Update on IFRS, IAS, IFRIC and SIC *for Professional Accountants*

The Journal is running a series of updates on IFRS, IAS, IFRIC and SIC. In this issue, Md. Monowar Hossain FCMA, FCA, CPFA(UK), FCS, CPA, former 'Consultant, ED, (Office of the Chief Accountant)'of BSEC, former GM,(ICC) of Rupali Bank Ltd., former Head of CGFRC, DSE, former Head of Finance & Company Secretary, Brummer & Partners AB, former Financial Management Consultant of ISS, Netherlands, has given a reflection of ***'IFRS-17: Insurance Contracts, few major new accounting standards will become effective in the next few years, IFRIC-23: Uncertainty over income tax treatments etc.',*** who has been working with Agrani Bank Limited, a state owned commercial Bank having 935B Branch Networking with 14,000 human capital, as the 'GM' & 'Head of Audit' and 'Head of Internal Control & Compliance (ICC)'.

IFRS-17: Insurance Contracts

The International Accounting Standards Board (IASB), on May 19, 2017, issued 'IFRS- 17: Insurance Contracts', which replaces 'IFRS-4'. The previous IFRS on insurance contracts, IFRS-4, was an interim standard that allowed entities to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements and variations of those requirements.

Effective date

An entity shall apply IFRS -17 for annual reporting periods beginning on or after 1 January 2021. If an entity applies IFRS-17 earlier, it shall disclose that fact. Early application is permitted for entities that apply IFRS-9: Financial Instruments and IFRS-15: Revenue from Contracts with Customers on or before the date of initial application of IFRS-17.

Why a new Standard?

The insurance industry plays a vital role in the global economy, said the Chairman of IASB, high-quality information to market participants on how insurers perform financially is therefore extremely important. IFRS-17 replaces the current myriad of accounting approaches with a single approach that will provide investors and others with comparable and updated information. Due to the range of accounting methods in use today, some countries will see more significant changes than others with the introduction of the new Standard.

The differences in accounting treatment across jurisdictions and products made it difficult for investors and analysts to understand and compare insurers' results. Most stakeholders, including insurers, agreed on the need for a common global insurance accounting standard even though opinions varied as to what it should be.

Long-term and complex insurance risks are difficult to reflect in the measurement of insurance contracts. In addition, insurance contracts are not typically traded in markets and may include a significant investment component, posing further measurement challenges. Some previous insurance accounting practicespermitted under IFRS-4 did not adequately reflect the true underlying financial positions or the financial performance of these insurance contracts.

To address these issues, the IASB undertook a project to make insurers' financial statements more useful and insurance accounting practices consistent across jurisdictions.

Scope of IFRS-17:

An entity shall apply IFRS-17: Insurance Contracts to: [IFRS 17:3]

- o Insurance contracts, including reinsurance contracts, it issues;
- o Reinsurance contracts it holds; and
- o Investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

Some contracts meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee. Such issued contracts are in the scope of the standard, unless an entity chooses to apply to them IFRS-15: Revenue from Contracts with Customers and provided the following conditions are met: [IFRS-17:8]

(a) the entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;
(b) the contract compensates the customer by providing a service, rather than by making cash payments to the customer; and
(c) the insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

IFRS-17 will:

- ✓ Provide a single definition of an insurance contract
- ✓ Establish a consistent international standard for insurance contract accounting
- ✓ Align standards for reporting (re)insurer assets (together with IFRS-9) and liabilities
- ✓ Enact a uniform valuation model for all types of insurance contracts
- ✓ Provide transparent and relevant information about the "black box" insurance contract accounting
- ✓ Enable consistent presentation of the performance drivers/factors for (re)insurers
- ✓ Improve quality, timeliness and comparability of risk management activities in the Financial statements

The key principles in IFRS-17:

The key principles in IFRS-17 are that an entity:

(a) identifies as insurance contracts those contracts under which the entity accepts significant insurance risk from another party (the policy holder) by agreeing to compensate the policy holder if a specified uncertain; future event (the insured event) adversely affects the policy holder;

(b) separates specified embedded derivatives, distinct investment components and distinct performance obligations from the insurance contracts;

(c) divides the contracts into groups it will recognise and measure;

(d) recognises and measures groups of insurance contracts at a risk-adjusted present value of thefuture cash flows (the fulfilment cash flows) that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information plus (if this value is a liability) or minus (if this value is an asset) an amount representing the unearned profit in the group of contracts (the contractual service margin);

(e) recognises the profit from a group of insurance contracts over the period the entity provides insurance coverage, and as the entity is released from risk; if a group of contracts is or becomes loss-making, an entity recognises the loss immediately;

(f) presents separately insurance revenue, insurance service expenses and insurance finance income or expenses.

(g) discloses information to enable users of financial statements to assess the effect that contracts within the scope of IFRS-17 have on the financial position, financial performance and cash flows of the entity. To do this, an entity discloses qualitative and quantitative information about:

(i) the amounts recognised in its financial statements from insurance contracts;

(ii) the significant judgements, and changes in those judgements, made when applying the Standard; and

(iii) the nature and extent of the risks from contracts within the scope of this Standard.

Separating Components from an Insurance Contract

An insurance contract may contain one or more components that would be within the scope of another standard if they were separate contracts. For example, an insurance contract may include an investment component or a service component (or both). [IFRS-17:10]

The standard provides the criteria to determine when a non-insurance component is distinct from the host insurance contract.

An entity shall: [IFRS-17:11-12]

(a) Apply IFRS-9: Financial Instruments to determine whether there is an embedded derivative to be separated and, if there is, how to account for such a derivative.

(b) Separate from a host insurance contract an investment component if, and only if, that investment component is distinct. The entity shall apply IFRS-9 to account for the separated investment component.

(c) After performing the above steps, separate any promises to transfer distinct non-insurance goods or services. Such promises are accounted under IFRS -15: Revenue from Contracts with Customers.

Level of aggregation

IFRS-17 requires entities to identify portfolios of insurance contracts, which comprises contracts that are subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. [IFRS-17:14]

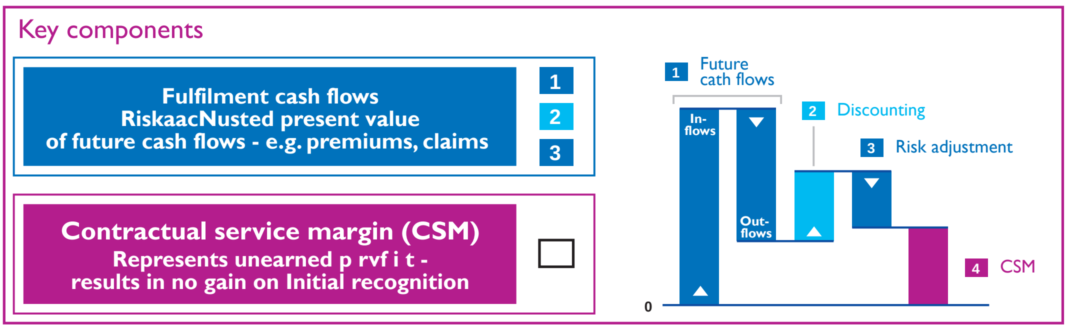
Each portfolio of insurance contracts issues shall be divided into a minimum of: [IFRS-17:16]

- o A group of contracts that are onerous at initial recognition, if any;
- o A group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- o A group of the remaining contracts in the portfolio, if any.

An entity is not permitted to include contracts issued more than one year apart in the same group. [IFRS-17:22]

If contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policy holders with different characteristics, the entity may include those contracts in the same group. [IFRS-17:20]

Initial Recognition



Net cash outflows result in no CSM -a loss is recognised immediately

Recognition

An entity shall recognise a group of insurance contracts it issues from the earliest of the following: [IFRS-17:25]

(a) the beginning of the coverage period of the group of contracts;
(b) the date when the first payment from a policyholder in the group becomes due; and
(c) for a group of onerous contracts, when the group becomes onerous.

Measurement

On initial recognition, an entity shall measure a group of insurance contracts at the total of: [IFRS-17:32]

(a) the Fulfilment Cash Flows ("FCF"), which comprise:

  (i) estimates of future cash flows;
  (ii) an adjustment to reflect the Time Value of Money ("TVM") and the financial risks associated with the future cash flows; and
  (iii) a risk adjustment for non-financial risk

(b) the Contractual Service Margin ("CSM").

An entity shall include all the future cash flows within the boundary of each contract in the group. The entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contracts. [IFRS-17:33]

The estimates of future cash flows shall be current, explicit, unbiased, and reflect all the information available to the entity without undue cost and effort about the amount, timing and uncertainty of those future cash flows. They should reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices. [IFRS-17:33]

Discount Rates

The discount rates applied to the estimate of cash flows shall: [IFRS-17:36]

(a) reflect the time value of money (TVM), the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
(b) be consistent with observable current market prices (if any) of those financial instruments whose cash flow characteristics are consistent with those of the insurance contracts; and
(c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

Risk Adjustment for Non-financial Risk

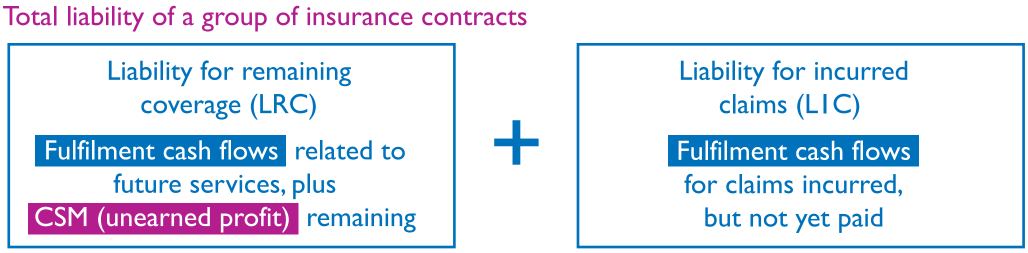
The estimate of the present value of the future cash flows is adjusted to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of future cash flows that arises from non-financial risk. [IFRS-17:37]

Contractual Service Margin (CSM)

The CSM represents the unearned profit of the group of insurance contracts that the entity will recognise as it provides services in the future. This is measured on initial recognition of a group of insurance contracts at an amount that, unless the group of contracts is onerous, results in no income or expenses arising from: [IFRS- 17:38]

(a) the initial recognition of an amount for the FCF;
(b) the derecognition at that date of any asset or liability recognised for insurance acquisition cash flows; and
(c) any cash flows arising from the contracts in the group at that date.

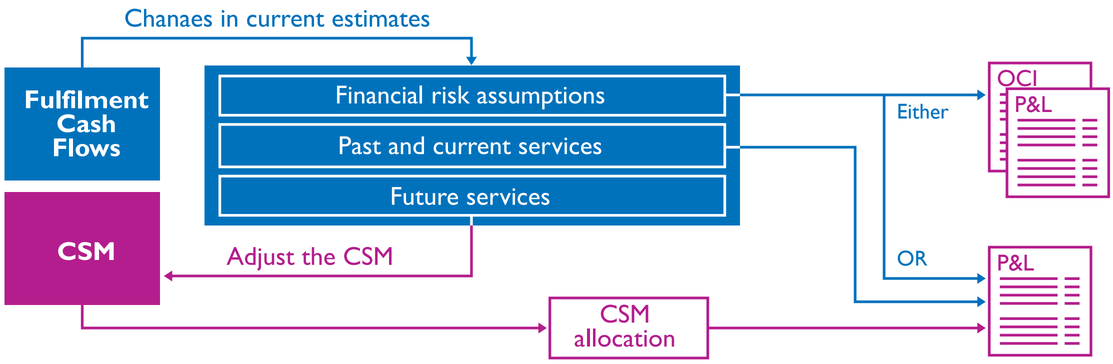
Subsequent Measurement



On subsequent measurement, the carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of: [IFRS-17:40]

(a) the liability for remaining coverage comprising:
 (i) the FCF related to future services and;
 (ii) the CSM of the group at that date;

(b) the liability for incurred claims, comprising the FCF related to past service allocated to the group at that date.



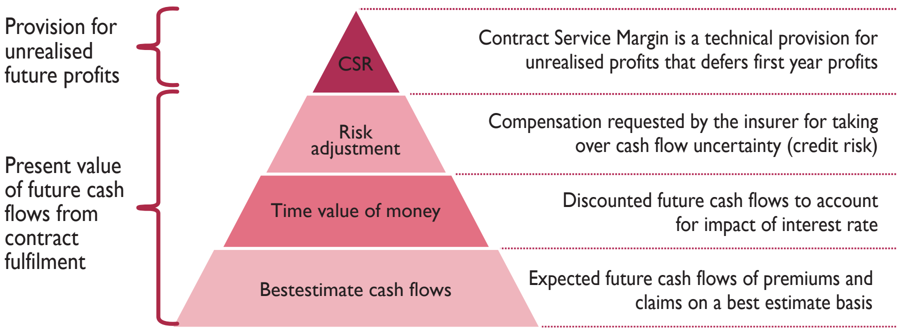
Onerous Contracts

An insurance contract is onerous at initial recognition if the total of the FCF, any previously recognised acquisition cash flows and any cash flows arising from the contract at that date is a net outflow. An entity shall recognise a loss in profit or loss for the net outflow, resulting in the carrying amount of the liability for the group being equal to the FCF and the CSM of the group being zero. [IFRS-17:47]

On subsequent measurement, if a group of insurance contracts becomes onerous (or more onerous), that excess shall be recognised in profit or loss. Additionally, the CSM cannot increase and no revenue can be recognised, until the onerous amount previously recognised has been reversed in profit or loss as part of a service expense. [IFRS-17:48-49]

Building Block Approach vs. Premium Allocation Approach

On IFRS-17, no discussionwould be complete without a look at the Building Block Approach. This approach is the default approach for calculating the cash-flows for insurance contracts under the Standard.

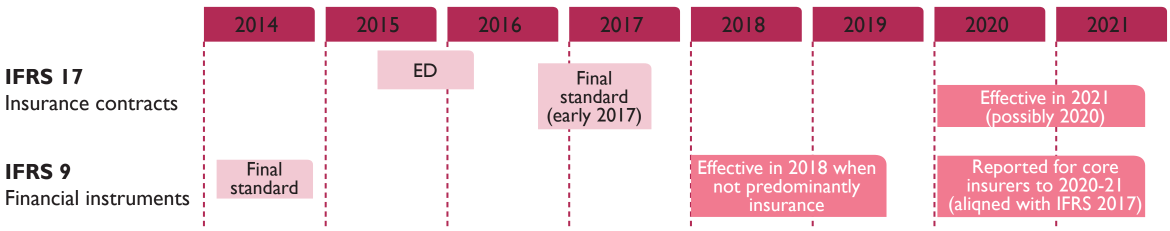


Those with longer-term life contracts or longer duration specialities contacts have no real option but to use the Building Block Approach.

The *Premium Allocation Approach* provides a simplified alternative to *Building Block Approach* for the valuation of reserves for short-term contracts (coverage period less than or equal to one year) with little variability, such as short-term general insurance, short-term life, and certain group contracts. *Premium Allocation* Approach applies to the pre-claims liability - similar to unearned premium accounting. The Building Block Approach is still applied to determine the present value liability for incurred claims.

Compliance (source: Mr. John Morley)

In 2021 compliance with IFRS-4 phase 2 will become effective, and with a deft last minute name change to IFRS-17, accounting for insurance contract, we can almost believe it will just take a few years and not decades. Alignment with insurance industry adoption of IFRS-9, financial instruments, for adoption at the same time means, sensibly that assets and liability accounting will be aligned.

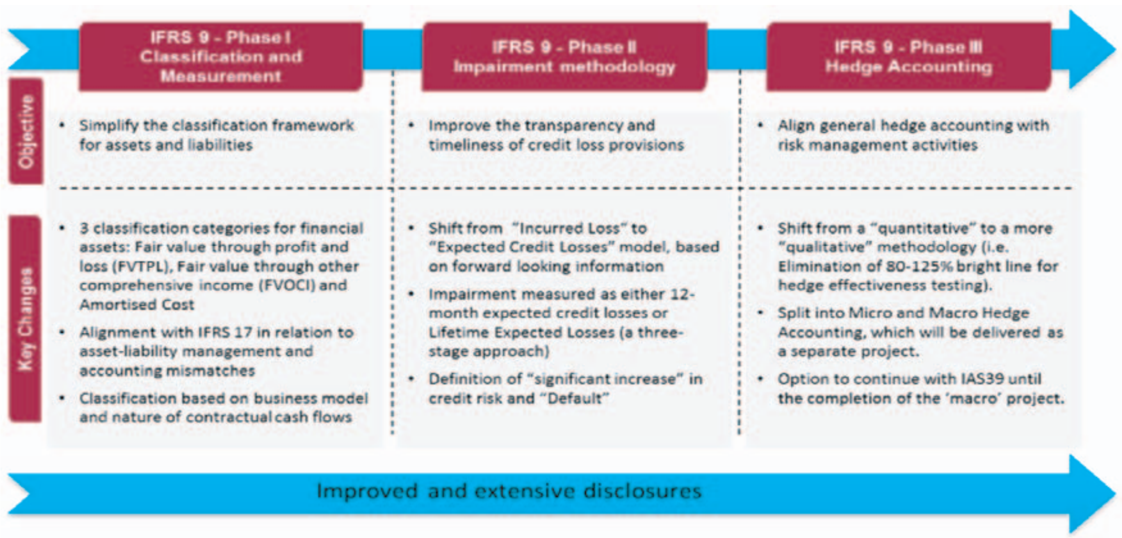


The insurance industry is by its nature liability side focused so let's take a moment to look at the asset side and IFRS-9. IFRS-9 replaces IAS-39. It is already effective for Banks so financial services as a whole has some experience of implementing it. It will become effective for insurance companies in 2021 and is based on a three stage implementation approach.

Disclosures

An entity shall disclose qualitative and quantitative information about: [IFRS-17:93]

(a) the amounts recognised in its financial statements that arise from insurance contracts;
(b) the significant judgements, and changes in those judgements, made when applying IFRS-17; and
(c) the nature and extent of the risks that arise from insurance contracts.



Transition

An entity shall apply the standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach. [IFRS-17:C3, C5]

Under the modified retrospective approach, an entity shall utilise reasonable and supportable information and maximise the use of information that would have been used to apply a full retrospective approach, but need only use information available without undue cost or effort. Under this approach the use of hindsight is permitted, if that is the only practical source of information for the restatement of prior periods. [IFRS-17: C6-C7]

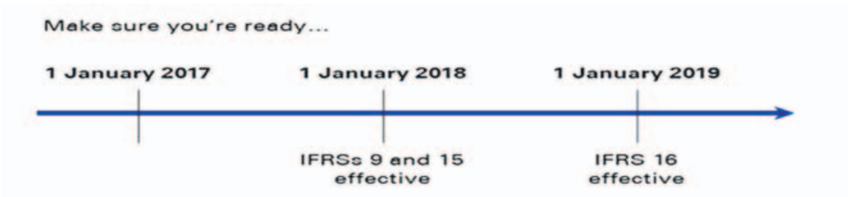
Under the fair value approach, an entity determines the CSM at the transition date as the difference between the fair value of a group of insurance contracts at that date and the FCF measured at that date. Using this approach, on transition there is no need for annual groups. [IFRS-17:C21, C24]

At the date of initial application of the Standard, those entities already applying IFRS-9 may retrospec-tively re-designate and reclassify financial assets held in respect of activities connected with contracts within the scope of the Standard. [IFRS-17:C30-C31]

Entities can choose not to restate IFRS-9 comparatives with any difference between the previous carrying amount of those financial assets and the carrying amount at the date of initial application recog-nised in the opening equity at the date of initial application. Any restatements of prior periods must reflect all the requirements of IFRS-9 [IFRS-17:C31].

In Bangladesh, we may adopt and implement the new standard for our insurance sector for the greater interest of our investors. By implementing, it may be able to protect the interest of the policy holders and other stakeholders under insurance policy, may supervise and regulate the insurance industry effectively by the regulator, may ensure orderly and systematic growth of the insurance industry in Bangladesh.

Three major new accounting standards will become effective in the next few years.



These standards may have a significant impact on your financial statements and may require an overhaul of the processes used to produce the required financial information.

Stage transfer criteria for impairment

Under IFRS-9: *Financial Instruments,* the principles-based approach to the measurement of impairment leaves significant room for interpretation and judgement.

One of the most prominent areas of judgement relates to the stage transfer criteria, which determine whether a loss allowance is measured as 12-month expected credit losses (ECLs) (Stage 1) or lifetime ECLs (Stage 2).

Determining whether there has been a significant increase in credit risk since initial recognition - and therefore whether to transfer to Stage 2 - is challenging.

Staging is one of the most material and complex elements of the new IFRS-9 impairment model for financial instruments.

Disclosures about the new standards

Regulators expect banks to provide increasingly more qualitative and quantitative information as the implementation of IFRS-9 and the other new standards progresses.

We have looked at disclosures that banks have made in their December 2016 annual financial statements accounting standards that have been issued but are not yet effective.

IFRIC-23: Uncertainty over income tax treatments

The Interpretation provides a helpful clarification on how the requirements of IAS-12 should be applied when there is uncertainty over income tax treatments. The application of the Interpretation requires an entity to make certain additional assumptions, estimates and significant judgements.

The IASB issued IFRIC Interpretation-23 :Uncertainty over Income Tax Treatments (the Interpretation) on 7th June 2017. The Interpretation clarifies application of recognition and measurement requirements in IAS -12: Income Taxes when there is uncertainty over income tax treatments. The Interpretation specifically addresses the following:

- ✓ Whether an entity considers uncertain tax treatments separately
- ✓ The assumptions an entity makes about the examination of tax treatments bytaxation authorities
- ✓ How an entity determines taxable profit (tax loss), tax bases, unused taxlosses, unused tax credits and tax rates
- ✓ How an entity considers changes in facts and circumstances

Scope

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS-12. The Interpretation does not apply to taxes or levies outside the scope of IAS-12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments.

Does an entity consider uncertain tax treatments separately?

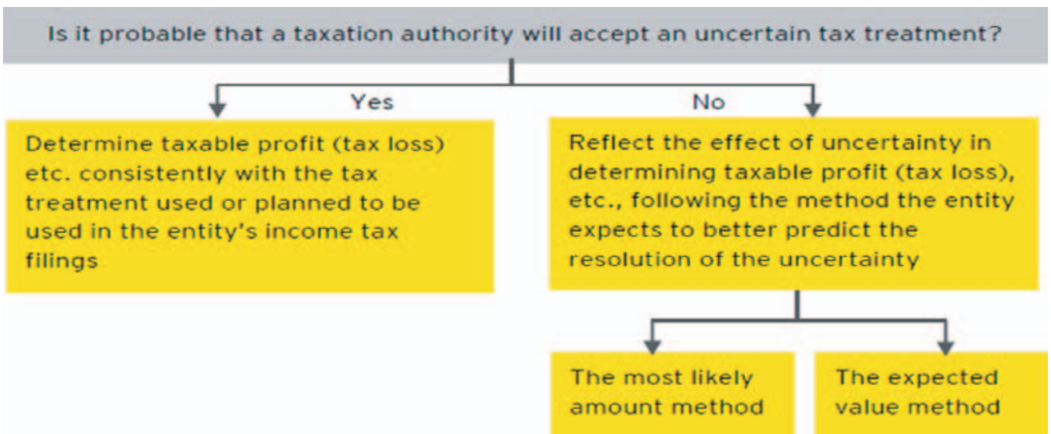
An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed.

Assumptions about the examination of tax treatments by taxation authorities

In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity should assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations.

Determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates

In determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity must consider the probability that a taxation authority will accept an uncertain tax treatment. The requirements in the Interpretation, in this respect, are set out in the diagram below:



How an entity considers changes in facts and circumstances

An entity should reassess any judgements and estimates made if the facts and circumstances change or new information becomes available. The effect of a change in facts and circumstances, or the emergence of new information, should be reflected as a change in accounting estimates as per IAS-8: Accounting Policies, Changes in Accounting Estimates and Errors. An entity should apply IAS-10: Events after the Reporting Period to determine whether a change that occurs after a reporting period is an adjusting or non-adjusting event.

Disclosure

The Interpretation does not add any new disclosure requirements. However, it highlights the existing requirements:

- Judgements, information about the assumptions made and other estimates are disclosed as per paragraphs 122 and 125-129 of IAS-1: Presentation of Financial Statements
- When it is probable that the taxation authority will accept an uncertain tax treatment, paragraph 88 of IAS-12 should be applied to determine the disclosure of a tax-related contingency

Effective date and transition

The Interpretation is applicable for annual reporting periods beginning on or after 1 January 2019; it provides a choice of two transition approaches:

- o The Interpretation may be applied retrospectively using IAS-8, only if the application is possible without the use of hindsight

Or

- o The Interpretation may be applied retrospectively with the cumulative effect ofthe initial application recognised as an adjustment to equity on the date of initial application. In this approach, comparative information is not restated. The dateof initial application is the beginning of the annual reporting period in which an entity first applies this Interpretation.

Conclusion

IFRSs are continually changing; the above technical update is designed to help ensure that finance teams are aware of those changes, allowing them to consider the impact that they may have on their company. Gain confidence with an update knowledge of IFRS, to help respond to the ever increasing complexity and changes in the financial reporting environment, professional accountants have to be developed him/herself as a specialist in IFRS - to support and achieve the organizational achievable positive goals. Companies in about 120 countries worldwide use and support IFRS, so the impact of regulatory changes under updated IFRS should understand by the professional accountants. Because the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, creditors and other stakeholders in making decisions about providing resources to the entity through understand how recent changes to accounting standards may impact company analysis, stay up-to-date on changes that are in the pipeline, especially those that will impact financial statements. These would make it easier for public companies to compete abroad, raise capital, win global contracts, and provide financial details, and that is *why we all have to know and understand the updated knowledge of IFRSs. (Reference: ifrs, ifrsbox, ey,kpmg,grant-thornton,Mr. John Morley,etc).*

> "I will tell you the secret to getting rich on Wall Street. You try to be greedy when others are fearful. And you try to be fearful when others are greedy."
>
> \- Warren Buffett