What to expect from the forthcoming Insurance Contracts standard

After 20 years in the making, we are seeing heightened anticipation for the forthcoming Insurance Contracts standard. What does the new standard mean for us? This article outlines the background of the standard.

Who will be impacted

Any entity that issues insurance contracts will be impacted by the standard – regardless of whether the entity is predominantly in the industry of pure insurance, asset management or banking.

When will the standard be ready

The International Accounting Standards Board is currently drafting the standard. It is anticipated to be issued early next year.

Why we need a new standard

The objective of the new standard, writes Patrick Finnegan, a former member of the IASB, "is primarily to create financial reporting that better portrays the economics of insurance contracts and to provide investors with better insights into the drivers of earnings and cash flows for entities that issue insurance contracts."

Insurance contracts have become increasingly complicated in response to developments in today's macro and socio-economic environment, such as changing demographics, declining interest rates, increasing competition and expanding regulation.

Finnegan notes that even in the face of these developments, the "accounting for insurance contracts has not kept pace with such changes in many markets. Also to the extent that accounting practices have changed, it has become more difficult for users to understand the financial statements of entities that issue insurance contracts because such changes have not been uniform across markets, producing an overall view of insurance contracts that is somewhat of a patchwork quilt. As a result, investors struggle to understand clearly the business as portrayed by current reporting."

What are the major changes

The forthcoming standard will result in a complete overhaul of the current accounting for insurance contracts in Hong Kong.

IASB member Steve Cooper has highlighted four key advances in the forthcoming accounting for insurance contracts in the table (see right). Cooper considers that these four advances will mean that "basic issues related to liability measurement, reporting the delivery of services, and the recognition and measurement of financial assets will become very similar to those in other industries and transactions."

Ultimately, these changes are expected to improve the relevance, understandability, usefulness and comparability of the accounting for insurance contracts.

What Hong Kong insurers should do now

At the very least, entities that will be impacted by the standard should have a high-level understanding of the forthcoming standard and its effects. The following are some suggested steps to take now.

- Understand what the forthcoming accounting requirements are. The IASB's eight-part webinar series will provide preliminary overview of what the tentative standard will look like: *www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Pages/Webinar-Series.aspx.*
- Conduct an initial assessment of how the major requirements will impact your company. A good way of doing this is via the IASB's field testing questionnaire available

Key advances in the forthcoming accounting for insurance contracts

Issue today	Proposed solution
Using old or outdated assumptions does not provide useful financial information.	A current, updated measure of insurance contract liabilities provides more relevant and useful information.
Using the "expected return on assets held" as the discount rate to measure unrelated insurance contract liabilities does not reflect the risks relating to insurance contracts.	Using an asset-based discount rate only where applicable improves the relevance of the information received.
There is diversity in practice and a lack of transparency about profit recognition patterns from insurance contracts.	The unearned profit arising from a contract will be recognized as the insurance coverage and related services are delivered, significantly improving transparency, and providing additional metrics to evaluate performance.
Reporting revenues on a cash or near-cash basis is inconsistent with all other industries.	Revenue will reflect the services provided, and exclude deposits, like any other industry, increasing comparability and understanding.

Source: IASB Investor Perspectives – February 2015

at: *www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Documents/2016/Insurance-Testing-questionnaire.pdf.*

- Engage with a consultant as soon as possible. Existing financial and operating systems may not be able to handle the massive volumes of data collection, retention, and automation that the forthcoming standard will require. Business practices on the management and pricing of products (as well as management reporting) may also potentially change.
- Communicate the changes and potential extent of impact internally to senior management or the board of directors as soon as possible. Potential changes will also impact financial budgets and require board approval.
- Start considering the company's external communications strategy. This is crucial – nobody likes surprises, in general.
- Work together with other industry peers. Remember that everyone is in the same boat and working towards the same goal. Reach out to your industry peers to understand how they are implementing the standard and share solutions on how to overcome operational challenges.
- Engage with the Institute's Standard Setting Department. We are currently reaching out to companies that will be impacted by the standard to understand the potential effects of, and discuss the remaining topical matters relating to, the forthcoming standard. Get in touch with the SSD (*outreachhk@hkicpa.org.hk*) if you have anything to discuss. The Institute will conduct further educational and implementation activities when the standard is issued.

This article is contributed by the Institute's Standard Setting Department