THE NEW INCOME STATEMENT OF INSURANCE COMPANIES IN IFRS 17: FIRST APPLICATION ISSUES

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Abstract

The introduction of International Financial Reporting Standards (IFRS) 17 represents for the insurance sector a deep change both in the presentation of the annual statements and in the main ratios that will be analyse to understand the key factors of the insurance business. Some of the major changes regard the economic items and the income statement. This study, that is only a first step analysis, will do a comparison of the different accounting principles framework with the scope to verify and evaluate the main impacts of the new contest on transparency and disclosure for the stakeholders.

1. RESEARCH QUESTIONS

The research presented is part of a larger project which concerns the preparation of a comprehensive monograph on the "new" consolidated financial statements of Italian and international insurance companies, both European Union (EU) and non-EU: the changes made by International Financial Reporting Standards (IFRS) 17 are in force since January 1, 2023, with a strong impact on the presentation of economic, financial and equity information to stakeholders and on the main indicators currently used by financial analysts in their evaluations. The research proposed in this extended abstract concerns the changes made to the income statement account and the information connected to it presented in the notes to the financial statements and the expected impact that these changes will have on the transparency of the profitability drivers of the insurance business for the stakeholders.

The analysis started considering both the previous discipline in the international accounting standards and the new Conceptual Framework of the International Accounting Standards Board (IASB) and the consistency of IFRS 17 choices with other IASB standards issued for sectors different from the insurance one. The national regulation was also evaluated with an analysis of the new income statement and of the linked mandatory information required by the Italian Insurance Supervisory Authority (IVASS) with a specific regulation in 2022.

2. THEORETICAL FRAMEWORK

For insurance contracts, it was necessary 20 years to have the IASB definitive accounting, testifying both the complexity of the subject and the non-homogeneous practices existing in the different countries. The first exposure draft on IFRS 17 was issued in 2007 and the original structure of the draft has been subjected to deep changes due also to an extensive debate at the European level in relation to existing practices and to the current Solvency II framework.

With IFRS 4, which was issued by IASB as a temporary principle, a broader number of different insurance liabilities evaluation methods were allowed because the technical provisions could be determined by applying the countries' local regulations with the only limit of the Liability Adequacy Test, with a consequent negative impact on the comparability of the operating and income results. For this reason, IASB, with a series of successive approximations, was identified in IFRS 17 as a "unique" model for the evaluation of insurance contracts and liabilities and the presentation of the profitability of the insurance business. The IASB purpose is ambitious: on the one hand, to make the financial statements of insurance companies more understandable to the capital markets and more comparable with other businesses, financial and non-financial, on the other hand, to ensure that the main value drivers of the insurance contracts are correctly represented in financial accounts and understandable for the stakeholders. Referring to some principles of IFRS 17, the debate at the European level was very long and the approval of IFRS 17 from the European Union with a carve-out referring to the annual cohorts is concrete proof of the relevance of the discussion on the valuation of insurance contracts that almost for one aspect remains without a common solution.

The research intends to contribute, for a specific sector, to the current debate regarding the impact in terms of transparency of the most recently issued international accounting standards as well as their internal consistency with the framework and with the other existing standards

3. METHODOLOGY

Following some papers previously mentioned and in the absence of numerical data given the applicability of IFRS 17 only from the 2023 financial statements, the research is based on a comparative analysis between regulatory systems and includes the effects that will occur as a result of the new regulations, with particular reference to the information level of the income statement and to the related details presented in the notes to the financial statements.

To achieve the proposed objectives, the authors first proceeded to examine the existing and current formats for both the consolidated financial statements and the individual local financial statements, giving particular attention to the technical and insurance items: evaluation changes in insurance liabilities, effects of reinsurance, commissions and income from investments, and to their impact on the return for the year. Subsequently, IFRS 17 was analyzed both as the main text and basis for the conclusion and the recent IVASS regulation in order to identify the main points of divergence as well as the potential impacts in terms of increasing the level of future disclosure compared to the current one, also considering the differences for life and non-life contracts. Comparison tables were created on the most relevant points which then led to the formulation of the first judgments on the potential effects of the new standard.

Remembering that the annual return is an "abstract" quantity because is deeply influenced by judgment, deep changes in the valuation discipline and in the income statement structure determine an important point of discontinuity which is justified only if the increase in the quality of information for stakeholders is significant. An immediate example of this discontinuity is the disappearance of the "premium" from the income statement and the appearance of "insurance revenue".

4. PRELIMINARY RESULTS

The analysis highlighted that the changes deriving from the application of IFRS 17 for the preparation of the income statement usually have a much greater impact on the life contracts than on the non-life contracts. Indeed, in the life businesses, the main drivers of the 2023 consolidated profit or loss statements will be very different from the current ones. In substance, the income statement passes from an "accounting" vision to an "economic" vision. Until 2022, the operating result and the return of the life business depended on technical profits, on the treatment of acquisition costs, on the financial margin and depends significantly on write-downs and realization policies on equity instruments; from 2023, with the simultaneous application of IFRS 17 and IFRS 9, there will be a systematic recognition in the income statement of the contractual service margin and of the risk adjustment as well as the change in the technical assumptions based on experience and the immediate recognition in the income statement of the expected losses on onerous insurance contracts. The income statement will probably be more volatile while the other comprehensive income should be more stable compared to the previous year's accounts.

Some indicators used until now by the markets should be replaced and the new elements of the liabilities evaluation model will have to be considered. The role of information in the notes will be fundamental in order to better understand the drivers of profitability as well as the assumptions underlying the valuations. IFRS 17 is a principle that, on one hand, should make the insurance income statement more intelligible to a generalist analyst and more comparable with the income statements of the other sectors but, on the other hand, it will require a high level of technicality to an in-depth understanding considering the high technical contents of the information presented in the notes. Furthermore, the distancing of the IFRS regulation of the consolidated income statement from the local individual income statement will add another important complexity, with consequent implications in terms of reconciliations to obtain a complete view of the financial and economic position of a company and of its group.

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