (IFRS Foundation 2019,1). As both of the latter exposure drafts brought changes to the standard, the comment letters addressed to the first two exposure drafts can be seen as irrelevant and therefore, those comment letters have been excluded from this research.

5.1 Research method and material

The research method used in this thesis is qualitative research, and in particular, a content analysis. In essence, qualitative content analysis allows the researcher to analyse and interpret documents systematically and form a pattern, or a result, based on the analysed data (Jackson, L. et al. 2007). Due to the complexity of the data used in this research, a quantitative research cannot be performed effectively. Analysing the comment letters of a broad group of experts allowed to gain a comprehensive understanding about the attitude and concerns about the standard, which would not have been possible if another research method had been used. In addition, the qualitative content analysis allows to research international material, which is considered very beneficial considering that IFRS standards are indeed international. Therefore, a qualitative content analysis is considered as the most suitable research method.

As the research is conducted in two different parts, the research material also varies. For investigative question 1, examples are presented based on IFRS 17 standard, the research material used in chapter 5.2 of this thesis, and a profit and loss statement of a

Finnish company. The research material used to answer investigative questions 2 & 3 are the comment letters received by the IASB concerning the exposure draft with amendments.

Typical to all exposure drafts, the IASB presents a collection of questions for entities answer. Not all questions and answers are included in the research, but rather, specific questions and answers related to the investigative questions have been chosen. The chosen questions are presented in chapter 6.2. In addition, many companies answered more broadly, not just answering questions presented in the exposure draft. The comment letters included, for instance, summaries and appendices, which are all included in the research as well. Including such segments in the research is considered to be beneficial, as some concerns of companies may not be addressed by any of the questions. This will result in a more holistic view of the companies' attitude towards the standard and the concerns related to the measurement and recognition of insurance contracts.

Regarding the comment letters, and similarly to the demarcation of exposure draft questions, analysed comment letters were also limited based on the commenting entity. European companies were primarily targeted, and in particular, those whose securities are traded publicly in European stock exchanges. As mentioned earlier in this thesis, IAS Regulation 1606/2002 requires companies listed in markets within the European Union to prepare their consolidated financial statements according to the IFRS. In addition, companies listed in United Kingdom are also included, as the deadline for the comment letters was before the United Kingdom's separation from the European Union. Therefore, limiting the research to those companies is logical, as the results efficiently reflect to Finnish companies. In addition, IFRS 17 will impact financial statements of companies selling insurance or reinsurance contract. Therefore, to ensure that the analysed comment letters would represent the research accurately, the focus group was set to include only companies selling insurance or reinsurance contracts and, at the same time, are listed in in the stock exchanges within the European Union.

5.2 Research process

To answer investigative question 1, the process of the research began by inventing hypothetical numbers and scenarios to demonstrate how the measurement can be performed. The example first focuses on the GMM, which calculates the CSM based on the given information. The results are then presented in a similar way to how it is done under IFRS 4 currently, using a profit and loss statement of a Finnish company as an example. The results of the example are then converted into a version of what a profit and loss statement under IFRS 17 could be presented. Lastly, an example of the Variable Fee Approach is provided, also based on hypothetical scenario and figures.

To select the profit and loss statement of a Finnish company, financial statements of well-known Finnish companies were analysed, and a company was selected based on the simplicity of the financial statement and whether or not the company prepares an IFRS financial statement. For group companies, the parent company was chosen to be in the test group, as they are often more likely to present their financials in accordance with the IFRS. The financial statements of following companies were all opened separately, and all the accounting policies regarding preparation was confirmed:

Table 5. Companies preparing financial statements in accordance with IFRS

	IFRS Financial statement
Fennia Group	No
LähiTapiola	No
Nordea	**Yes**
Pohjantähti	No
Sampo Group	**Yes**
POP-Pankki	**Yes**
OP Group	**Yes**
Säästöpankkiryhmä	**Yes**
Turva	No

Table 5 shows that out of the 9 companies, 5 prepared their financial statements in accordance with the IFRS. These financial statements were compared with each other and to present a simple example which eases the readers understanding, Säästöpankkiryhmä's financial statement was selected as the comparative. The company presents their net profits of the life insurance sector in the notes of their financial statement, which is used to demonstrate the difference between IFRS 4 and 17.

Regarding the comment letters, the sum was counted to a total 123 for the exposure draft with amendments. The process of demarcation began by taking all the comment letters into excel and removing individuals and entities such as committees and federations. Subsequently, if the comment letter did not clearly state where the company was listed, the information was researched using Google Finance. Finally, and similarly to the previous, if the company did not state that it sold insurance or reinsurance contracts in their comment letters, the information was researched from the company's website. The demarcation process resulted in a target group of 18 companies in total, listed in table 6. Those companies are listed in the United Kingdom, France, Germany, Austria and Italy.

Table 6. Target group companies, listings and comment letter number

Company	Listed in			Comment letter
Allianz	DE	GB		5
Munich Re	DE	VIE		10
Old Mutual	DE	GB		14
Hannover Re	DE			15
Willis Towers Watson	DE	GB		28
Legal & General Group	DE	GB		68
Deutsche Bank	DE	BIT		106
BNP Paribas	DE	BIT	FRA	110
AMP Life	DE			40
Insurance Australia Group (IAG)	DE			42
KB Insurance [Korea]	DE			50
China Reinsurance (Group) Corporation	DE			67
Manulife Financial	DE			77
Prudential [UK]	GB			21
Barclays [Global]	GB			46
AIA	GB			71
AON	GB			107
Aviva	GB			112

6 Results

6.1 Examples of measurement models

Note that this conversion to IFRS 17 should not be taken as an absolute fact but rather, a hypothetical version of what the measurement models and the impacts to the profit and loss statement can be measured in a simplified scenario.

According to the standard (International Financial Reporting Standard 17 paragraph 80) companies are to report insurance revenue result, encompassing insurance revenue and insurance service expenses, and insurance finance income and expenses in the statement of profit and loss or other comprehensive income.

Next example of Insurer A will demonstrate how IFRS 17 impacts a profit and loss statement. In this example, GMM is initially used to measure an insurance portfolio, and the following facts are considered:

- Insurer A measures a portfolio of a 100 similar life insurance contracts.
- Contract length is 3 years and all policyholders pay a one-time premium of 100 euros.
- The discount rate is set at 5%.
- In the case of policyholder's death, the insurer A will pay claims of 150 euros.
- Each year, insurer A pays claims to 10 policyholders.

First, the company must define the fulfilment cash flows (FCF) and the CSM. Therefore, it will need to define the present value (PV) of cash inflows and outflows of the portfolio, or in other words, the future cash flows of the portfolio. As each policyholder pays a premium of 100 euros, the inflows sum up to 10 000 euros. However, the present value of cash outflows are calculated using the formula below, where PMT represents to expected yearly outflows of 1500 euros, n represents the number of years and r representing the interest rate:

$$PV = \quad PMT \text{ x } \frac{1 - ((1 + r) \text{ \textasciicircum } {-n})}{r}$$

Figure 4. Present value of future cash outflows formula (Christian 2022)

Leading to:

$$PV = \quad 1500 \text{ x } \frac{1 - ((1 + 5\%) \text{ \textasciicircum } {-3})}{5\ \%}$$

Figure 5. Present value of future cash outflows

According to this formula, the present value of the cash outflows is 4084,87 euros, which for simplicity, will be rounded to 4085 euros. In addition, the company has defined a risk adjustment (RA) of 10% from the expected outflows of the contract, resulting to a RA of 408,5 euros. Therefore, the CSM is calculated as follows:

Table 7. CSM Calculation

Estimated PV of cash inflows	-10 000
Estimated PV of cash outflows	4805
Estimated PV of future cash flows	**-5 195**
RA	408,5
FCF	**-4 787**
CSM	**4 787**

The CSM is then recognized as earned income in the profit and loss statement, which will be deducted from the fulfilment cash flows, or the insurance contract liabilities, in the statement of financial position.

Before allocating the CSM to profit and loss statement, to provide a more illustrative example, it is worthwhile to examine a financial statement before the effective date of the new standard. Finnish group company, Säästöpankkiryhmä, has prepared their financial statement according to the IFRS. The group company's subsidiary, Sp-Henkivakuutus Oy, operates in the life insurance sector and therefore, the insurance-related portion of the financial statement is prepared in accordance with the IFRS 4. A simplified version of the group company's financial statement notes, encompassing the net income of life insurance, is presented below in table 8.

Table 8. Net income of life insurance, Säästöpankkiryhmä (Säästöpankki 2022, 100)

Premium income	115 601
Investment income	95 946
Incurred claims	-68 808
Change in insurance contract liabilities	-121 971
Other expenses	-2 256
Profit or loss	18 511

Using the previous information from the example of insurer A, a similar profit and loss statement to of Säästöpankkiryhmä, could be presented the following way if, in addition to the previous, the following fact is considered: insurer A will further invest all the premiums and expects a yearly return of 5% (Invested premium of 10 000 x 5% = 500).

Table 9. Profit and loss statement under IFRS 4

Premium income	10 000
Investment income	500
Incurred claims	-1 500
Change in insurance contract liabilities	-8 500
Profit or loss	**500**

In comparison, a profit and loss statement prepared in accordance with the IFRS 17 is presented below. Due to the nature of the CSM, as the profit is recognized yearly, the contract duration is presented in full. In addition, as mentioned, the fulfilment cash flows need to be remeasured at the end of the year. In this case, consider that the actual discount rate was at 6% after the first year, leading to a finance expense of 85 euros, which is recognized in the profit and loss statement:

Table 10. Profit and loss statement under IFRS 17

	Year end		
	1	2	3
Insurance revenue	1 596	1 596	1 596
Insurance claims and other expenses	-1500	-1500	-1500
Insurance revenue result	**96**	**96**	**96**
Investment income	500	525	551
Insurance finance expenses	-85	0	0
Financial result	**415**	**525**	**551**
Profit and loss	**511**	**621**	**647**

If an insurance contract had an investment component, the results would be slightly different. As a simple example, consider the following scenario.

- An insurance company invests premium received from the policyholder of 1000 €.
- The expected return of the investment would be 10% (100 €)
- The insurance company pays the policyholder 80% of the return (80 €)
- The entity expects to pay claims of 10 € to the policyholder.

Through this estimate the policyholder receives 90 €, and the insurance provider receives 10 euros. Therefore, the proportion of the policyholder will be considered when determining the cash flows of the contract, and the remaining portion will be accounted for under other IFRS standards.

6.2 Companies’ concerns about the standard

Analysis of the comment letters had two different objectives. The first objective was to find the concerns companies have about the standard, related to measurement and recognition of insurance contracts. The second objective was to find the overall attitude towards the new standard, and whether or not companies believe that IFRS 17 will improve comparability. The analysis was focused on finding similarities and differences among the comment letters. In particular, the research was focused on the three following questions: is the attitude towards the standard among companies similar, are the concerns of companies similar, and do they have a similar rationales.

In 2019, the IFRS 17 experienced amendments, which resulted in a version of IFRS 17 it is today. The amended exposure draft tackled a variety of issues, and the amendments and questions related to measurement and recognition were addressed in questions 2, 3, 6 & 8. The exposure draft proposed amendments to the following subjects:

- The expected recovery of insurance acquisition cash flows
- Contractual service margin being attributable to investment-return service and investment-related service
- The risk mitigation option, and
- Transition requirements

Generally, companies welcomed all the amendments, and agreed that some issues were fixed. However, companies did have some concerns related to the questions and solutions provided by the IASB.

The amendment on expected recovery of insurance acquisition cash flows proposed that acquisition cash flows would also be assigned to those contracts which are renewed. The overall response was perhaps the most unanimous of all the answers, as all respondents welcomed the amendment with only smaller concerns about fixation of wording. According to the comment letter of AON, the acquisition costs can be very material and contracts are renewed at a rate as high as 90%. Therefore, from the companies’ point of view, allocating acquisition cash flows to also renewed contracts seems rational, as the costs also relate to those contracts.

Paragraphs 44, B119 and B119B of the exposure draft proposed that the CSM would be attributable to investment-return service and investment-related service, meaning that the companies are able to recognize those services for contracts that are not eligible for the VFA. Many companies agreed with the proposed amendment, for example, Legal & General, Munich Re and Old Mutual all support the proposal, as it is more consistent determining the CSM. However, concerns about the complexity of the weighting of services included in the insurance contract arise, as well the criteria of recognition of insurance contracts with investment-return service. For example, AIA was concerned about the amendment as weighting of services is subjective, which leads to different practices in the industry and therefore, will decrease comparability. Another concern, pointed out be Legal &

General, was that if the insurance and the investment component are written separately, the investment component is not present in the contract, and will reduce comparability. Therefore, the company suggests a revised definition to investment component. Currently, the investment component is defined as an amount that an insurance contract requires companies pay to the policyholder, whether or not the insured event occurs (International Financial Reporting Standard 17 Appendix A), which may not capture all the insurance contracts with investment components.

The exposal draft also proposes an amendment to the risk mitigation option, provided that the entity meets the conditions of chapter B116. B116 states that an entity needs to have a documented risk-management objective and a strategy for mitigating financial risks from insurance contracts using derivatives. The risk mitigation option under IFRS 17 allows entities to immediately recognize profits or losses from contracts with direct participation features, which would otherwise affect the CSM (PwC 2020). This option was extended, from using derivatives to mitigate financial risk from insurance contracts with direct participation features, to also include reinsurance contracts, meaning that reinsurance contracts would be treated as items which mitigate risk, and therefore, could also be recognized as profit or loss immediately. All the respondents also vastly supported the proposal. Furthermore, a transition relief was also proposed, which would allow entities to apply the risk mitigation option prospectively, meaning after the effect date of IFRS 17.

The amended exposure draft fixed a number of issues, which, according to Allianz, result in cost savings and is better aligned with the objective of the standard. However, while many companies perceive the amended exposure draft as an improvement, the amendments do not solve all the issues that companies have identified in the standard. Prudential, for example, wrote the following:

> There are previously advised flaws which still need correction to enable meaningful results. These flaws should not be ignored on a mistaken judgement that no standard is ever perfect, the points have been discussed before by the IASB, and that blemishes can be addressed by post implementation of the standard (Prudential 2019.)

Indeed, the amended exposure draft seemed to solve only a proportion of the issues companies perceive in the standard. Those concerns of companies that were not addressed by the questions of the exposure draft and were mentioned at least twice in the comment letters are presented in table 11.

Table 11. Common concerns of companies

Popular concerns among the comment letters	Number of mentions
Transition - Modified retrospective approach	6
Level of aggregation	5
Accounting mismatch from VFA	3
Locked-in discount rate	3

As seen in table 11, the most common concern of companies was related to the transition, and in particular, the modified retrospective approach. As mentioned earlier, the exposure draft did propose transition reliefs concerning the approach, but the feedback did not limit to the question asked by the IASB. IFRS 17 offers companies three different options for transition, the full retrospective approach, the modified retrospective approach and the fair value approach. According to the comment letter of Allianz, the company has been able to measure their opening balances using all the different transition methods. However, concerning the modified retrospective approach, the balances include a variety of different estimates, and while the company does believe that the requirements for the given approach are met, it is not completely sure if the auditors would accept the outcomes. The issues related to the modified retrospective approach were mentioned in other comment letters as well. For example, Aviva & BNP Paribas believe that this approach is too restrictive:

> We believe that more flexibility should be introduced in the Modified Retrospective Approach (MRA) in order to promote the use of that retrospective transition approach. Another reason to facilitate the use of the MRA is that there is a widespread opinion that the Fair Value approach would result in a lower level of CSM at transition compared to the retrospective approaches (BNP Paribas 2019)

Currently, when the company is unable to apply either of the retrospective approaches, it must use the fair value approach. However, according to Prudential, the measurement under fair value approach is very different, and results in a lower CSM. Companies believe that the CSM using the fair value approach should be closer to the values under the retrospective approaches or alternatively, if the modified transition methods would be more flexible, more companies would be able to opt to the modified retrospective approach. In addition, Munich Re, BNP Paribas and Legal & General commented that principle-based modified retrospective approach is preferred. According to Munich Re, applying the full retrospective approach requires recalculation of large part of the business, and therefore, introducing a more principle-based approach would improve comparability between full and modified retrospective approach.

Another more common concern of companies was linked to the level of aggregation. IFRS 17 requires portfolios of insurance contracts to be separated into groups of insurance contracts, in which, those contracts are also measured. However, companies may not include contracts which are issued one year apart in the same group. This is particularly an issue concerning the variable fee approach, as contracts which are issued over one year apart from each other, may still share the same investment component. As investments may often include fees, the same fees are then related to two or more different groups of insurance contracts, which brings more complexity to the measurement. According to the comment letter of BNP Paribas, this kind of aggregation is not currently done in practice and therefore, will increase costs implementing the standard. Similarly, Aviva commented that this practice is not aligned with the insurance business, also concerned about the complexity and cost increase brought by the requirements.

Regarding the variable fee approach, three different companies also discovered another issue. For contracts that are in the scope of, and are measured under the variable fee approach, a potential accounting mismatch exists when a contract includes non-participating features. IFRS 17 requires that under the Variable Fee Approach, the CSM is adjusted by the time value of money, and that investment components are accounted for using other standards. Under IFRS 9, however, the investment result does not affect the CSM, but is recognized in the profit and loss statement. This leads to overstatement in of investment results, and understatement of the CSM, and may completely extinguish the CSM, meaning that in the eyes of investors, the group of contracts is seen as onerous, when it actually is not.

The locked-in discount rate under the GMM also received some criticism. The locked-in rate refers to where companies adjust the CSM at period end using the same discount rate which was used at initial recognition of the contract. Three companies found this problematic, as a locked-in rate results in inconsistencies in the measurement. On that matter, Insurance Australia Group (2019) commented the following:

‘’The use of different inception date discount rates will result in accounting mismatches that do not reflect the economics of the contracts and have the potential to significantly distort financial results in a given period.’’

From AIA’s perspective those contracts that do not meet the criteria to measure insurance contracts under the variable fee approach, the locked-in rate, along with other requirements of the standard, do not offer meaningful information to stakeholders and causes unnecessary complexity to accounting practices. Furthermore, in certain scenarios where the reduction in best estimate liability, or the probability-weighted estimates of future cashflows, are lower than the increase in the CSM, the result can lead to a loss in the profit and loss statement.

Although the costs were not addressed as a general concerns, the issue was brought up a number of times in the comment letters and were often linked to different answers. From the companies' perspective, the standard still includes some requirements with are considered complex and lead to increase in costs, and the same requirements do not result a notable amount of benefit to stakeholders.

6.3 Expectations on comparability

Many companies acknowledge the benefits of the standard and understand why insurance accounting is being updated. However, not all companies commented whether or not the company believes that IFRS 17 is an improvement to IFRS 4, but instead, the focus was more on the concern side. Nevertheless, analysis of all the comment letters showed that those companies with more thorough responses were supportive towards the standard. For example, Legal & General (2019) stated the following in their comment letter:

> ''We continue to believe that the insurance industry requires an accounting basis that reflects the business model and the underlying economics of the contracts. It is also essential that the presentation allows users to understand the underlying profitability and cash flows of the contracts.''

The reasoning behind the support was often related to the support of universally adopted accounting standard, which improves global comparability and transparency in the insurance industry. Generally, companies also agreed that the amended exposure draft was an improvement to the originally published version in 2017 and companies showed support towards amendments. Two of the companies also mentioned that they had performed somewhat successful test runs. However, in many cases, the concerns seem to outweigh the benefits of the standard. Aviva commented that in their perspective, the amendments proposed in the exposure draft do not reach the level in which the objective of IFRS 17 would be achieved. Similarly, AIA sees that for IASB to publish a high-quality standard, further amendments need to be made.

While there are still concerns revolving around certain aspects which have not been addressed, or have not been addressed enough, half of the companies who commented more thoroughly, seem to perceive the transition as achievable. However, no company implied that the standard is high-quality as it is currently.

7 Discussion

The objective of this thesis was to examine, how is the measurement different under IFRS 4 and IFRS 17, what are the concerns of companies concerning the measurement and recognition, and do companies believe that IFRS 17 will increase comparability of financial statements. IFRS 17 brings significant changes to accounting in the insurance industry. The standard introduces three different measurement models for diverse kinds of contracts and the contribution service margin. In addition, it requires companies in the field of industry to separate and measure different components of insurance contracts. The change does not limit to a minor part of financial statements or measurement of insurance contracts, but reinvents the whole system. That being said, introducing a whole new system has been expected since the introduction of IFRS 4, as the plan to change insurance accounting has been in motion for nearly twenty years.

The example presented in chapter 6.1 shows that IFRS 17 simplifies the presentation due to the new measurement models. The profit and loss statement presents the two main profit drivers in the insurance industry, premium income and investment income. Formerly, the profit and loss statement included confusing line items, which are hard to comprehend for shareholder not familiar with the accounting policies in the industry. In addition, not recognizing profit before the service has been provided is more consistent with other industries, which makes the insurance industry comparable on a larger scale. However, all industries are different as the business models vary, and therefore, one may conclude that comparing insurance companies with, for example retail companies, seems irrelevant. Nevertheless, comparability among the insurance companies has the potential to increase, as the standard provides clear requirements and guidelines for each type of insurance contract. As many companies are obligated to prepare financial statements under the IFRS, using the same measurement models will most likely lead to more similar results. As the measurement models presented by the standard are limited and the scope focuses solely on insurance contracts, insurance companies are given less moving space for measurement and presenting their financials. Generally, less options lead to more comparability, which is why the standard can indeed be seen as a step forward.

IFRS 17 still offers room for judgement, which also affects comparison. While the valuation methods are similar, and only used for certain types of contracts, the voluntary use of the PAA, and different risk adjustment calculation variations will create some inconsistency among companies, even with similar business models. In addition, the standard offers three types of transition models, which further bargains from comparability. Nonetheless, IFRS standards are principal based for the most part and therefore, some variation is inevitable.

The implementation of the standard certainly seems to be burdensome for all companies affected by the standard. Companies have been investing significant efforts into the implementation of IFRS 17, Allianz, for example, stated in their comment letter (2019) that the company had been investing significant efforts into the implementation of IFRS 17, which included, among other things, developing actuarial and IT systems. According to the same comment letter, the company had also performed a test run in the first half of 2019. The analysed comment letters show that there have been, and still is, a number of concerns around the new standard, especially concerning transition requirements and level of aggregation. A number of entities also mentioned that additional guidance is required for both, the preparers, and the users of the financial statements. It was suggested that the IASB should consider providing additional educational material different sections of the standard. Nevertheless, majority of the companies believe in the objective of IFRS 17, and that a universally adopted standard will increase comparability, provided that it is of high-quality, and companies have enough time to implement the standard. The effective date has been postponed by two years since the amendments were published, leaving companies more time to prepare their systems accordingly. Furthermore, according to the comment letters, entities think that along with the amendments, the standard is moving towards the right direction.

Despite the concerns, IFRS 17 still seems to offer more comparability than its predecessor, IFRS 4, which allowed a large variety of accounting practices. Furthermore, as the IFRS-standards are principle-based, the standard can be implemented more efficiently internationally. In theory, a universal standard adopted by all countries must increase comparability on average. Therefore, IFRS 17 can indeed be an improvement and another step towards more comparable financial statements.

Given that the standard creates confusion, errors and miscalculations are also possible. Since the first financial statements prepared according to IFRS 17 are prepared next year, it is impossible to tell what kind of mistakes, or even misuses, are included, and what would their impact be on transparency and comparability.

The publishment of first financial statements prepared according to IFRS 17 may also change the strategy of some companies in preparing their own financial statements. For example, one insurance company may change their strategy after seeing other financial statements of companies in the same industry. The downside in this is that financial statements may not be very comparable during the first year, or even the year after that. As the standard is effective from 2023, and given the complexity of the standard, there is a lot of room for education in the upcoming years. However, eventually, comparability is likely to improve.

7.1 Research trustworthiness and future use

Trustworthiness of a research can be assessed using different methods. Efficient methods also depend on the research type. For example, validity and reliability are methods than are often used to assess the reliability of research. However, those methods are more efficient when assessing quantitative research. Common methods that can be used to assess qualitative research are, for example, equivalence and objectivity (Peda s.a..)

Perhaps the author cannot reliably address objectivity. However, it is worthy to mention that the author had limited knowledge about the IFRS and insurance in general, which is why assumptions could not have been made before the thesis process. Equivalence on the other hand, can be measured by comparing the results to other similar research. If multiple research with similar material come to the same conclusion, the research can be seen as more trustworthy. Most research found related to IFRS 17 are not accessible or are not closely related to the measurement and recognition of insurance contracts. However, one other thesis about IFRS 17, which has been written in Finland as part of Master's thesis at Jyväskylä University. The thesis examined the impact of IFRS 17 on the transparency and comparability of financial statements and was also conducted using qualitative research. While the research material varied from the research material used in this thesis, the conclusions are similar. Both suggest that increase in comparability may not be that evident in the upcoming years but will eventually increase.

This thesis focused on examining IFRS 17 from the perspective of insurance companies. As insurance companies are affected directly by the changes, perhaps a research examining other perspectives would be useful. As insurance companies may have a somewhat subjective approach to the standard and its impact to comparability. Other entities, such as committees and boards may see the impacts more objectively.

7.2 Own learning and process

The topic of this thesis was chosen based on personal interests and has been interesting since the beginning. Furthermore, an international topic such as the IFRS standards can be seen very beneficial, especially since the standards are widely used in the world. During the process, the author gained a thorough understanding about the IFRS 17, insurance industry and insurance accounting. In addition, the author also learned skills related to time management and the ability to read and use information more critically. Basic knowledge about the IFRS is beneficial, not only considering future opportunities, but also at current workplace. Auditors are often working with IFRS standards, the experience and knowledge gained from writing this thesis can surely be utilized further at work.

IFRS standards are indeed difficult to interpret, and considerable amount of knowledge is required to successfully analyse comment letters related to any topic. Understanding about the insurance industry and perhaps a broader understanding in accounting would have been beneficial. The writing process has been difficult at times, while balancing between work and writing the thesis. The plan was to write thesis in three months, partly during the summer holiday, and it seemed very achievable. However, work was present during the summer, and therefore focus was sometimes hard to retain in the thesis. Perhaps a too ambitious schedule to write the thesis resulted in some stress at times. Despite that, a valuable experience which can potentially be further utilized in Master's studies. In addition, the importance of demarcation proved to be an important aspect of the thesis. With hindsight, more research could have been during the planning phase of the thesis, as the topic turned out to be a bit broader than expected, which resulted in some confusion at times.

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