

EARLY IMPRESSIONS

Ind AS 117, Insurance Contracts



Foreword

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The financial reporting landscape in India has undergone significant transformation over the past decade. Whilst Corporates and Non-Banking Finance Companies (NBFCs) have successfully transitioned to Indian Accounting Standards (Ind AS), Insurance entities continue to prepare their financial statements using the Generally Accepted Accounting Principles in India (I GAAP) and Insurance Regulatory and Development Authority of India (IRDAI) regulations. However, during the same period, the global financial reporting landscape for insurance contracts has seen significant advancements with the implementation of International Financial Reporting Standards (IFRS) 17. The new standard, IFRS 17, Insurance Contracts, became applicable on 1 January 2023, marking a pivotal shift in how insurance contracts get reported.

In India, Ind AS 117 in exposure draft stage was first issued by the ICAI in 2018. This was then sent to the National Financial Reporting Authority (NFRA) for feedback, whereby in July 2023, the NFRA shared its recommendations with the Ministry of Corporate Affairs (MCA). Following this, in August 2023, the IRDAI directed select insurance entities to adopt and prepare their financial statements under IFRS 17. Furthering this initiative, in February 2024, IRDAI announced the reconstitution of the Expert Committee on the implementation of Ind AS 117. This committee was tasked with developing steps for the effective implementation of Ind AS, providing phase-wise timelines, and offering recommendations on proforma financial statements and financial disclosures in compliance with Ind AS.

Recently, the MCA, via notification no. G.S.R. 492(E) dated 12 August 2024 has amended the Companies (Indian Accounting Standard) Rules, 2015, and introduced the new Ind AS 117, Insurance Contracts. This standard is proposed to be effective from 1 April 2024, marking a crucial step towards aligning India's accounting practices with global standards.

In this Uniquus Early Impressions publication, we have outlined the journey of IFRS 17 globally and Ind AS 117 in India, along with the key

transition measures detailed in the recent notification. We believe that the notification issued by the MCA represents a significant step towards the implementation of Ind AS relating to insurance contracts in India. Whilst the government has notified Ind AS 117 to be effective 1 April 2024, for its applicability by Insurance companies, the roadmap for implementation by the IRDAI will be keenly awaited. Irrespective, certain insurance companies may still need to apply Ind AS 117 with immediate effect for consolidation by their parent company. Finally, non insurance companies will also need to assess the impact of Ind AS 117 on their contractual arrangements such as warranty contracts, fixed fee contracts, credit cards with insurance coverage, guarantee contracts, etc.

We sincerely hope you find the enclosed publication informative. We will be happy to participate in any discussions required to provide clarifications on our views enclosed in the attached publication. We look forward to hearing from you

Thank you.



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Insurance Contracts, journey so far

1. Foreword

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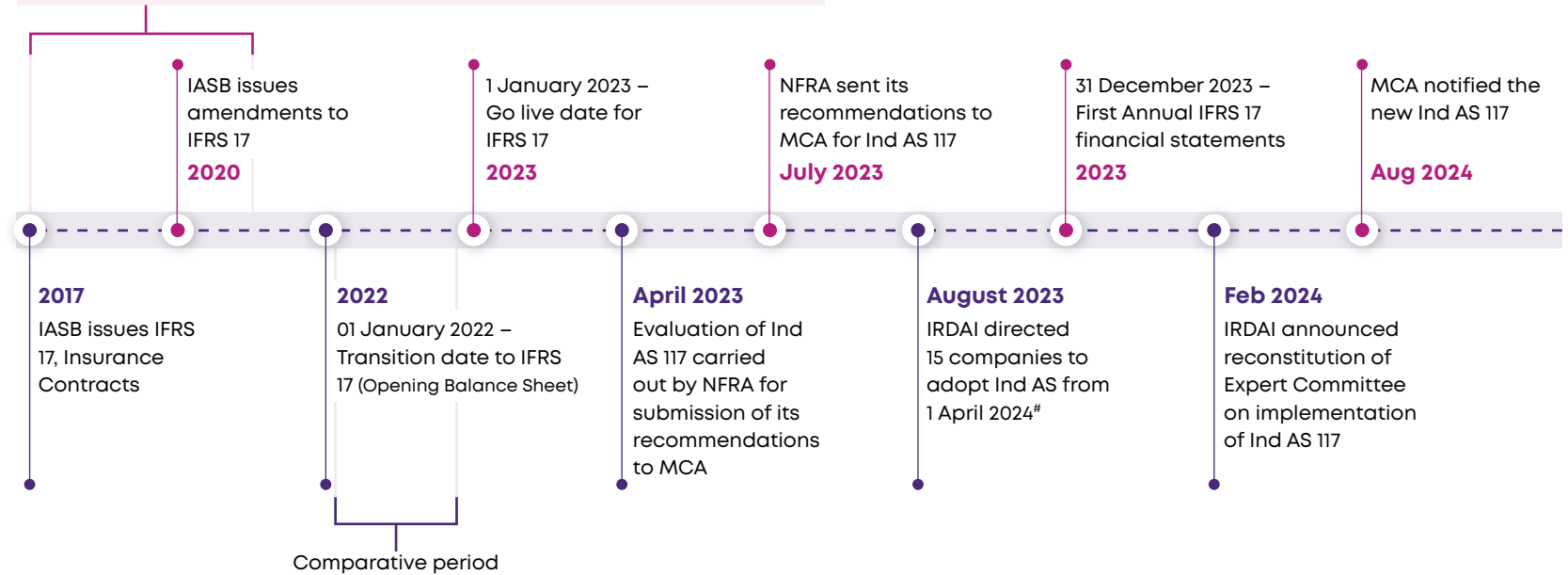
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Globally, the insurance entities had started their implementation work for transitioning to IFRS 17, which included gap analysis, assessment and implementation of new systems, preparation of dry run IFRS 17 results, discussion of key implementation challenges with regulators, disclosures and audit of dry run results



The IRDAI had required 15 firms with foreign equity partners and/or strategic alliances to adopt Ind AS from 1 April 2024. These companies are significant because they may have financial estimates in accordance with IFRS 17 for their consolidated balance sheets. These estimates are required for presentation in the financial statements of their foreign associates ([Link - https://www.goodreturns.in/news/irdai-asks-15-insurance-companies-to-adopt-ind-as-from-april-2024-1293147.html](https://www.goodreturns.in/news/irdai-asks-15-insurance-companies-to-adopt-ind-as-from-april-2024-1293147.html))

The Institute of Chartered Accountants of India ('ICAI') had earlier issued an Exposure Draft on Indian Accounting Standard (Ind AS) 117, Insurance Contracts, which is consistent with IFRS 17

With this new notification now issued by MCA, IRDAI is expected to issue the next steps and roadmap for implementing Ind AS 117 for insurance entities in India

Ind AS transition for insurance entities/ contracts

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Effective date – 01 April 2024

Uniquis point of view:

- The MCA via notification no. G.S.R. 492(E) has amended the Companies (Indian Accounting Standard) Rules, 2015 and introduced the new Ind AS 117, Insurance Contracts (notification dated 12 Aug 2024)
- However, the roadmap for implementation of Ind AS is awaited from IRDAI
- Although insurance companies have not yet transitioned to Ind AS, as their roadmap will be finalized separately by IRDAI, those preparing Ind AS for consolidation purposes by their non-insurance parent or investor will need to apply Ind AS 117
- Additionally, companies that were previously applying Ind AS 104 to their guarantee and other insurance contracts will now need to apply Ind AS 117

Early adoption

Uniquis point of view:

- For insurance entities, earlier adoption is permitted only for consolidation purposes by its parent company
- Insurance companies with non-banking parents have the option to adopt Ind AS 117 early. However, once IRDAI issues guidance on Ind AS 117, these companies may need to maintain two sets of financial statements, i.e., one for the parent company's consolidation results / financial statements and another for their own statutory reporting, in case the forthcoming IRDAI guidance has any accounting related impacts
- Insurance companies with banking parents may be unable to adopt the Ind AS framework early, as the Reserve Bank of India (RBI) has not yet applied Ind AS to banking entities. Currently, banks prepare their financial statements under IGAAP, and the RBI has not provided a timeline for the implementation of Ind AS

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Initial application of Ind AS 117 and Ind AS 109

Uniquis point of view:

- The introduction of a new classification overlay method will enhance comparability for financial assets derecognized before the date of initial application, requiring relatively lower effort

Date of initial application ('DIA') and Date of transition ('DOT')

Uniquis point of view:

- The date of initial application is the beginning of the annual reporting period in which an entity first applies Ind AS 117
- The transition date is the beginning of the annual reporting period immediately preceding the date of initial application



For instance, if the regulator sets the implementation date as 01 April 2025, the timeline will be as follows:



Key Highlights of Ind AS 117 for Insurance entities

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1

New measurement models for insurance contracts:

General Measurement Model, Premium Allocation Approach and Variable Fee Approach

2

Contracts are segregated into cohorts:

Profitable and non-profitable (onerous). Upfront recognition of contracts that are identified as onerous at the initial recognition

3

Combination and separation of components from an insurance contract

4

Incorporating risk-adjustment for non-financial risk and time value of money to discount the cash-flows

5

Separate category of insurance results and service expenses are presented in the Profit and Loss with finance income and expenses being presented separately

6

Better comparability of insurance companies due to enhanced level of disclosure requirements

Indian GAAP vs Ind AS 117

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Key Differences	Indian GAAP	Ind AS 117	Impact
Level of aggregation	<ul style="list-style-type: none"> There is no requirement for aggregation of contracts 	<ul style="list-style-type: none"> Insurance contracts to be grouped at portfolio level. Further grouping to be done for onerous and non - onerous contracts. Finally, an annual cohorting of contracts to be undertaken 	<p>High</p>
Measurement of Insurance Contracts	<ul style="list-style-type: none"> Typically measured based on historical cost/accrual basis 	<ul style="list-style-type: none"> Upfront revenue recognition is not permitted. Liability will consist of fulfilment cash flows, which represent the risk-adjusted present value of the entity's rights and obligations to the policyholders, and the Contractual Service Margin (CSM) which reflects the profit that has not yet been recognized in profit or loss because it relates to future service 	<p>High</p>
Onerous Contracts	<ul style="list-style-type: none"> Does not specify any specific treatment for onerous contracts 	<ul style="list-style-type: none"> A contract is onerous if the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Loss will be recognized in profit or loss immediately for the group of onerous contracts 	<p>Moderate</p>
Acquisition Costs	<ul style="list-style-type: none"> Acquisition cash flows are expensed out as incurred 	<ul style="list-style-type: none"> Insurance acquisition cash flows are included in the measurement of the insurance liability, thereby reducing the CSM recognized on initial recognition. Under PAA, there is an option available to expense the acquisition cost as incurred 	<p>Moderate</p>
Presentation	<ul style="list-style-type: none"> Reinsurance recoverable is presented on a net basis 	<ul style="list-style-type: none"> Insurance revenue and insurance service expenses presented in profit or loss exclude any investment component Income or expense from reinsurance contracts held is presented separately from expense or income from insurance contracts issued 	<p>Low</p>
Disclosures	<ul style="list-style-type: none"> Disclosures are limited and less detailed 	<ul style="list-style-type: none"> More detailed disclosures to enable users to understand and compare performance of insurance companies 	<p>Moderate</p>

Ind AS 109 transition approaches

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Following are the three transition approaches to Ind AS 109 available to an insurer:

Transition approaches	Description
Full retrospective approach	<ul style="list-style-type: none"> Restate comparative information without the use of hindsight On restatement of comparative financial information under Ind AS 109, Ind AS 109 is not applied to financial assets that are derecognised before the DIA
Full retrospective approach along with certain exemptions available in Ind AS 109 standard	<ul style="list-style-type: none"> Opt not to restate comparative information Difference if any, for continuing contracts, is recognised in opening retained earnings as at the date of DIA
Classification overlay approach (Ind AS 117 – para C28A)	<ul style="list-style-type: none"> Allow an insurer to classify and measure these financial assets (i.e., at amortised cost, FVTPL, or FVOCI) in a comparative period based on its expectations, using reasonable and supportable information available at the transition date, of how these assets would be classified on initial application of Ind AS 109

Ind AS 117 for non-insurers

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The new insurance standard, Ind AS 117 Insurance Contracts, will apply for all companies, not just insurers. This is because it applies to contracts, regardless of the issuer.

This requires an assessment of the contracts / arrangements to evaluate whether the contract issued is an insurance contract under Ind AS 117. Certain type on contracts which require such evaluation include:

- **Guarantees between group companies – e.g., parent and subsidiary**
- **Performance guarantees**
- **Other financial guarantees**
- **Mobile device replacement contracts**
- **Product or extended warranties**
- **Loan contracts e.g., with waiver on deaths**

Ind AS 117 applies only to insurance contracts issued and reinsurance contracts held. It does not apply to insurance contracts held

Contracts scoped out of Ind AS 117

Type of contract	Applicable Ind AS standard
Warranties provided by a manufacturer, dealer, or retailer in connection with the sale of its goods or services to a customer	Ind AS 115 Revenue, Ind AS 37 Provisions, Contingent Liabilities and Contingent Assets
Employer's assets and liabilities	Ind AS 102 Share-based Payment, and Ind AS 19 Employee
Contractual rights/obligations contingent on the future use of, or right to use, a non-financial item –e.g., some licence fees, royalties, variable and other contingent lease payments, and similar items	Ind AS 115 Revenue, Ind AS 38 Intangible Assets, Ind AS 116 Leases
Residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease	Ind AS 115 Revenue, Ind AS 116 Leases
Contingent consideration payable or receivable in a business combination	Ind AS 103 Business Combinations
Credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract if, and only if, the company does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer	Ind AS 109 Financial Instruments and other applicable standards

Ind AS 117 for non-insurers

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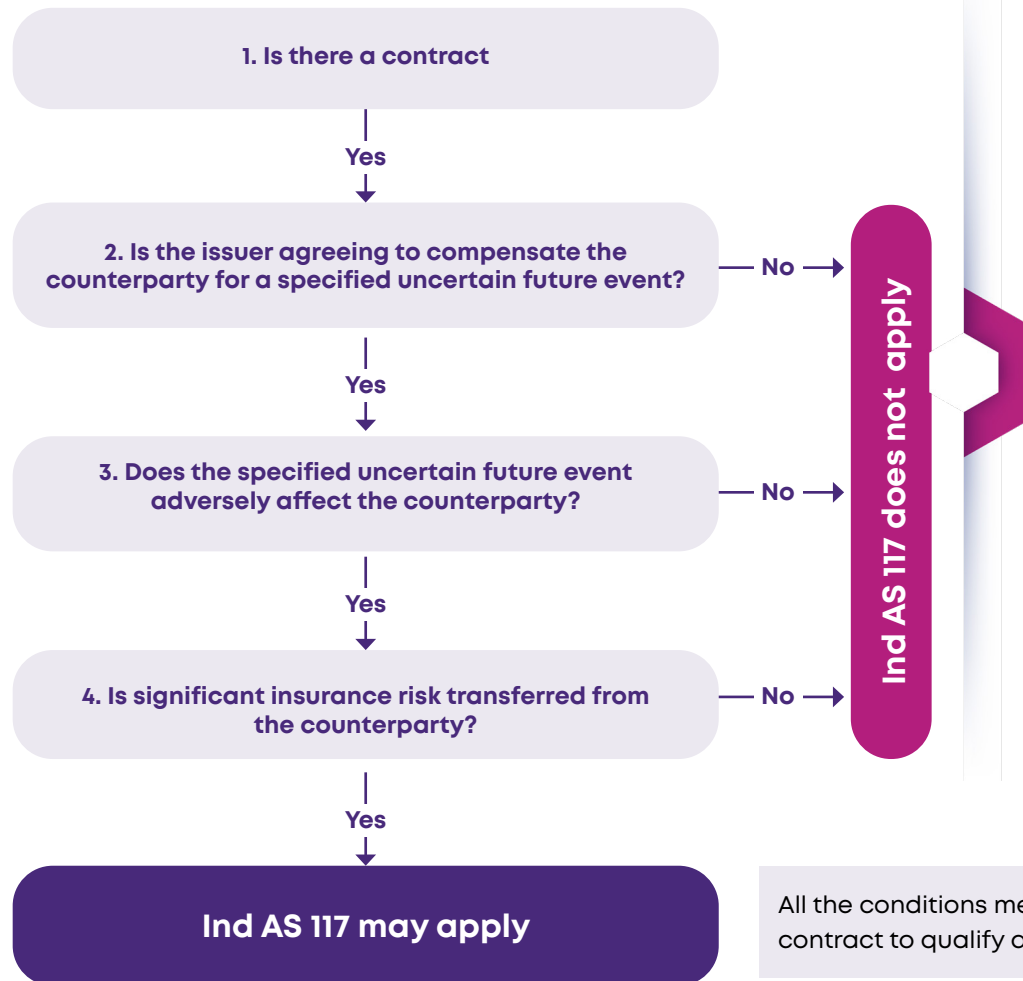
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Ind AS 117 refers to a 'policyholder', which is the term insurers typically use for their customers. It does not matter whether the contract refers to a policyholder or a different title for another party to the contract –e.g., a counterparty.

All the conditions mentioned above shall be met for a contract to qualify as an insurance contract under Ind AS 117

Illustration – Applying the Four-Step Process

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Maintenance contract

A company provides a maintenance contract in which it agrees to repair specified equipment after a malfunction for a fixed fee

This agreement is between two or more parties and creates enforceable rights and obligations

The fixed service fee is based on the expected number of malfunctions for the customer's specified equipment

The cost to repair the specified equipment could significantly exceed the fixed service fee received in some circumstances

1. Is there a contract

Yes

2. Is the issuer agreeing to compensate the counterparty for a specified uncertain future event?

Yes – because the company has agreed to compensate the customer if the machine malfunctions, which is an uncertain future event

3. Does the specified uncertain future event adversely affect the counterparty?

Yes – because malfunctioning equipment would adversely affect its owner

4. Is significant insurance risk transferred from the counterparty?

Yes – because if the specified equipment breaks down, the cost could be significantly more than the service fee received for that contract. This creates a significant insurance risk

However, if the **fee varied** based on the maintenance to be performed **to reflect the cost of the repairs plus a margin**, then it would not be an insurance contract

This is because the maintenance company would not be taking on significant insurance risk

The company will need to make an **irrevocable election on a contract-by-contract basis** whether to account for these contracts (i.e., those that meet all of the above criteria) under Ind AS 117 or Ind AS 115

Ind AS 117 may apply

Other Key Considerations

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Are financial guarantee contracts in the scope of IFRS 17

A financial guarantee contract grants the counterparty the right to be reimbursed by the issuer for a loss that it incurs when a specified debtor fails to make a payment when it is due under the terms of a debt instrument. These types of guarantees usually meet the definition of an insurance contract

When a company first applies Ind AS 117, **it may irrevocably elect to apply Ind AS 117** to its existing issued financial guarantees contracts on a contract-by-contract basis if it has:

- previously explicitly asserted that it regards such contracts as insurance contracts; and
- accounted for them on that basis –i.e., as insurance contracts

If Ind AS 117 is not applied, then an issued financial guarantee contract is accounted for under the financial instruments standards (Ind AS 107 Financial Instruments: Disclosures, Ind AS 109, Ind AS 32 Financial Instruments: Presentation)

The same election may be available on initial recognition of a new financial guarantee contract

A company has issued a fixed-fee service contract that it currently accounts for under IFRS 15. The contract meets the definition of an insurance contract under IFRS 17. Will IFRS 17 apply to the contract?

Fixed-fee service contracts that meet the definition of an insurance contract may be accounted for under Ind AS 115 if:

- there is no assessment of risk associated with an individual customer in setting the price of the contract with that customer – i.e., the price is based on a collective assessment of customers;
- the contract compensates the customer by providing services rather than by making cash payments to the customer; and
- 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

A company makes an **irrevocable election on a contract-by-contract basis** whether to account for these contracts (i.e., those that meet all of the above criteria) under Ind AS 117 or Ind AS 115

Possible examples of such contracts may be road-side assistance contracts, boiler breakdown services, and mobile phone repair and replacement contracts. Companies will need to assess whether the exemption criteria are met

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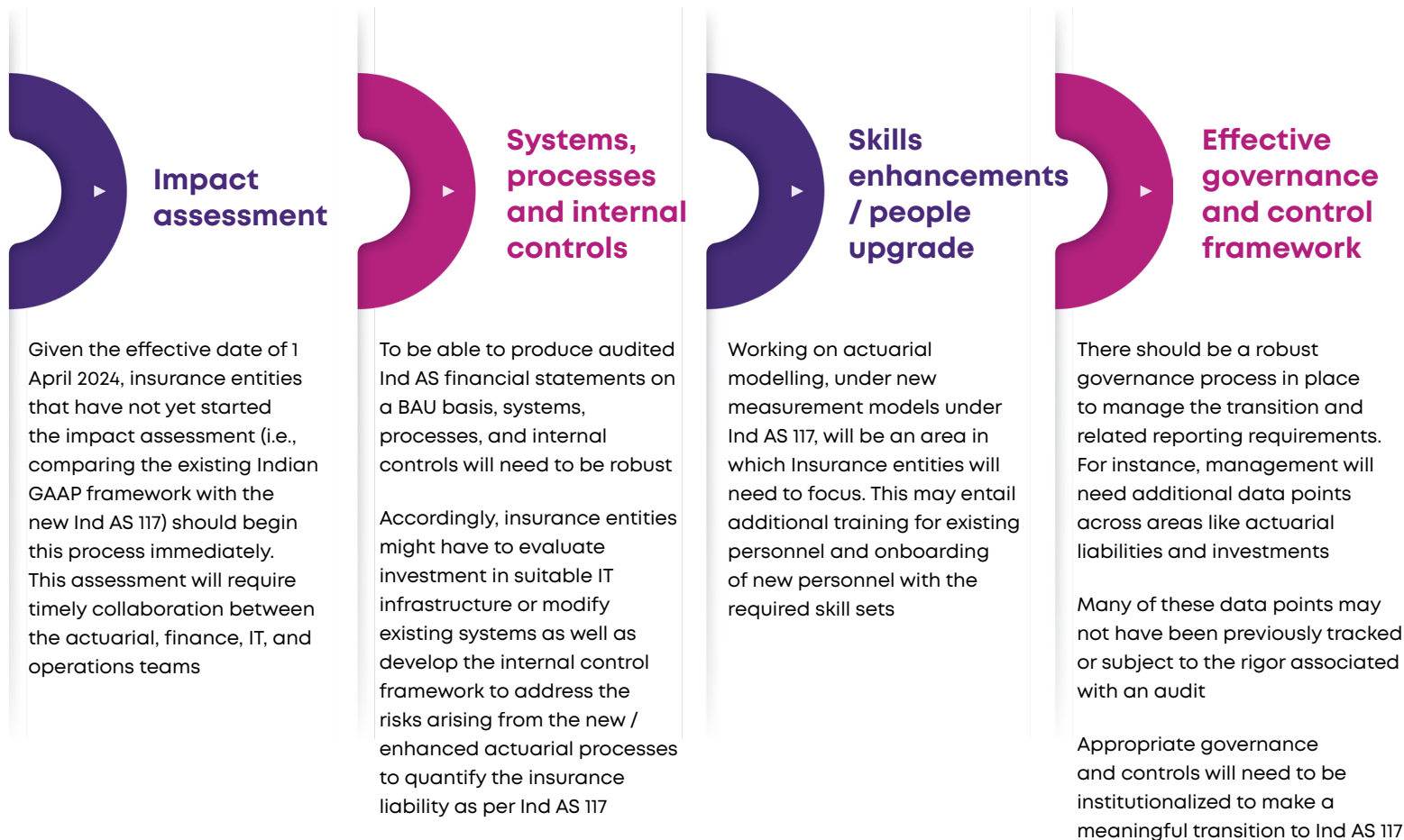
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For insurers



For non-insurers

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Existing contracts

- Identify whether you have existing contracts that might meet the definition of an insurance contract



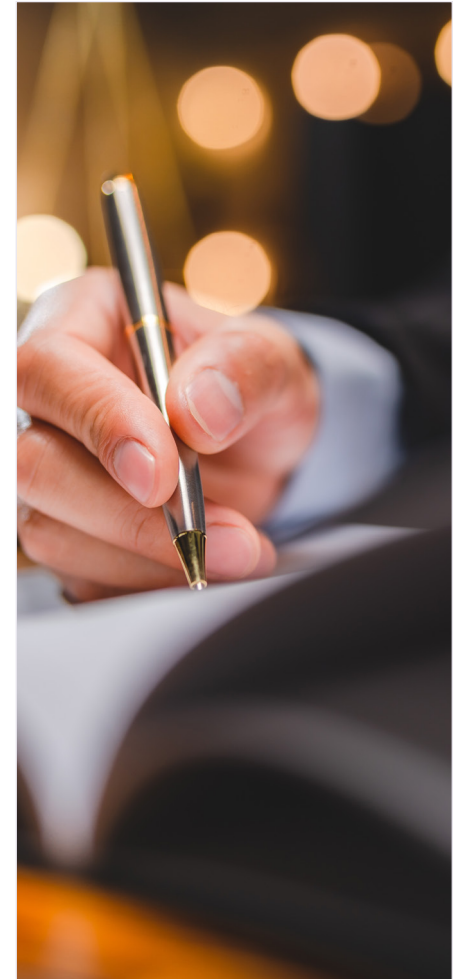
Accounting policy/ elections

- Consider whether you need to make any elections when deciding how to account for those contracts



Systems, processes and internal controls

- Assess whether there are accounting implications under Ind AS 117 for any new contracts
- Evaluate whether you have the appropriate systems, processes and controls in place



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