



## Lesego Mafadza

**Senior Manager**  
**IFRS 17 technical accounting**  
**Tel:** +27 78 496 6408  
**Email:** [lesego.mafadza@kpmg.co.za](mailto:lesego.mafadza@kpmg.co.za)

## Lyndall Green

**Senior Manager**  
**IFRS 17 technical accounting**  
**Tel:** +27 82 710 4976  
**Email:** [lyndall.green@kpmg.co.za](mailto:lyndall.green@kpmg.co.za)

## Thalisha Moodley

**Assistant Manager**  
**Insurance**  
**Tel:** +44 7518 786312  
**Email:** [thalisha.moodley@kpmg.co.uk](mailto:thalisha.moodley@kpmg.co.uk)

Benjamin Franklin once said,  
"failing to plan, is planning to fail..."

IFRS 17 Insurance Contracts is imminent as it is effective for year-ends commencing on or after 1 January 2023. What once seemed many reporting periods away is now becoming more of a reality for insurers - the countdown has begun. The dilemma for many insurers currently is how they are going to get there? Are they going to be ready?

### Transition - all great changes are preceded by chaos

IFRS 17 needs to be applied retrospectively unless this is impracticable, or the risk mitigation option<sup>1</sup> has been chosen for insurance contracts with direct participation

features. The transition approach is determined for each group of contracts. To the extent that full retrospective application is impracticable, an insurer applies either the modified retrospective approach or the fair value approach.

The big unknown at transition date is the Contractual Service Margin (CSM) which represents the unearned profit for future services to be provided by that specific group of contracts. In essence, the starting point will be to determine the group of insurance contracts based on historical issue dates. The next steps are as follows:

- determine fulfilment cash flows and CSM at the date of initial recognition of the contracts in the group before transition.
- revise fulfilment cash flows using current assumptions as at each reporting date prior to transition to identify CSM and other adjustments for each period prior to transition.
- roll forward the CSM to the transition date to reflect interest accretion, changes in assumptions and foreign exchange rates, changes in the variable fee for VFA contracts and release the CSM to profit or loss.

**"You can have data without information, but you cannot have information without data" -Danie Keys Moran**

In order to apply the standard full retrospective historical data at a granular level is required and this is where insurers are having difficulties. On initial recognition, at a minimum an insurer needs the following data:

- Contract related data which includes start date and premiums and claims information which should be in the insurer's policy administration system.
- A full set of demographic and economic assumptions used.
- Actual premium data for changes in premiums related to future service.
- Data on insurance acquisition cash flows.
- Data and related assumptions to determine the risk adjustment.

In certain instances, the fully retrospective approach will be impracticable for longer duration contracts that were issued long before the transition date. For example, where it's not possible to obtain the historic data or determine assumptions without the use of hindsight.

<sup>1</sup> The risk mitigation option in IFRS 17 permits an entity to recognise immediately in profit or loss some or all of the changes in the effect of financial risk on insurance contracts with direct participation that usually adjust the contractual service margin

# Do or die...its crunch time in the IFRS 17 world!

Data cavities need to be assessed based on the facts and circumstances of the entity. The more common data pitfalls arise because of information that is now required by IFRS 17 that was not required by IFRS 4. For example, historic interest rate data that now needs to be available for the CSM determination (i.e. yield curve reflecting the current market rates of returns of a reference portfolio of assets or a risk-free yield curve). IFRS 17 requires a company to discount the cash flows from insurance contracts using discount rates that reflect the characteristics of the cash flows and the liquidity characteristics of the insurance contracts. Fulfilment cash flows, including expense allocations may be required at a disaggregated level not previously captured under IFRS 4 which poses an additional hurdle.

Data cavities which are impracticable to remedy must be used to articulate why the fully retrospective approach will not be adopted after every reasonable effort to do so has been made. Insurers will also need to be continuously mindful of not using hindsight as part of their transition calculations.

Once the extent of existing historical data has been identified, including resolution of the data cavities, data integration becomes the next challenge. For many insurers data is captured and stored on different platforms. IFRS 17 requires aggregation at a portfolio and grouping level of similar contracts or similar risks. If the insurer underwrites contracts from the same portfolio in two different systems, there is a data quality risk when trying to merge the data into one system.

It is therefore important that management has an effective, integrative system to support IFRS 17. Entities will have to make decisions on how to

manage and integrate the data from source system through to disclosure in the financial statements. A very detailed IFRS 17 solution / system needs to accommodate multiple data sources including actuarial, finance, policy and administration, and economic data. The system will need to be set up to do the following at a minimum:

- To analyse data in sufficient granularity to identify and maintain consistent groups of contracts.
- Be able to trace and follow information about the inception dates and the coverage period of those group of contracts.
- To calculate the CSM using all the required information, accrue interest on the contractual service margin at year end and release a portion of the contractual service margin for each group of contracts in profit or loss.
- Store information on historical, current, and future cash flows, discount rates and risk adjustments for each group of contracts.

An IFRS 17 solution / system can look perfect on paper, but will need to be tested from start to finish and adequate time needs to be put aside by management to do this.

There is no doubt that this exercise will come at an extensive cost to the insurer, but it is a critical component for determining an efficient operating system to incorporate all the data required for a successful IFRS 17 implementation.

#### Extract from Effects Analysis accompanying IFRS 17 Insurance Contracts published by the International Accounting Standards Board

Entities transitioning to the final standard [IFRS 17] may incur significant costs to comply with the new requirements. However, we believe the need for a comprehensive standard for the accounting for insurance contracts outweighs these costs.

Normally, when an accounting standard is updated, all companies have costs that are somewhat comparable. However, the current IFRS 4 is not a comprehensive model and the cost for companies to implement any update to IFRS 4 will be impacted by the information that they maintain today to prepare their financial statements.

The implementation of new systems and data requirements will have a knock-on impact on the entity's processes and day-to-day activities including a revamp of the end-to-end processes, risks, and controls. This in turn impacts the people element of an organisation – current staff may need to undergo training to understand the new systems and requirements and additional resources may be required specifically to support the transition activities and potentially for BAU purposes.

#### Insights from KPMG's benchmarking of leading insurers' readiness for IFRS 17<sup>2</sup>

1. Half of the leaders have fully updated IT systems which have either been tested or are ready for testing.
2. One third of the leaders have tested new data feeds.
3. One and a half of the leaders have completed updating the actuarial models.
4. 40% of the leaders are developing new KPIs to support this new accounting standard.
5. Nearly 80% of the leaders are still developing their approach to transition and opening balance sheet while a third are still collating the different data requirements.

Most insurers are currently in the thick of IFRS 17 implementation, performing the balancing act of making decisions and taking action against the ever-running clock, while remaining agile enough to switch tactics and limit backtracking when implementation problems are encountered. However, insurers need to start considering and contemplating the way forward with regards to transition. Time is running out, and significant deliberation on transition is still to take place before insurers are in a position to release results to the market. A detailed gap analysis or financial impact assessment may still need to be performed and the most appropriate action needs to be taken to ensure all the factors important for the transition have been considered.

#### Conclusion

To sum up in a single paragraph: IFRS 17 implementation and transition is challenging. There is a significant impact on systems, processes, and people within an entity. A key aspect of any project's success will be the availability of data. There is no one size fits all approach. Transition decisions are complex and not straightforward, even with planning there will be pitstops and detours on the journey.

**"The only way to make sense of the change is to plunge into it, move with it and join the dance"**  
- Alan Watts

