

**ACCOUNTING PRACTICE IMPROVEMENT
AND INCREASEMENT IN LEVEL OF COMPARABILITY
FOR THE DATA REPORTING FOR INSURANCE COMPANIES**

Abstract

In this article the issues of improving accounting for insurance companies are considered according to IFRS–17. The new standard on accounting of contracts for insurance makes cardinal changes to the international order of accounting for insurance contracts. It establishes the principles of recognition, assessment, representation and disclosure of contracts for insurance and replaces IFRS–4 «Contracts of insurance». Nowadays reporting, prepared on the basis of IFRS–4 makes the comparison very difficult for insurance companies for investors. IFRS–17 demands consecutive accounting for all insurance contracts on the basis of model of the ongoing measurements. The model of the ongoing measurements and the sequence will help investors to carry out the analysis, allowing them to easily compare profitability for insurance companies. Separate presentation of results on underwriting activity and financial results will provide greater transparency regarding sources of profit and qualitative characteristics of the reported profit. A higher comparability of the reporting data could stimulate the growth of activity in the field of mergers and acquisitions, raise the level of competition for investment capital and help gain investor confidence. For many insurance companies, the task becomes more complicated because the time horizon of insurance contracts is very long, and the systems used by many companies are somewhat outdated.

Key words: current assessment, modification, service margin, financial statements, insurance company, investors, analysis, insurance contract.

The difficult financial data reporting is available to understanding only by narrow experts, are the reason of unpopularity for insurance activity at many investors. It is very difficult to compare results of activity for various insurance companies because now the existing of IFRS–4 allows to use a number of inconsistent approaches to accounting. It promotes a disorientation of users and unpopularity for insurance as subject to investment [1].

The complexity of financial data reporting for insurers is a consequence of the fact that insurance is very difficult business where profits or losses can arise in many years with uncertain dynamics. The financial data reporting of the insurer represents interrelation between assets and liabilities. It also reflects the fact that profit isn't an unambiguous concept of business. However, users of financial data reporting are generally disturbed by impossibility to compare results.

Aim of IFRS–17 is increasing the level of transparency and comparability of the reporting in comparison with the existing standard [2]. The IFRS–4 allows simultaneous application of huge number for accounting policies even in case within one group inconsistency is found.

IFRS–17 will become obligatory for applying to the reporting periods at the beginning on January 1, 2021 or after this date.

The main problems of accounting for insurance contracts are shown in Figure 1 (p. 222).

The main research in article is the set of methods for reflecting the system of accounting to assets and liabilities under insurance contracts. Methodological aspects are the following:

- ◆ a model of the current estimate;
- ◆ an adjustment by obvious risk;
- ◆ flows of the money on discharge;
- ◆ a contract margin under the contract.

Accounting of contracts will be based on the three key ideas.

1. It is necessary to show the profit got from the provided services, but not to received money in financial data reporting.

2. Estimates of future flows of the money have to be based on the current assumptions, but not on the historical “fixed” assumptions.

3. Assessment has to include a reserve under risk and uncertainty.

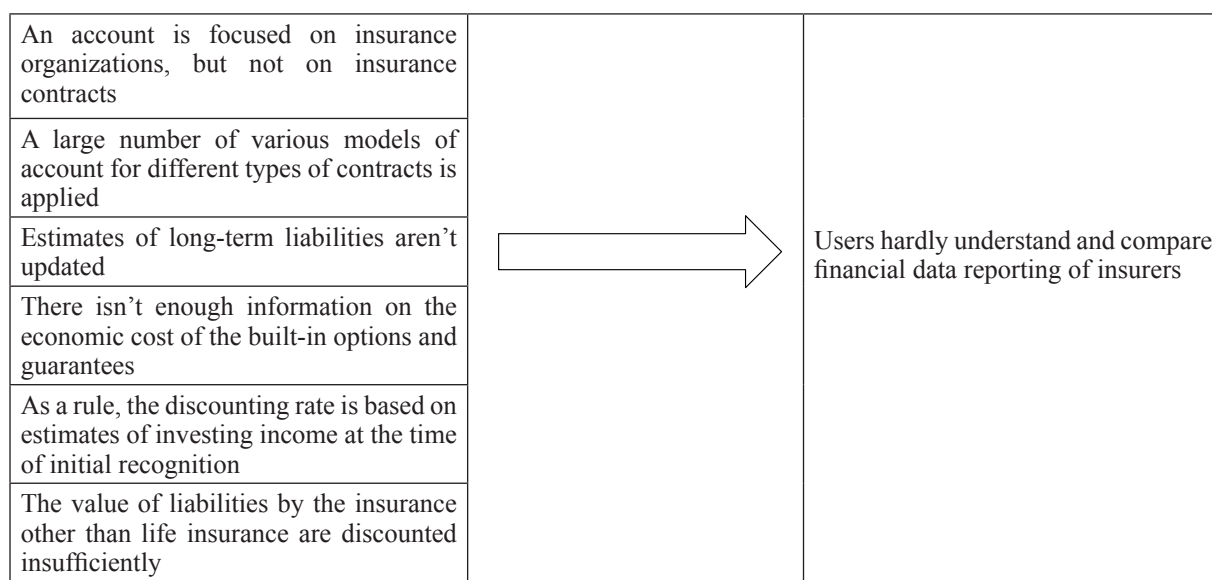


Figure 1 – Problems of accounting for insurance contracts [3]

From the point of operating activities view the mechanisms necessary for calculation and submission for liabilities and profit by the new standard, will demand from most of insurers on difficult modeling and attraction for large volume of data. It is about the current estimates for liabilities, including a reserve under the economic risks connected with the built-in options and unchangeable insurance risks.

A Margin Service Under Contracts Calculation is necessary for control of profit accounting according to the provided services. It is also necessary to take into account new rules of classification and assessment in IFRS–9 [4].

The IFRS–17 will be applied retrospectively to all contracts which will affect date of transition to the new standard. It creates considerable problems for many insurers at assessment of impacting on historical assumptions for defining indexes of the entering balance. The volume of data which will need to be traced and stored considerably will increase in comparison with what is required today. For some companies the costs of introducing for new technologies can also be considerable. As always, it will be possible to reach a certain compromise between the cost and accuracy, however even the analysis of options and understanding of their influence won't be indivisible on all.

Application of the new standard will still demand preparation for difficult financial data reporting which will strongly differ from the majority of the ongoing reports on IFRS. It will mean need of carrying out cardinal changes in a method of calculating liabilities and applying a new method to profit presenting for many insurers. Investors will need some time to get used to a modern history of profit. The complexity of such information will still be a problem, but maybe it is the inevitable price for comparability which is so necessary to investors and analysts [5].

Most likely, the new standard will exert more considerable impact on many organizations engaging in life insurance taking into account long-term character of the contract which are made out by them. However, other insurance companies will also face to changes in the sphere of operating accounting on reinsurance: they will be obliged to discount insurance payments.

Key changes are connected with the fact that all flows of the money will be based on the current assumptions whereas now insurance assessment is carried out with using historical assumptions for some contracts.

Accounting of earnings will be comparable to provisions of IFRS–15, excepting deposit components and income won't admit by a cash method which is now used by the organizations specializing in life insurance [6].

As for evaluating the historical data as discounting rates and not earned profit which aren't applied now in accounting and the data reporting presenting to regulators will be required. Calculation will be carried out at lower level of specification in comparison with what many insurance companies use at the moment.

The influence of IFRS–17 will exert impact not only on financial accounting of the organizations as actuarial calculations and development of their systems. Moreover, it can influence on developing, products selling, programs motivating and remunerations cash policy in a broader sense and also on process of drawing up budgets as well as affecting to a monetary tax position and dividends [7].

There are certain modifications reflecting specific economic characteristics of special contracts with the purpose of performing the fundamental purposes for the standard in IFRS–17. In addition to above IFRS–17 stipulates accounting of contracts for short term of a covering where the results of measurements within the standard are achieved by easier way.

Insurance contracts are measured by the sum of two components: flows of the money on discharge and a contract margin. The first component, flows of the money on discharge, represents assessment of future flows of the money weighed in term of probabilities. It also reflects financial risks. In addition, flows of the money on discharge reflect non-financial risks as the award for non-financial risks (adjustment by risk) is added to the specified cost for value of flows of the money on discharge.

The second component, a contract margin is a profit uncollected at the moment for rendering services in the contract. This approach in the recent past was sometimes called as building block approach.

It should be noted that the broad principles and estimates, used at measuring for insurance contracts at initial recognition are specific to each organization. However, the organization can use market variables for assessment in some cases. Then these market variables have to remain consecutive with any observed net realizable value. Own credit risk of the insurer isn't considered in measuring for insurance liabilities because they aren't measured at fair value.

The flows of the money on discharge represent as the first component for the insurance liabilities. The specified cost of future flows of the money is its first component on discharge.

Future flows of the money include acquisition cost, cost line and also the expected insurance requirements. These estimates also reflect behavior of the owner of the contract. The temporary cost of guarantees finds the reflection in measurements too which will be incomplete without one more important components as all awards in validity borders.

Requirements of IFRS–17 for borders define the flows of the money which need to be used at measurement for the insurance contract. Applicability defines whether there are expected awards, also payments and requirements from the existing or future insurance contracts. Borders belong to the existing insurance contract if the company has an opportunity to estimate risks and to redefine the price for this contract. If the company estimates borders for a portfolio of contracts instead of the one itself. However, it has to be looked whether the price considers the risks relating for future periods.

The first component in assessment for flows of the money in validity borders includes all monetary the flows-in and runoffs which are directly resulting from the implementation of an agreement. Estimates are obliged to include all rational and reasonable information without excessive costs of its search.

Rational and reasonable information means that the expected future flows of the money are estimated on the basis of the list of all possible scripts reflecting to all range for possible outcomes. After defining all range for possible outcomes and corresponding the scripts to them the company determines the size and time of generating flows of the money, applies the discounting rate suitable to these ones and estimates further probability for outcome to each script that means weighs it in term of probability for its outcome.

In addition to it is required that estimates were not displaced. To speak specifically, unbiased estimators are an average value of distribution. Further if there are some else financial opportunities or guarantees in the insurance contract. Financial opportunities and guarantees create nonlinearity. Therefore, stochastic models of assessment can be required to consider this nonlinearity in evaluating flows of the money.

Discounting rates are applied to reduction for unbiased probability estimators to the current values. The flows of money are discounted at the rates reflecting characteristics of liabilities. Using rates are the ongoing prevailing rates. If flows of money have no binding to profitability to assets (speaking in other words if the insurance contract is non-participating contract) , then as discount in fact the risk-free rate corrected by taking into account the fact that insurance liabilities are less liquid is used.

And insurance liabilities are indeed illiquid or they are less liquid because the holder of contracts should impose at first insurance requirement before he be paid. As an example the risk-free rate on marketable bonds should be corrected for receiving illiquid or less liquid risk-free rate. If flows of money under the contract are tied to profitability on an asset, then both flows of money and a discount rate will reflect this risk to the asset.

IFRS–17 allows two approaches to defining a discount rate. The first approach is bottom-up. It is assumed that flows of money aren't tied to profitability on an asset that in fact, means the insurance contract is a non-participating contract. We begin with a risk-free rate on the marketable bond which then should be corrected to pass to illiquid risk-free rate within bottom-up approach. This adjustment reflects the fact that insurance liabilities are less liquid than risk-free ones.

The second approach is called top-down approach. The rate on other asset is used instead of a risk-free rate on the bond. The organization will fulfill requirements of IFRS–17 only if resulting rate reflects characteristics for the insurance liabilities. It is reached by the right correction of the resulting rate on the asset. The company should do appropriate adjustments on all attendees in an asset to the characteristics as well as absent ones in the insurance liabilities. For example, awards for market risk on the asset and distinctions arising on the sums and terms of generating flows of money. After all these adjustments within top-down approach are made, the organization won't need to correct in addition a rate taking into account differences in liquidity of the asset and the insurance contract any more.

Both top-down and bottom-up approaches have to lead to the same value. However, they lead to different results due to these or those reasons. Therefore, it is required to do disclosures by information used under determining a discounting rate.

The company has to apply judgment correctly to correct observed market data and to carry out correction between flows of money on observed market instruments and flows of money under the insurance contract.

It is necessary to use the vanguard technology for assessment in case of absence of market data for the company. The company should develop observed entrance data with using the best of the available information in term of all conditions. Further the company should correct these data by taking into account all available information on participants of the markets.

The specified cost of future flows of money is estimated by means of the possible scripts reflecting the full list of possible outcomes. By list the company determines the size and time for generating flows of money. Then applies to them a suitable discounting rate and estimates probability to this outcome as uses the balanced approach on the basis of probabilities.

Adjustment on risks is the second assessment component. It treats non-financial risks. Adjustment on risks reflects uncertainty for the flows of money falling in presenting non-financial risks at the contract. For example, it can be the uncertainty relating to the size or time for generating payments/requirements.

Adjustment on risk represents income which the company wishes to receive in exchange for the assumed non-financial risk. Compensation will be responsible for a difference between implementing liabilities with a certain list of outcomes and implementing liabilities which the fixed flows of money with the same value of the expected specified cost will be.

It is assumed the group of A companies has 50% probability of payment by the specified cost in 1 million in a year and 50% probability of payment for the zero sum. The group of B companies has 100% probability of payment for 500 thousand in a year. Both that and at other group of companies has an identical value of the average value of payments weighed in term of probabilities for 500 thousand. Therefore, adjustment on risk will be compensation with to the group of B companies which insurance company will be all the same whether to issue insurance contracts for the A or B group.

Adjustment on risk reflects own sensitivity of the company to risk and also ideas of the company of advantages for diversification is concrete for her. IFRS–17 isn't stipulated vanguard technologies or methods which the organizations are obliged to use when calculating the adjustments on risks. However, elected the vanguard technology or a method have to answer the purposes of the adjustment on risks. It is required to do disclosures on how exactly the company determines vanguard technology.

The contract margin is the size defining lack of profit in reporting the profit and loss at the time for initial recognition. It is uncollected profit under group of the contracts stipulating rendering future services.

How to estimate value of the contract margin? Let's say there is a group of contracts for which adjustment on risks makes 800, and the specified cost for future monetary runoffs – 4200, awards make 6500. The contract margin will make 1500 ($6500 - (4200 + 800)$). This value turns out as a result of subtraction for flows of money and adjustments on risks from awards.

The contract margin won't arise when monetary runoffs and adjustment exceed awards. Let's say awards make 4400, in this case for the first day at the company losses for 600 which immediately admits reporting the profit and loss.

To estimate a contract margin on start date of validity, the company at first determines flows of money on discharge. Further it subtracts any costs for acquisition incurred during the period before starting date for contract validity and recognizes the assets and liabilities. Also the company needs to take into consideration the actual flows of money for this date. CSM is the size leveling income on start date for contract validity.

Flows of money at the beginning of validity are the flows of money arising in selling and start for insurance contracts group, having direct reference on a portfolio of insurance contracts to which this group belongs. If flows of money arise before there is a recognition for insurance contracts (i.e. belong for the previous period), then the company needs to recognize these flows of money as the liabilities or assets. For date of recognition for insurance contracts group the organization writes off liabilities or assets for these flows of money for acquisition.

Comparing the operating and new models of accounting for insurance contracts has allowed to mark out their main distinctions. The variety of accounting methods in the existing standard is observed, estimates aren't updated, the discounting rate is defined proceeding from information on a basic asset, insufficient discounting, a lack of information on options and guarantees.

The new standard on accounting for insurance contracts brings the coordinated accounting method, estimates will be corrected taking into account new data, discounting rates will reflect flow of money under the contract. The new model demands discounting of future flows of money when it is essential. All possible options of succession for events are reflected in accounting and the reporting.

LIST OF LITERATURE

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Аңдатпа

Мақалада қаралған тақырып сақтандыру компанияларындағы бухгалтерлік есептеуді IFRS–17 сәйкестендіре отырып жетілдіру. Сақтандыру шарттарын есепке алу бойынша жаңа стандарт сақтандыру шарттарын есепке алудың халықаралық тәртібіне түбегейлі өзгерістер енгізеді. Ол сақтандыру шарттарын тану, бағалау, ұсыну және ашып көрсету қағидаларын белгілейді және IFRS–4 «сақтандыру шарттарын» алмастырады. Қазіргі сақтандыру компанияларының есептеулері МСФО (IFRS–4) негізделгендіктен, инвесторлардың сақтандыру компанияларын салыстыруына қиындық туғызады. IFRS–4 ағымдағы есептеу моделі негізінде барлық сақтандыру шарттарының дәйекті есебін талап етеді. Ағымдағы есептеу үлгісі мен жүйелілік талдау жүргізу арқылы сақтандыру компанияларының кірістілігін оңайырақ салыстыруға мүмкіндік береді. Іскерліктің рентабельділігі туралы ақпараттың ашықтығын арттыру пайдаланушыларға сақтандыру компанияларының қаржылық тұрақтылығын бағалауға мүмкіндік береді. Андеррайтингтік қызметтің нәтижелерін және қаржы нәтижелерін жеке таныстыру табыс пен шығындардың көздеріне қатысты ашықтықты қамтамасыз етеді. Есеп беру деректерінің жоғары жолы бірігу және сатып алу саласындағы белсенділікті көтереді, инвестициялық капиталға бәсекелестік деңгейін арттырады және инвесторлардың сеніміне кіре алады. Көптеген сақтандыру компанияларының қиналатына келісімшарттарының белгіленген уақытының ұзақтығы және көптеген компаниялар әлі де пайдаланатын жүйелердің ескіргені болып табылады.

Тірек сөздер: ағымдағы есептеу, түрлендіру, қызмет көрсету маржасы, қаржылық есеп, сақтандыру компаниясы, инвесторлар, талдау, сақтандыру келісімшарты.

Аннотация

В статье рассмотрены вопросы совершенствования бухгалтерского учета в страховых компаниях согласно IFRS–17. Новый стандарт по учету договоров страхования вносит кардинальные изменения в международный порядок учета страховых договоров. Он устанавливает принципы признания, оценки, представления и раскрытия договоров страхования и заменяет IFRS–4 «Договоры страхования». В настоящее время отчетность, подготовленная на основе МСФО (IFRS–4), делает очень сложным сравнение страховых компаний инвесторами. IFRS–17 требует последовательного учета всех страховых контрактов на основе модели текущих измерений. Модель текущих измерений и последовательность помогут инвесторам с проведением анализа, позволяя им намного проще сравнивать доходность страховых компаний. Повышение прозрачности информации о рентабельности бизнеса даст возможность пользователям оценивать финансовую устойчивость страховых компаний. Раздельное представление результатов по андеррайтинговой деятельности и финансовых результатов обеспечит большую прозрачность в отношении источников прибыли и качественных характеристик отчетной прибыли. Более высокая сопоставимость отчетных данных могла бы стимулировать рост активности в сфере слияний и приобретений, поднять уровень конкуренции за инвестиционный капитал и помочь завоевать доверие инвесторов. Для многих страховых компаний задача усложняется еще и тем, что временной горизонт, на который заключаются договоры страхования, является весьма длительным, а системы, которые многие компании все еще используют, являются несколько устаревшими.

Ключевые слова: текущая оценка, модификация, сервисная маржа, финансовая отчетность, страховая компания, инвесторы, анализ, договор страхования.