

FEATURES OF APPLICATION OF PROVISIONS OF IFRS 17" INSURANCE CONTRACTS"

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Abstract. *The necessity of implementing of IFRS 17 "Insurance contracts" arose primarily because investors faced difficulties in analyzing the financial statements of insurance companies of different jurisdictions, in terms of the incompatibility of information presented in the financial statements of various countries. 17 IFRS "Insurance contracts" defines an insurance contract is a contract under which the holder transfers a significant insurance risk to the Issuer, who promises to compensate in case of insured event the contract holder. However, there are a number of questions as to whether some contracts involving payments fall under the definition of insurance contracts. For example: this applies to annuities and derivatives. As for annuities, a number of them fall under the definition of the insurance contract. For example: those who transfer a significant part of the insurance risk and have an obligation to pay a fixed amount to the contract holder for a certain period of time (retirement insurance contract).*

Key words: *annuities, derivatives, insurance contracts, financial instrument.*

JEL CLASSIFICATION: M41

INTRODUCTION

International Financial Reporting Standard 17 "Insurance Contracts" will replace the eponymous International Financial Reporting Standard 4, which was interim and allowed insurance companies to apply it in the process of transition to international financial reporting standards. It should be noted that the International Financial Reporting Standards Board (IASB) included issues related to insurance contracts in its agenda in September 2001, but only in May 2007 a preliminary discussion of the draft international standard on insurance contracts was held. IFRS 17 Insurance Contracts was published on 15 May 2017. The need to modify IFRS 4 "Insurance Contracts" is explained by the fact that when analyzing the financial statements of insurance companies in different jurisdictions, investors faced certain difficulties in terms of the incomparability of information presented in the financial statements of different countries. International Standard 17 "Insurance Contracts" was supposed to come into force for periods beginning on or after January 1, 2021, however, insurance companies should revise the comparative financial information for the previous year after the application of IFRS 17 Insurance Contracts began.

However, the International Accounting Standards Board has published a number of amendments to this standard, including in June 2020, namely postponing the effective date by two years for IFRS 17 "Insurance contracts", so that insurance companies can apply the provisions of this standard starting on or after 1 January 2023. However, earlier application of the provisions of this standard is allowed.

DEBATABLE QUESTIONS

IFRS 17 "Insurance contracts" defines an insurance contract, as a contract in which its holder transfers a significant insurance risk to an Issuer that promises to provide compensation in case of an insurance event for the contract holder.

However, there are a number of questions as to whether certain contracts involving payments fall within the definition of insurance contracts. For example: this applies to annuities and derivatives. As for annuities, a number of them fall under the definition of an insurance contract. For example: those that transfer a significant part of the insurance risk and have an obligation to pay the contract holder a fixed amount over a certain period of time (for example: an insurance contract at retirement). In this case, the holder of the contract transfers a significant insurance risk in the form of uncertainty about the duration of his life and the adequacy of savings at retirement. Regarding derivative can be stated as follows: to meet the definition of an insurance contract, they must transfer significant insurance risk if this does not happen, then it does not qualify as insurance contracts.

It should be noted that a number of contracts that were previously recognized as such, were excluded from the scope of application of IFRS 17 "Insurance contracts", applying the provisions of IFRS 4 "Insurance Contracts", for example: guarantees issued, obligations for pension benefits under defined benefit pension plans, insurance contracts of an insurance company in which it is not the Issuer, but the contract holder. These contracts are not covered by IFRS 17 "Insurance contracts" unless they are reinsurance contracts.

In certain situations, certain insurance contracts may be accounted for in accordance with the provisions of IFRS 17 "Insurance contracts" or other international financial reporting standards, as appropriate. This applies primarily to financial guarantee contracts: both IFRS 17 "Insurance contracts" and the requirements of IFRS 9 "Financial instruments" can be used. This also applies to fixed-fee service contracts that can be accounted for in accordance with IFRS 17 "Insurance contracts" or IFRS 15 "Revenue from contracts with customers".

A new point in IFRS 17 "Insurance Contracts", which distinguishes it from the provisions of IFRS 4 "Insurance Contracts", is the fact that the provisions of the new standard apply to contracts where there is no significant insurance risk. For example, in cases of investment contracts with discretionary participation characteristics that are issued by the same company that issues insurance contracts. These contracts are financial instruments with discretionary payments.

As a summary, it can be stated that an insurance contract, in accordance with the provisions of IFRS 17 "Insurance Contracts", is an agreement between two or more parties that creates legal rights and obligations that are regulated by law, include explicit or implied conditions. However, the terms of contracts may differ from one jurisdiction to another - therefore, insurance companies will have to apply judgment to determine their material rights and obligations.

The insurance company must identify and separate the non-insurance components of contracts and account for them in accordance with the provisions of other IFRSs. Such non-insured events include: embedded derivatives, investment components that are accounted for in accordance with the provisions of IFRS 15 "Revenue from contracts with customers". Companies are not allowed to allocate other non-insurance components.

Once it is identified that an insurance contract falls within the scope of the specified standard, it should be determined what exactly is measured within the standard. IFRS 17 "Insurance contracts" requires companies to account for (measure) insurance contracts as the sum of cash flows on

performance of obligations and contract margins. Cash flows on performance of obligations represent the present value, taking into account the probability of expected cash flows, adjusted for risk, so as to take into account the uncertainty associated with insurance risk.

The contract margin reflects the profit that the insurance company expects to earn. However, these two components form an asset or liability in accordance with the requirements of the standard.

Therefore, a liability or asset under IFRS 17 includes the present value of cash flows, insurance risk adjustment, and profit.

From the point of view of contract measurement, IFRS 17 "Insurance contracts" has included provisions for a simplified approach to measurement, in the part that relates to the premium allocation approach applied to short-term contracts. When presenting information in financial statements with a simplified approach, the standard sets out a number of disclosures that are necessary, but they are not as extensive as for contracts that are accounted for in accordance with the basic requirements.

IFRS 17 "Insurance contracts" provides for the following disclosures in financial statements:

✓ ***in the balance sheet:***

ASSET

Assets under reinsurance contracts

Assets under insurance contracts

LIABILITY

Obligations under insurance contracts

Obligations under reinsurance contracts

The standard therefore requires that insurance and reinsurance receivables and liabilities are reported separately in the balance sheet, with information aggregated by group of insurance contracts.

In world practice, in most cases, assets and liabilities under insurance contracts were offset and presented as a single line. At the same time, just as in accordance with the requirements of IFRS 4 "Insurance Contracts", reinsurance contracts are reflected separately from insurance contracts.

To present information about the financial result, IFRS 17 "Insurance Contracts" sets out the following disclosures:

Income from insurance

Recognized claims and expenses

Result from insurance services

Investment income

Insurance financial expenses

Net financial result

Profit (loss)

Insurance financial expenses (optional)

Total comprehensive income

From the point of view of financial results disclosure, the standard provides more detail, since investors will receive information about two sources of financial results: from insurance services and net financial results. In other words, it will be possible to analyze the results of the company's insurance and investment activities. Previously, in accordance with the provisions of IFRS 4 "Insurance Contracts", this information was often not disclosed.

It should pay attention to the fact that the net financial result includes investment income minus insurance financial expenses. At the same time, investment income can be determined in accordance with the requirements of IFRS 9 "Financial instruments".

With regard to insurance finance costs, the standard allows to choose an alternative option that is reflected in the company's accounting policies and present such expenses related to claims obligations in profit or loss – or divide them by reflecting profits and losses and other comprehensive income.

If the company chooses to separate insurance finance costs in the financial statements, it should systematically reflect the total insurance finance costs for the period using a fixed interest rate at the date of claims, and in other comprehensive income reflect the difference between the amounts recognized in profit or loss and the result of discounting liabilities for claims based on the current discount rate in the balance sheet.

CONCLUSIONS

It should be noted that insurance contracts combine the features of both a financial instrument and a service agreement. Many insurance contracts generate cash flows with significant variability over a long period of time. In this regard, IFRS 17 "Insurance Contracts" requires the presentation of results from the provision of insurance services (including the presentation of insurance income) separately from insurance finance income or expenses, and the choice in the accounting policies of the insurance company of the recognition of all insurance income or expenses in profit or loss, or the recognition of part of these income or expenses in other comprehensive income.

Thus, the insurance company must:

- ✓ *separate particular embedded derivatives, investment components and insurance contract performance obligations;*
- ✓ *divide insurance contracts into groups;*
- ✓ *adjust groups of insurance contracts to the:*
 - *present value of future cash flows, which includes all available information about cash flows, should be reflected in such a way that it corresponds to market information; plus (liability) or minus (asset),*
 - *amount representing unearned profit in the contract group (contract services margin);*
- ✓ *recognize profit from a group of insurance contracts during its term, if the group of contracts is unprofitable or becomes unprofitable, the insurance company immediately recognizes the loss;*
- ✓ *separately present insurance income (without investment component), expenses for insurance services (without investment component) and financial income or expenses for insurance;*
- ✓ *disclose information that allows users of financial statements to assess the impact of contracts subject to IFRS 17 "Insurance contracts" on the financial position, financial results and cash flows of the insurance company.*

IFRS 17 "Insurance contracts" includes a simplified approach to valuation, or premium allocation, for simpler insurance contracts.

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