Research partner

Achieving Effective IFRS 17 Reporting

Enabling the right accounting policy through technology

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Chartis Research is the leading provider of research and analysis on the global market for risk technology. It is part of Infopro Digital, which owns market-leading brands such as Risk and WatersTechnology. Chartis' goal is to support enterprises as they drive business performance through improved risk management, corporate governance and compliance, and to help clients make informed technology and business decisions by providing in-depth analysis and actionable advice on virtually all aspects of risk technology. Areas of expertise include:

- Credit risk.
- Operational risk and governance, risk and compliance (GRC).
- Market risk.
- Asset and liability management (ALM) and liquidity risk.
- Energy and commodity trading risk.
- Financial crime including trader surveillance, anti-fraud and anti-money laundering.
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Chartis is solely focused on risk and compliance technology, which gives it a significant advantage over generic market analysts.

The firm has brought together a leading team of analysts and advisors from the risk management and financial services industries. This team has hands-on experience of implementing and developing risk management systems and programs for Fortune 500 companies and leading consulting houses.

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Workiva provides a connected reporting and compliance platform used by thousands of enterprises across 180 countries, including 75% of the 500 largest US companies by total revenue, and by government agencies. Workiva's customers have linked over five billion data elements to build trust in their data, reduce risk, and save time. For more information about Workiva (NYSE:WK), please visit **workiva.com**.

Table of contents

List of figures and tables

1. Executive summary

International Financial Reporting Standard (IFRS) 17, the first comprehensive global accounting standard for insurance products, is due to be implemented in 2023, and is the latest standard developed by the International Accounting Standards Board (IASB) in its push for international accounting standards. IFRS 17, following other standards such as IFRS 9 and Current Expected Credit Losses (CECL), is the latest move toward 'risk-aware accounting', a framework that aims to incorporate financial and non-financial risk into accounting valuation.

As a principles-based standard, IFRS 17 provides room for different interpretations, meaning that insurers have choices to make about how to comply. The explicit integration of financial and non-financial risk has caused much discussion about the unprecedented and distinctive modeling challenges that IFRS 17 presents. These could cause 'tunnel vision' among insurers when it comes to how they approach compliance.

But all stages of IFRS 17 compliance are important, and each raises distinct challenges. By focusing their efforts on any one aspect of the full compliance value chain, insurers can risk failing to adequately comply. In the case of IFRS 17, it is not necessarily accidental non-compliance that is at stake, but rather the sub-optimal presentation of the business' profits. To achieve 'ideal' compliance, firms need to focus on the logistics of *reporting* as much as on the mechanics of modeling.

Effective and efficient reporting comprises two elements: *presentation* and *disclosure*. Reporting is the culmination of the entire compliance value chain, and decisions made further up the chain can have a significant impact on the way that value is presented. Good reporting is achieved through a mixture of technology and accounting policy, and firms should follow several strategies in achieving this:

- Anticipate how the different IFRS 17 measurement models will affect balance sheet volatility.
- Understand the different options for disclosure, and which approach is best for specific institutional needs.
- Streamline IFRS 17 reporting with other reporting duties.
- Where possible, aim for collaborative report generation while maintaining data integrity.
- Explore and implement technology that can service IFRS 17's technical requirements for financial reporting.
- Store and track data on a unified platform.

In this report we focus on the challenges associated with IFRS 17 reporting, and consider solutions to those challenges from the perspectives of *accounting policy* and *technology implementation*. And in highlighting the reporting stage of IFRS 17 compliance, we focus specifically on how decisions about the presentation of data can dictate the character of final disclosure.

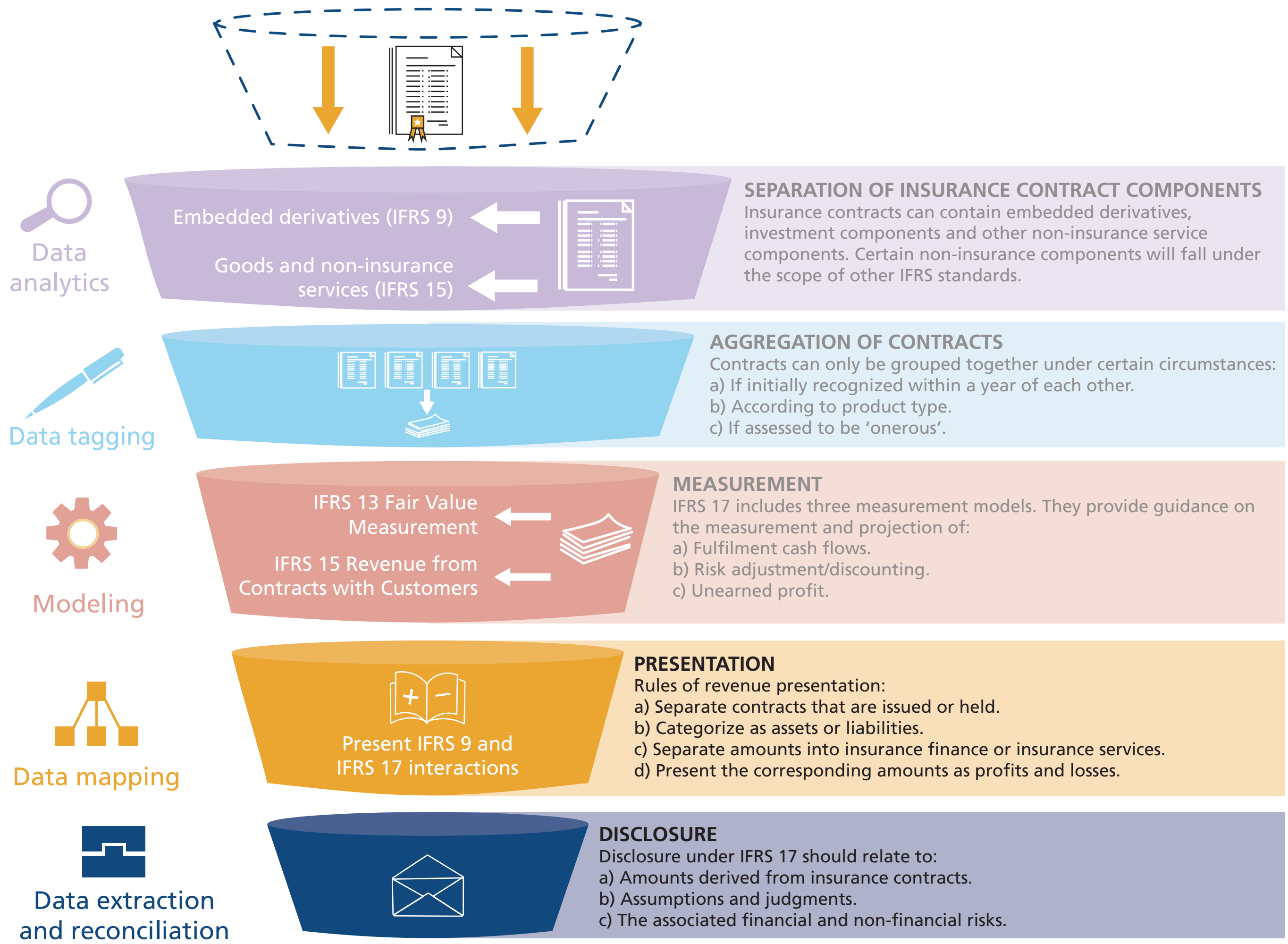
2. Introduction: more than modeling

IFRS 17 compliance necessitates repeated stochastic calculations to capture financial and non-financial risk (especially in the case of long-term insurance contracts). Insurance firms consistently identify modeling and data management as the challenges they most anticipate having to address in their efforts to comply. Much of the conversation and 'buzz' surrounding IFRS 17 has therefore centred on its modeling requirements, and in particular the contractual service margin (CSM)[1] calculation.

But there is always a danger that firms will get lost in the complexity of compliance and forget the aim of IFRS 17. Although complying with IFRS 17 involves multiple disparate process elements and activities, it is still essentially an accounting standard. First and foremost its aim is to ensure the transparent and comparable disclosure of the value of insurance services.

So while IFRS 17 calculations are crucial, they are just one stage in the compliance process, and ultimately enable the intended outcome: reporting. Complying with the modeling requirements of IFRS 17 should not create 'compliance tunnel vision' at the expense of the presentation and disclosure of results. Rather, presentation and disclosure are the culmination of the IFRS 17 compliance process flow and are key elements of effective reporting (see Figure 1).

Figure 1: Focusing on disclosure and reporting in IFRS 17



Source: Chartis Research

[1] *A glossary of terms is provided at the end of this report.*

3. Context: the rise of risk-aware accounting, and its implications

Statement scrutiny

IFRS 17 is the latest instalment in a wider move toward risk-aware accounting, following standards such as CECL and IFRS 9. It will require firms to address significant changes to financial reporting, regulatory disclosures, and management and performance reporting.

The objective of IFRS 17 compliance is to isolate insurance services and integrate financial and non-financial risk into their valuations. IFRS 17's predecessor, the interim standard IFRS 4, permitted a wide variety of accounting practices. However, IFRS 17 ushers in a new era of accounting uniformity that will significantly impact compliant entities' financial statements. To give a more accurate and consistent picture of profit, IFRS 17 requires firms to recognize profit as they deliver insurance services. Furthermore, any components of insurance contracts that do not constitute an insurance service will have to be separated and valued by a separate standard.

The separation of insurance service components and the amortization of the CSM will significantly affect the appearance of firms' financial statements. The way different types of insurance product are accounted for, for example, affects how profitable they appear. For instance, IFRS 17 excludes the recognition of insurance product deposit components as revenue, making a firm's balance sheet appear weaker. South Korean life insurers are already facing a decline in savings policies, in part because IFRS 17 will change the way these policies appear on the balance sheet by excluding the deposit as revenue.

Narrative requirements

Financial reporting will involve more than just numbers on financial statements. An entity will have to disclose the decision-making process behind the numbers. Firms will need to provide:

- The amounts recognized in their financial statements that arise from insurance contracts.
- The significant judgements, and changes to those judgements, made when applying IFRS 17.
- The nature and the extent of the risks that arise from insurance contracts.

Consequently, firms are required to produce significant narrative documentation on their IFRS 17 results, including policy statements, footnotes and commentary for review by auditors and regulators. The ability to capture both the numbers and the narrative around IFRS 17 results will be imperative. To achieve compliance and optimal presentation of comprehensive income, entities will need to develop tailored governance practices and implement the necessary technology architecture.

While changes in accounting practices do not change the economic material of a balance sheet, the presentation of profits and losses can affect the perception of business performance, and subsequently business strategy. Firms need to understand how IFRS 17 compliance will affect the appearance of their balance sheet and consolidate the presentation of income with the context from which it has emerged.

Reactive and multi-entity compliance

Coping with parallel reporting

IFRS 17 is the first coherent and global insurance accounting standard, but it is not the only accounting standard that insurers will have to comply with. Other IFRS standards will also impact the way that profit is reported. Compliance with IFRS 9 in particular will coincide and interact with that for IFRS 17. And it is not just IFRS standards that require a considered and concerted approach: solvency regimes already in effect in many countries can also impact IFRS 17 compliance, and will require parallel reporting[2].

As institutions move from previous reporting regimes, they will need to make business investments in technology and develop accounting policies to ensure they have a streamlined approach to multiple reporting requirements. For multi-entity institutions, this transition will be further complicated by reporting under a variety

[2] *In a companion report to this one, 'Controlling data across borders', we explore how firms are contending with multiple reporting requirements, central to which are data integrity and control and integrated firm-wide reporting governance.*

of generally accepted accounting principles (GAAPs). This complication will continue for multi-entity institutions that will continue to operate in non-IFRS jurisdictions (such as the US). Those institutions will have to report under both US GAAP and IFRS 17. Indeed, some US firms are choosing to voluntarily comply with IFRS 17, to ensure comparative reporting in an increasingly globalized industry.

As the risk-aware accounting framework develops, firms will need to ensure they are not complying reactively with new accounting standards and solvency regimes. Market-adjusted accounting can also give firms a realistic view of their performance in the current and future economic climate. Once firms view compliance as a business opportunity and not an additional liability they will able to compete in an increasingly standardized insurance market.

4. Developing an IFRS 17 accounting policy

A key step in developing reporting compliance is having an accounting policy tailored to a firm's specific interaction with IFRS 17. Firms have decisions to make about how to comply, together with considerations of the knock-on effects IFRS 17 will have on the presentation of their comprehensive statements of income. There are a variety of considerations: in some areas IFRS 17 affords a degree of flexibility; in others it does not. Areas that will substantially affect the appearance of firms' profits are:

- The up-front recognition of loss and the amortization of profit.
- The new unit of account.
- The separation of investment components from insurance services.
- The recognition of interest rate changes under the general measurement model (GMM)[3].
- Deferred acquisition costs under the premium allocation approach (PAA).

As a principles-based standard, IFRS 17 affords a degree of flexibility in how firms approach valuation. One of its aims is to ensure that entity-specific risks and diverse contract features are adequately reflected in valuations, while still safeguarding reporting comparability. This flexibility also gives firms some degree of control over the way that value and risk are portrayed in financial statements. However, some IFRS 17 stipulations will lead to inevitable accounting mismatches and balance-sheet volatility.

Accounting policy impacts and choices

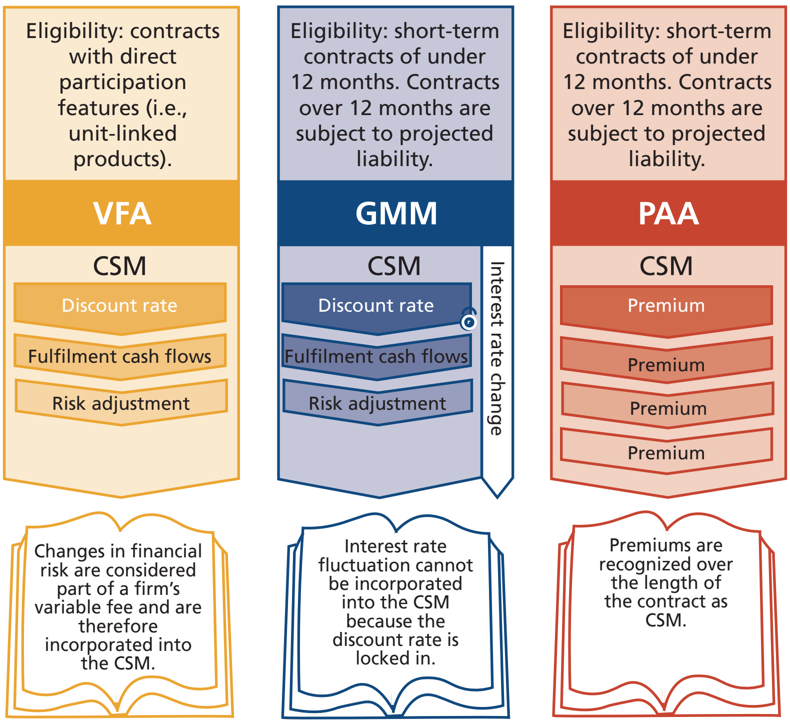
Balance sheet volatility

One unintended consequence of IFRS 17 compliance is balance sheet volatility. As an occurrence of risk-aware accounting, IFRS 17 requires the value of insurance services to be market-adjusted. This adjustment is based on a firm's projection of future cash flow, informed by calculated financial risk. Moreover, although this will not be the first time firms are incorporating non-financial risk into valuations, it is the first time it has to be explicit. Market volatility will be reflected in the balance sheet, as liabilities and assets are subject to interest rate fluctuation and other financial risks.

The way financial risk is incorporated into the value of a contract can also contribute to balance sheet volatility. The way it is incorporated is dictated by the measurement model used to value it, which depends on the eligibility of the contract. There are three measurement models, the PAA, the GMM and the variable fee approach (VFA). All three are considered in the next section, and explored in more detail in the Chartis report *IFRS 17: The next stage in risk-aware accounting*.

The three measurement models

Figure 2: IFRS 17 measurement models



Source: Chartis Research

Features of the three measurement models (see Figure 2) can have significant effects on how profit – represented by the CSM – is presented and ultimately disclosed.

[3] *The IFRS 17 measurement models are examined in more detail in the Chartis report 'IFRS 17: The next stage in risk-aware accounting'.*

To illustrate the choices around accounting policy that insurance firms will need to consider and make, we provide two specific examples, for the PAA and the GMM.

Accounting policy choices: the PAA

When applying the PAA to shorter contracts – generally those of fewer than 12 months – firms have several choices to make about accounting policy. One is whether to defer acquisition costs. Unlike previous reporting regimes, under IFRS 17's PAA indirect costs cannot be deferred as acquisition costs. Firms can either expense these costs upfront or defer them and amortize the cost over the length of the contract. Expensing acquisition costs as they are incurred may affect whether a group of contracts is characterized as onerous at inception. Deferring acquisition costs reduces the liability for the remaining coverage; however, it may also increase the loss recognized in the income statement for onerous contracts.

Accounting policy choices: the GMM

Under IFRS 17, revenue is the sum of the release of CSM, changes in the risk adjustment, and expected net cash outflows, excluding any investment components. Excluding any investment component from revenue recognition will have significant impacts on contracts being sold by life insurers.

Contracts without direct participation features measured under the GMM use a locked-in discount rate – whether this is calculated 'top down' or 'bottom up' is at the discretion of the firm. Changes to the CSM have to be made using the discount rate set at the initial recognition of the contract. Changes in financial variables that differ from the locked-in discount rate cannot be integrated into the CSM, so appear as insurance service value. A firm must account for the changes directly in the comprehensive income statement, and this can also contribute to balance-sheet volatility.

As part of their accounting policy firms have a choice about how to recognize changes in discount rates and other changes to financial risk assumptions – between other comprehensive income (OCI) and profit and loss (P&L). Recognizing fluctuations in discount rates and financial risk in the OCI reduces some volatility in P&L. Firms also recognize the fair value of assets in the OCI under IFRS 9.

5. The technology perspective

Data integrity and control

At the center of IFRS 17 compliance and reporting is the management of a wide spectrum of *data* – firms will have to gather and generate data from historic, current and forward-looking perspectives. Creating IFRS 17 reports will be a non-linear process, and data will be incorporated as it becomes available from multiple sources. For many firms, contending with this level of data granularity and volume will be a big leap from other reporting requirements. The maturity of an insurer's data infrastructure is partly defined by the regulatory and reporting context it was built in, and in which it operates – entities across the board will have to upgrade their data management technology.

In regions such as Southeast Asia and the Middle East, however, data management on the scale of IFRS 17 is unprecedented. Entities operating in these regions in particular will have to expend considerable effort to upgrade their infrastructure. Manual spreadsheets and complex legacy systems will have to be replaced with data management technology across the compliance value chain.

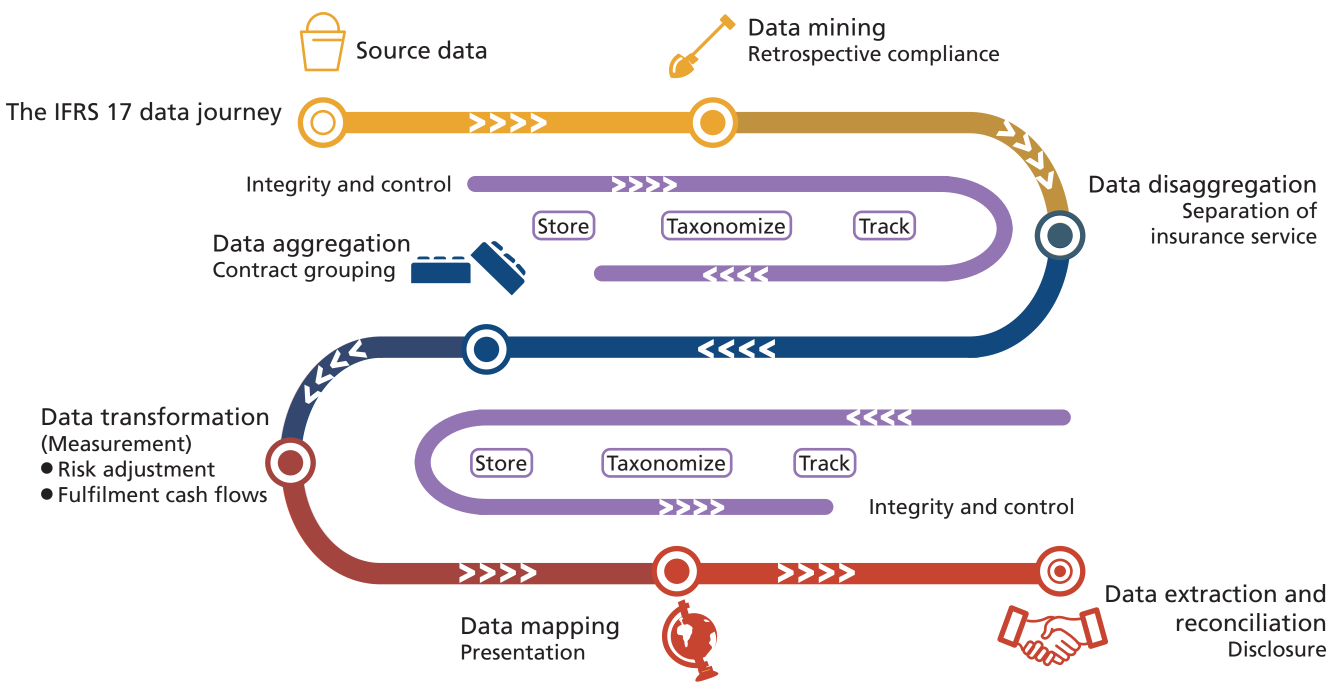
According to a 2018 survey by Deloitte[4], 87% of insurers believed that their systems technology required upgrades to capture the new data they have to handle and perform the calculations they require for compliance. Capturing data inputs was cited as the biggest technology challenge.

Tracking and linking the data lifecycle

Compliance with IFRS 17 demands data governance across the entire insurance contract valuation process. The data journey starts at the data source and travels through aggregation and modeling processes all the way to the disclosure stage (see Figure 3). In this section we focus on the specific areas of data lineage, data tracking and the auditing processes that run along the entire data compliance value chain.

For contracts longer than 12 months, the valuation process will be iterative, as data is transformed multiple times by different users. Having a single version of reporting data makes it easier to

Figure 3: The IFRS 17 data journey



Source: Chartis Research

[4] https://www2.deloitte.com/global/en/pages/financial-services/articles/global-ifrs-insurance-survey.html

collaborate, track and manage the iterative process of adapting to IFRS 17. *Cloud platforms* help to address this challenge, providing an effective means of storing and managing the large volumes of reporting data generated by IFRS 17. The cloud allows highly scalable, flexible technology to be delivered on demand, enabling simultaneous access to the same data for internal teams and external advisors.

It is essential that amendments are tracked and stored as data falls through different hands and passes through different IFRS 17 'compliance stages'. *Data lineage* processes can systematically track users' interactions with data and improve the 'auditability' of the compliance process and users' 'ownership' of activity.

Data linking is another method of managing IFRS 17 reporting data. Data linking contributes to data integrity while enabling multiple users to make changes to data. It enables the creation of relationships across values while maintaining the integrity of the source value, so changing the source value creates corresponding changes across all linked values. Data linking also enables the automated movement of data from spreadsheets to financial reports, updating data as it is changed and tracking users' changes to it.

Disclosing the data

Highlighting how IFRS 17 is more than just a compliance exercise, it will have a fundamental impact on how insurance companies report their data internally, to regulators, and to financial markets. For the final stage of compliance, firms will need to adopt a new format for the balance sheet, P&L statement and cash flow statements. In addition to the standard preparation of financial statements, IFRS 17 will require a number of disclosures, including the explanation of recognized amounts, significant judgements made in applying IFRS 17, and the nature and extent of risks arising from insurance contracts. As part of their conversion to IFRS 17, firms will need to assess how data will have to be managed on a variety of levels, including transactions, financial statements, regulatory disclosures, internal key performance indicators and communications to financial markets.

Communication with capital markets will be more complex, because of changes that will have to be made in several areas:

- The presentation of financial results.
- Explanations of how calculations were made, and around the increased complexity of the calculations.
- Footnotes to explain how data is being reported in 'before' and 'after' conversion scenarios.

During their transition, organizations will have to report and explain to the investor community which changes were the result of business performance and which were the result of a change in accounting basis. The new reporting basis will also impact how data will be reported internally, as well as overall effects on performance management. The current set of key metrics used for performance purposes, including volume, revenue, risk and profitability, will have to be adjusted for the new methodology and accounting basis. This could affect how data will be reported on and reconciled for current regulatory reporting requirements including Solvency II, local solvency standards, and broader statutory and tax reporting.

IFRS 17 will drive significant changes in the current reporting environment. To address this challenge, firms must plan how they will manage both the pre-conversion and post-conversion data sets, the preparation of pre-, post-, and comparative financial statements, and the process of capturing and disclosing all of the narrative that will support and explain these financial results. In addition, in managing the complexity of the numbers and the narrative before, during and after the conversion, reporting systems will also need to scale to meet the requirements of regulatory reporting – including disclosure in eXtensible Business Reporting Language (XBRL) in some jurisdictions. XBRL is a global reporting markup language that enables the encoding of documents in a human- and machine-legible format for business reporting. (The IASB publishes its IFRS Taxonomy files in XBRL.) But XBRL tagging can be a complex, time-consuming and repetitive process, and firms should consider using available technology partners to support the tagging and mapping demands of document drafting.

6. Conclusion

Ostensibly, modeling appears to be the main burden imposed by IFRS 17 accounting. However, no single feature of the extensive IFRS 17 compliance value chain should dominate firms' focus. Effective and efficient presentation and disclosure processes are also critical. To ensure optimal compliance, firms need to develop a sensible accounting policy and robust technology strategies.

Now more than ever, under the new paradigm of risk-aware accounting, compliance is a mixture of good governance and technology. At stake is potential non-compliance and the sub-optimal presentation of business reports.

In this report we have focused on the logistics of reporting in IFRS 17, including how accounting policy decisions can affect a firm's presentation of profits. These policy decisions go on to inform a firm's enterprise-wide reporting strategy, of which IFRS 17 is just one component, and core to an effective strategy is streamlining IFRS 17 with other reporting duties.

Suitable technology needs to be implemented to support these governance decisions. Legacy systems will not suffice – firms will need to invest. They should seek to optimize their approach by implementing the storage and tracking of data on a unified cloud platform, using XBRL software. Competitive firms of the future will have automated and scalable technology to distribute the massive flow of information they surface into multiple prescribed formats.

7. Glossary

Term	Definition
Acquisition cost	Acquiring a new customer can incur significant costs, including commissions to brokers and underwriting.
Balance sheet	An accounting statement listing the balance of income according to a business' assets and liabilities for the previous reporting period.
Contractual service margin (CSM)	A projection of unearned profit from a contract. Unlike loss, it is not recognized up front but is amortized over the length of the contract.
Direct participation contracts	Under these, a portion of the fair value return on a contract's underlying items is paid to the policyholder.
Discount rate	A calculation that uses market data to assess the future time value of money (see below).
Expected cash flows	These include insurance premium rate, investment return from underlying assets, liabilities, and interest rate return.
Explicit adjustment for risk	During the calculation process, risk is quantified and the measurement explicitly included into cash-flow valuations.
Exposure draft	The published proposed version of a standards document, which is open to public discussion. The final document may be subject to amendments.
Fulfilment cash flows	Unbiased, probability-weighted projections of expected future cash flows, including adjustments for discounting, financial risk and non-financial risk.
Other comprehensive income (OCI)	An accounting report located in the equity segment of the balance sheet. It documents incomes and losses that have yet to be realized.
Present discounted value	The value of an insurance contract that has been measured using discounted projections.
Time value of money	The potential increase in the value of money over time.

8. How to use research and services from Chartis

In addition to our flagship industry reports, Chartis offers customized information and consulting services. Our in-depth knowledge of the risk technology market and best practice allows us to provide high-quality and cost-effective advice to our clients. If you found this report informative and useful, you may be interested in the following services from Chartis.

For risk technology buyers

If you are purchasing risk management software, Chartis's vendor selection service is designed to help you find the most appropriate risk technology solution for your needs.

We monitor the market to identify the strengths and weaknesses of the different risk technology solutions, and track the post-sales performance of companies selling and implementing these systems. Our market intelligence includes key decision criteria such as TCO (total cost of ownership) comparisons and customer satisfaction ratings.

Our research and advisory services cover a range of risk and compliance management topics such as credit risk, market risk, operational risk, GRC, financial crime, liquidity risk, asset and liability management, collateral management, regulatory compliance, risk data aggregation, risk analytics and risk BI.

Our vendor selection services include:

- Buy vs. build decision support.
- Business and functional requirements gathering.
- Identification of suitable risk and compliance implementation partners.
- Review of vendor proposals.
- Assessment of vendor presentations and demonstrations.
- Definition and execution of Proof-of-Concept (PoC) projects.
- Due diligence activities.

For risk technology vendors

Strategy

Chartis can provide specific strategy advice for risk technology vendors and innovators, with a special focus on growth strategy, product direction, go-to-market plans, and more. Some of our specific offerings include:

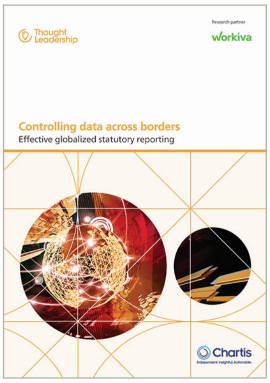
- Market analysis, including market segmentation, market demands, buyer needs, and competitive forces.
- Strategy sessions focused on aligning product and company direction based upon analyst data, research, and market intelligence.
- Advice on go-to-market positioning, messaging, and lead generation.
- Advice on pricing strategy, alliance strategy, and licensing/pricing models.

Thought leadership

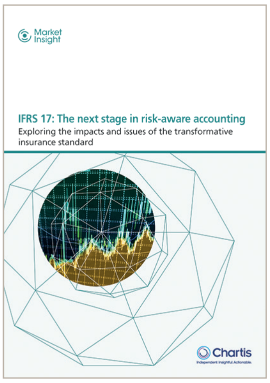
Risk technology vendors can also engage Chartis to provide thought leadership on industry trends in the form of in-person speeches and webinars, as well as custom research and thought-leadership reports. Target audiences and objectives range from internal teams to customer and user conferences. Some recent examples include:

- Participation on a 'Panel of Experts' at a global user conference for a leading Global ERM (Enterprise Risk Management) software vendor.
- Custom research and thought-leadership paper on Basel 3 and implications for risk technology.
- Webinar on Financial Crime Risk Management.
- Internal education of sales team on key regulatory and business trends and engaging C-level decision makers.

9. Further reading



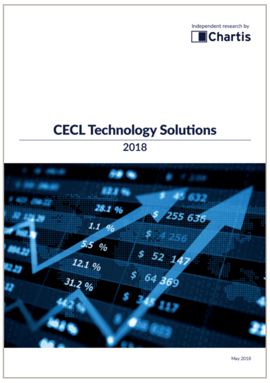
Controlling data across borders: Effective globalized statutory reporting



IFRS 17: The next stage in risk-aware accounting

IFRS 17 Technology Solutions, 2019: Market and Vendor Landscape

IFRS 9 Technology Solutions: Market Update 2017



CECL Technology Solutions, 2018

Data Integrity and Control in Financial Services: Market Update 2018

For all these reports, see **www.chartis-research.com**