

Discussion

Making Sense of the IFRS 17 Transition Effects



Accounting for Insurance Contracts

What do I know?



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Business School ■ Area Accounting & Taxation ■ Daske ■ Teaching ■ Master Courses ■ ACC 620 Accounting for Financial Instruments & Financial Institutions

ACC 620 Accounting for Financial Instruments & Financial Institutions

Module Outline

The course addresses in-depth the accounting for financial instruments and by financial institutions under IFRS as well as related conceptual issues currently discussed by standard setters and bank regulators. It covers the definition of financial instruments, their classification, initial and subsequent measurement, impairment, derecognition, as well as their accounting in the context of hedging transactions. We also discuss relevant notes disclosures in example banks' financial statements and links to capital regulation.

- 40 Financial instruments: Definitions and scope
- 41 Financial instruments: Derivatives and embedded derivatives
- 42 Financial instruments: Financial liabilities and equity
- 43 Financial instruments: Classification
- 44 Financial instruments: Recognition and initial measurement
- 45 Financial instruments: Subsequent measurement
- 46 Financial instruments: Impairment
- 47 Financial instruments: Derecognition
- 48 Financial instruments: Hedge accounting
- 49 Financial instruments: Presentation and disclosure
- ~~50 Insurance contracts (IFRS 17)~~

Accounting for Insurance Contracts

What does the profession know?

- References in your paper: Three unpublished working papers
- ChatGPT: “I did *not* locate many studies on insurance accounting (especially insurance contracts accounting) that are published in those top journals.”
- “This suggests that insurance contract accounting may be underrepresented in the very top accounting journals. That in itself is an interesting gap for further research.”

Accounting for Insurance Contracts

What do the standard setters know?

- Development of a standard on insurance accounting started in the 1990s, no consensus reached by IASC
 - IASB issued IFRS 4 as an interim standard, just before EU adoption in 2005
 - It took until 2017 for standard IFRS 17 to be issued
 - It became binding from 2023, after postponement
- Overall, I applaud the authors for tackling a truly **complex accounting issue!**

Overall Evolution

- Clearly written manuscript
 - Modern data-collection process
 - Carefully executed, but entirely descriptive study
 - Pro: Type of input the IASB is looking for; IAAER's "Informing the IASB" program (Round 9 to come: <https://www.iaaer.org/research/informing-the-iasb>)
 - Con: Not overly "ambitious"; they let the data speak
- Goal of my discussion is to suggest **small** incremental pieces for improvement

Comment 1: Transition Disclosures

Analyzing Transition Disclosures not as “unique” as claimed

In Becker, Bischof and Daske, 2021, FnT we write:

“First, studies have made use of *reconciliation requirements in the adoption year*, holding the firm and the economics of the reporting period constant. In the initial adoption year, firms are required by IFRS 1 to prepare both the current year’s and the prior year’s financial statements under IFRS (to ease comparison). This requirement allows benchmarking IFRS with the local GAAP numbers disclosed in the prior year, holding the underlying transactions constant (e.g., **Hung and Subramanyam, 2007**). In addition, IFRS 1 mandates reconciliations of earnings and book values in the footnotes of the first IFRS report, such that users can understand which standards drove material differences (e.g., **Barth et al., 2014**). In the United Kingdom, firms disclosed standalone IFRS reconciliation documents separately from other disclosures (in timing and content), thus enabling the use of an event-study design (e.g., **Christensen et al., 2009; Horton and Serafeim, 2010**). However, all reconciliation settings share the limitation of allowing only for cross-sectional analyses in the IFRS adoption year.”

- Link contribution to these studies
- One or two data points? (current year)? -> Explain!
- IFRS 1?

Comment 2: Transition Incentives

Transition period incentives pollute IFRS 17 effects

1. **Transition smoothing:** Firms anticipate and try to “minimize” distortion effects in the “run-up” to a new accounting standard/disclosure requirement
 - E.g., Daske (2005) Diss.; Fiechter, Hitz, Lehmann (2022), JAR:
“We document that firms within the scope of the directive respond by increasing their CSR activities and **that they start doing so before the entry-into-force of the directive.**”
 2. **Transition incentives** due to specific transition options
 - E.g., Beatty and Weber (2006), JAR
 - Study SFAS 142 adoption decisions and “above-the-line vs. below-the-line” accounting treatment of possible goodwill impairments
 - Show that firms strategically time goodwill impairments at transition
- **Transition options in IFRS 17:** What type of transition incentives are at play?

Comment 3: Writing

- **Tension:** Writing very much “pro IFRS Foundation” (reads almost “too obvious”)
 - Why then so much political opposition and arguments against IFRS 17?
 - Can you also speak to the critics’ arguments?
- **Conceptual underpinnings:** “Theory part” is missing
 - Accounting mismatches due to mixed-attributes model
 - Barth, Hodder, and Stubben, 2008, TAR: Fair Value Accounting for Liabilities and Own Credit Risk
 - Apply Merton’s (1974) model of the firm to illustrate the “portfolio nature” of financial assets & liabilities, and how accounting mismatches emerge

Comment 3: Writing

- **Insurance contract accounting changes:** Help the reader more!
 - Illustrate, like in a teaching slide
 - Illustrate disclosures and application of “transition bridge”
 - Types of accounting mismatches?
- **Title:** “Making sense of”: sounds well, but really?
 - “Documenting” seems more appropriate, as purely explorative.

Comment 4: Economics

- **Interpretation:** When it comes to the **economics**, risk of “overselling”
 - “Tests” are very limited (one year, transition, stock return in one window)
 - Thus, interpretations as to whether the “standards works as intended” not backed by sufficient evidence yet
 - For example, analysis captures one year of interest-rate changes (2022), but does not directly link IFRS 17 effects to firms’ real interest-rate risks
 - Here, you could relate IFRS transition patterns to Solvency II interest-rate sensitivity disclosures (regulatory measure of insurers’ duration & ALM risk) to show that the accounting effects correspond to actual exposure

Overall, a lot more work to be done for us as a community!