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INSURANCE INDUSTRY: PATH TOWARDS GLOBAL STANDARD

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ABSTRACT

International financial reporting standard (IFRS) has been practiced by more than 100 countries to ensure long term benefits perceived due to its homogeneity and standardization. IFRS is fair valuation approach which brings significant changes in Indian GAAP particularly in formats of accounts, accounting policies and disclosure requirements. This paper attempts to identify impact of IFRS on insurance industry and found several major areas which are significantly affected by IFRS i.e. product design and offering, investment management, risk management, assets and liabilities management, merger and acquisition, claim management, reinsurance and solvency. Furthermore, regulatory changes, technology up gradation, and corporate support are needed for implementation of IFRS in Indian insurance sector.

KEY WORDS: *IFRS, Indian GAAP, Insurance, Investment Management, Risk Management.*

INTRODUCTION

International financial reporting standard (IFRS) contemplates a reporting system that is all inclusive and expressive in content. IFRS encompasses certain standards and frameworks for preparation and presentation of financial statements which can furnish consistent, comparable and reliable information. IFRS is the principle based standard rather than rule based. The key principle form the rationale of IFRS is fair value. IFRS may be defined as a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets (Yadav & Sharma, 2012). IFRS comprises:

- ⇨ International Financial Reporting Standards (standards issued after 2001)
- ⇨ International Accounting Standards (standards issued before 2001)
- ⇨ Interpretations from the International Financial Reporting Interpretations Committee (issued after 2001)
- ⇨ Standing Interpretations Committee (SIC) - issued before 2001.

International Accounting Standards (IASs) had been emanated from the International Accounting Standards Committee (IASC) during 1973 to 2000. The International Accounting Standard Board (IASB) replaced the IASC in 2001. Since then, the IASB has been amended, adopted or proposed certain new IFRSs on the topics for which there was no previous IAS (Baingani & Agrawal, 2005). The International Accounting Standards Board (IASB) founded on July 1, 2000 is the successor of the International Accounting Standards Committee (IASC) formed in June 1973 in London. On April 1, 2001, the IASB absorbed the responsibility for setting International Accounting Standards from the IASC. The objectives of IASB is to promote the acceptance of IFRS across the globe and ensure that accounting standard in different countries are systematize. The standards developed by the IASB follow a meticulous process inviting public, accountants and regulators to express their views and ensure that the views of the various stakeholders are incorporated in the requirements warranted by the IASB.

In recent years, International Accounting Standards bring in tune with standard followed in different countries. Over more than 100 countries comprising countries of European Union (EU), Australia, New Zealand, Russia and China currently require or plan the use of IFRS's in their countries. IFRS is gaining momentum in US. The IASB and the Financial Accounting Standard Board (FASB) have been working together to converge IFRS and US GAAP since 2002. However, IFRS is not fully converged with US GAAP. IASB standards are getting a drift of positive response within the European Commission, G4+1 group of standard setters, World Bank etc. G4+1 Group of standard setters comprise of representative of the national accounting standard bodies of Australia, Canada, New Zealand, UK and USA (The chartered accountant, 2005).

IFRS in India:-

The Institute of Chartered Accountants of India (ICAI) established the Accounting Standards Board (ASB) on 21st April 1977 in an attempt to harmonise the diverse accounting policies and practices in India. While formulating accounting standards, the ASB takes into consideration International Financial Reporting Standards (IFRSs)/International Accounting Standards (IASs) issued by IASB and tries to integrate them with the existing policies and practices prevailing in India. For this purpose a task force was set up by ICAI in 2006 in order to lay down a ground plan for convergence of IFRS in India. Ministry of Corporate Affairs on 25th February 2010 in pursuance of G-20 commitment has carried out the process of convergence of Indian Accounting Standards with IFRS as a result which thirty five IND AS came into force. Various categories of companies are required to adopt IFRS with effect from 1 April 2011. In 2007, it was expected that IFRS would fully implemented by 2011. All companies having net worth of over ₹ 1000 crores and part of Nifty 50 Index, Sensex 30 should implement IFRS from April 1, 2011. Those companies having net worth of over ₹ 500 crores and up to ₹ 1000 crores should implement IFRS from April 1, 2013 and for rest of companies the timeframe would be April 1, 2014. But, government has not succeeded to enforcing IFRS from April 1, 2011.

But now recently, ICAI has given provisional roadmap to corporate ministry, for implementation of IFRS standard. All companies having net worth in excess of ₹ 1000 crores will require to prepare their balance sheet in accordance with IFRS standard from April 1, 2015 and will follow the IFRS converged standards from this date. Those companies having net worth in excess of ₹ 500 crores and but less than ₹ 1000 crores should implement IFRS from April 1, 2016. And for companies, having net worth of below ₹ 500 crore but listed, the timeframe would be April 1, 2017. However, the roadmap is not applicable for banking, insurance and NBFC. However, in India some blue-chip companies have begun to line up their accounting standards with the International Financial Reporting Standards (IFRS.) The list of companies includes IT firms like Wipro, Infosys Technologies and NIIT, automakers like Mahindra & Mahindra and Tata Motors; and textile companies like Bombay Dyeing and pharma firm Dr Reddy's Laboratories.

IFRS in Insurance: A case of Indian insurance Industry:-

Earlier, there was no accounting standard for insurance contract under International Accounting Standard (IAS). The IASB introduced an interim standard (IFRS 4) for insurance contract in course of preparation of International Financial Reporting Standards (IFRS) for adoption by the European Union and others in 2005. This standard presented for comprehensive review that begun in 2007 with publication of discussion paper followed by exposure draft that was open for public comment in 2010. While the model presented in the 2010 Exposure Draft was broadly supported, some specific issues were raised that the IASB has to address.

In the shed light of this, one question can be raised, why IASB make a single standard for insurance? This can be answered by the way that IASB saw an insurance standard as a need of heydays because of the ever increasing presence of insurance companies in world capital markets and frequent M&A activity of insurance companies. In this view, IASB issued IFRS 4 aimed at providing information that will enable readers to compare insurance companies more effectively. IFRS 4 is applicable to all entities dealing in insurance contracts. IFRS 4 basically defines insurance as a contract where one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event occurred. Therefore, the accounting in IFRS 4 applies to all contracts that meet this definition whether regulated or unregulated.

LITERATURE REVIEWS

A large body of theoretical literature has focussed on international accounting standards, international financial reporting standards and Indian GAAP. Different literatures cover diverse aspect of reporting and its impact on various dimensions. Kapoor and Ruhela (2013) showed that the biggest challenge in India is to harmonize IFRS with respect to existing laws & regulations. Authors suggested that proper implementation of IFRS will require substantial amendment in existing laws. Srivastava and patel (2009) highlighted that adoption of IFRS in India would significantly change the contents of corporate financial statements because of more refined measurements of performance and state of affairs and enhanced disclosures leading to greater transparency. Vinayagamoorthy and Senthilkumar (n.d) confirmed that convergence to IFRS bring changes in existing GAAP, accounting policies, reporting system and company personnel. Rathod (2006) mentioned that the adoption of IFRS could have a huge positive impact on the Indian economy by affording more Indian companies access to foreign capital and lowering the cost of capital generally. Yadav and Sharma (2012) discussed that IFRS require a complete change in formats of accounts, accounting policies and more extensive disclosure requirements. Therefore, all parties concerned with financial reporting need to share the responsibility of international harmonization and convergence. In highlighting importance of IFRS Swamynathan and Sindhu (2011) confirmed that the IFRS is fair valuation approach and Indian GAAP is conservative approach. In context to insurance sector, IFRS brings substantial change throughout the organization including in accounting and financial reporting, finance/treasury, investment management, risk and controls, performance and decisions, actuarial and claims management, and tax among others. Meanwhile, IFRS for insurance contracts will decrease volatility in financial reporting statements, enable consistency and transparency of reporting across insurance entities, raise need for eXtensible Business Reporting Language (XBRL) and require solvency-related requirements and increasing attention on risk management (The IFRS Journey in Insurance.... n.d.). (IFRS in focus...... 2010) also confirmed that the development of IFRS 4 Phase II has been highly controversial as it significantly changes the current accounting for insurance contracts due to the proposal for insurance liabilities to be measured on a current value basis with maximum use of market consistent inputs. (A jump into unknown......n.d.) defined that the proposed changes to the current IFRS 4 will have a significant impact on the reporting, profitability, processes and operations of business. Klumpes and Morgan, (n.d) found that cost of capital estimates are significantly understated when applied using GAAP or SAP relative to either IFRS or Solvency II definitions of profit and book value. Shil, Das and Pramanik (2009) mentioned that IFRS concerned with removing unnecessary differences in accounting principles and practice throughout the world. Jain (2011) highlighted that IFRS adoption in India is inevitable. Indian Government and Accounting Body should take every possible step for a smooth transition process. Meyer (2005) described that the development of an international standard for the accounting of insurance contracts is aimed at high transparency and decision usefulness for participants in the capital markets. But (IFRS Insurance Reporting, n.d) gave some different view comparison to other. It highlighted that adoption of IFRS in the insurance industry has not brought about the much hoped for consistency in presentation and disclosure between companies. What IFRS has actually done is to make even more apparent the inconsistency and complexity inherent in the accounting models that currently exist. Tripathi & Gupta (n.d) highlighted that IFRS convergence will lead to conflicting legal and regulatory requirements related to financial statements. Ramanna and Sletten (2009) by making a cross section study of several countries finds that there is evidence that more powerful countries are less likely to adopt IFRS consistent with more powerful countries being less willing to surrender standard-setting authority to an international body. Furthermore they mentioned that a country is more likely to adopt IFRS if its trade partners or countries within in its geographical region are IFRS adopters.

OBJECTIVES

- ✡ To discuss the impact of IFRS on insurance industry in India;
- ✡ To discuss the utility for insurance companies in adopting IFRS;
- ✡ To discuss the problems faced by the insurers in the process of adoption of IFRS in India.

METHODOLOGY

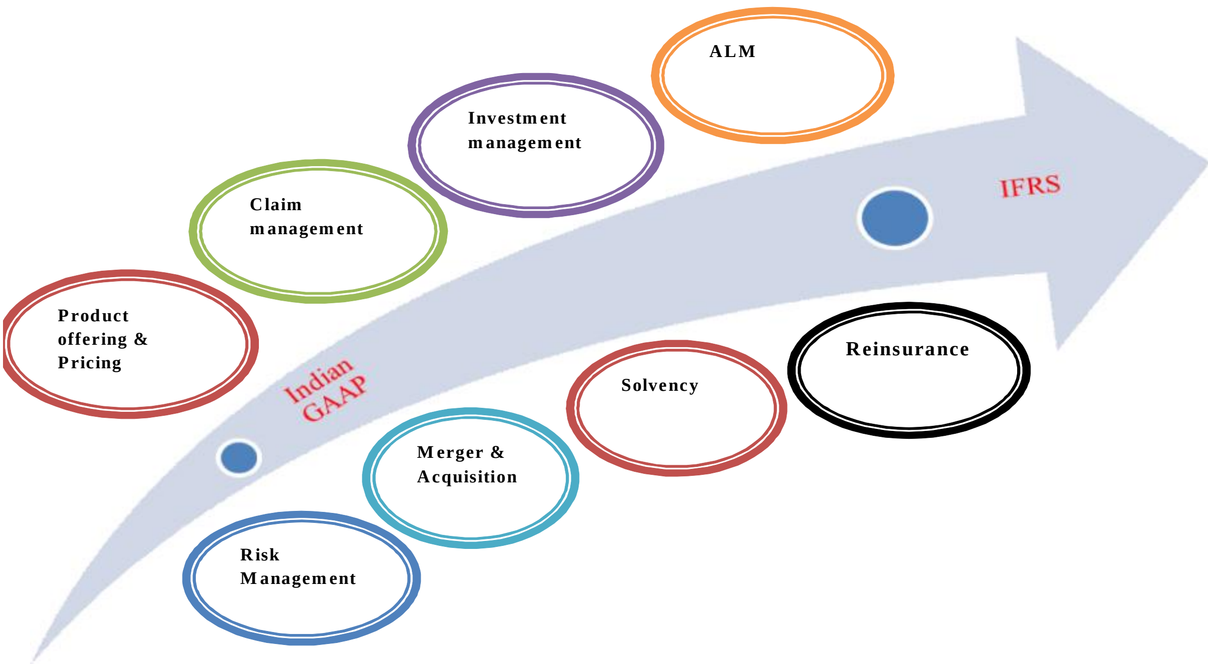
The study is primarily qualitative in nature and do not use any quantitative tool to analyze the data. It has been conducted mainly on the basis of literature survey and secondary Information. Various journals, newspaper and magazines articles, internet and experts in the fields have been referred in writing this paper.

IMPACT OF IFRS ON INSURANCE

The aftermaths of convergence of the International Financial Reporting Standards (IFRS) have become the centre of heed for both practitioners and academics in recent years. Notwithstanding, most of the empirical research emphasised on the outcome of the adoption of IFRS at an economy-wide level, there is very few studies reviewing the impact of IFRS on insurance sector. These sectors are of point of convergence as with the adoption of IFRS, insurance companies would start the reporting of assets and liabilities at fair value. Several major areas affect by IFRS are product design and offering, investment management, risk management, assets and liabilities management, merger and acquisition, claim management, reinsurance and solvency.

Product offering & Pricing:-

IFRS 4 provides for classification of insurance companies products into insurance products and other than insurance products. The contracts that do not comply with the characteristic of an insurance contract mentionedin IFRS 4 will be treated as financial instruments under IAS 39. At present, there is no standard in India for accounting of Insurance contracts. Therefore, the classification of Insurance/non–insurance products does not prevail in India. Classification of contracts into Insurance and/or Investment contracts would have remarkable impact on product design and on company's finance as insurance risk product measure at amortise cost according to IFRS 4 and investment according to IAS 39 at fair value. Apart from this, recognition of premium would also change due to such classification as well as contract revenue would also replace by margin revenue. The rationale of IFRS for such treatment is to manage the risks associated with products within precise limits and priced for those risks appropriately. It further facilitates the management to develop an understanding about their product offerings by examining their book of business which includes logical classification of products as insurance contract and financial instruments. Furthermore, in present day dynamic environment where customers demand products with additional features, it enables insurers to price their features and show customers the value they are providing in return of the corresponding price they charged. Insurance companies will also provide with more details in financial statement regarding how risk is priced which bring transparency and enhance their pricing capability.



Investment management:-

IFRS brings significant change in measurement of investment and financial instruments. IFRS also bring notable changes to current accounting practice for investments and other financial assets. In India, investment of insurance companies subjected to IRDA regulation which categorised securities into (i) debt securities (ii) equity securities and derivative instruments (iii) unlisted instruments and (iv) loans. While, under IFRS investment classified into (i) financial assets at fair value through profit or loss (ii) held to maturity investments (iii) loans and receivables and (iv) available for sale financial assets. Accordingly, measurement of such investments and financial assets will change on adoption of IFRSs by Indian entities. For their accounting treatment, IFRS held that if securities taken as held to maturity, it will measure at amortised cost using effective interest method or if classified as held for sale or fair value through profit or loss, it will measured at fair value. While under the existing regulations the investments of an insurance company are segregated as linked, non linked and shareholders investments. All investments in the linked portfolio are evaluated at market value in the balance sheet and the marked to market unrealized gains/losses are accounted in the revenue account and resulted effected is shows under the head 'Increase in Policyholders liability' in the revenue account. Investments in the non linked and shareholders portfolio are recognized at market value in the balance sheet and the corresponding mark to market unrealized gain/loss is shown in the balance sheet under 'Fair Value Change Account'. Recognition and measurement of investments under IFRS are governed by IAS 39 - 'Financial Instruments: Recognition and Measurement'.

Risk management:-

IFRS will be enable insurance companies to make their risk management decision by providing a realistic review of business. IFRS provide insurance companies with a better economic view of business portfolio which facilitate better internal control, bring transparency, improved management of the business and help them to attain better understanding of risk & uncertainty associate with their business. The move to IFRS is likely to encourage insurance companies to improve their risk management practices. IFRS provides significant disclosure with respect risks inherent in the business. The main disclosures in this area are concerning insurance reactivity and the maturities of assets & liabilities. An analysis of the maturity dates of financial assets and liabilities helps users to understand the risks associated with asset & liability and the uncertainties surrounding the amount and timing of the insurers' future cash flows. This would require the attention of readers on risk management practices of insurers and not only have them focusing on profit as a metric.

Asset-liability management:-

Insurers manage assets and liabilities based on their appetite for risk and availability of capital while keeping in mind the underlying commitments in the liabilities. IFRS presumes detailed disclosure on the nature of assets and liabilities and any likely mismatches between them. Under IFRS 4, classification of assets and liabilities between the current and the noncurrent is required and liability adequacy test is used to determine adequacy of liability. The test would also confirm that insurance liabilities are not downgraded taking into consideration related assets. A fair value approach to measure liability will stimulate insurers to reduce asset liability mismatch. IFRS 4 requires an insurer to assess whether its recognised insurance liabilities are adequate at each reporting date.

Merger and acquisition:-

IFRS will also bring certain changes concerning business combination. Under Indian GAAP, business combinations with few exceptions are recorded at carrying values and not at fair values of net assets taken over. Purchase consideration paid for intangible assets not accounted in the acquiree's books and is usually not reflected separately in the financial statements instead the amount gets added to goodwill. Hence, true value of the business combination is not reported through financial statements. IFRS will overcome this issue as it reports net assets taken over in a business combination at fair value. It also requires recognition of intangible assets, even if they have not been recorded in the acquiree's financial statements.

Claim management:-

An insurer shall disclose claims development information by preparing claim development table. These tables provide information about variances between management's estimation and the final cost of settling claims. As such, they provide an indication of the reliability of these highly complex estimates. Claims development tables convey valuable information about accuracy of management prior estimates and the extent to which insurance contract liabilities are subject to variation.

Reinsurance:-

The overall reinsurance strategy may include disclosure of retention limits, any evident individual reinsurance treaty including inherent counterparty risks and the approach used to monitor these risks. Further as, insurance companies continue to seek ways to mitigate their risks and potentially focus on reducing volatility in financial position. In general, IFRS interdict the offsetting of assets and liabilities, and income and expenses, besides specifically required or permitted. In addition, IFRS 4 specifically prohibits offsetting reinsurance assets against related insurance liabilities; and income or expenses from reinsurance contracts against expenses or income from related insurance contracts. Therefore, insurers are required to change existing accounting policies which allow for offsetting to comply with IFRS 4.

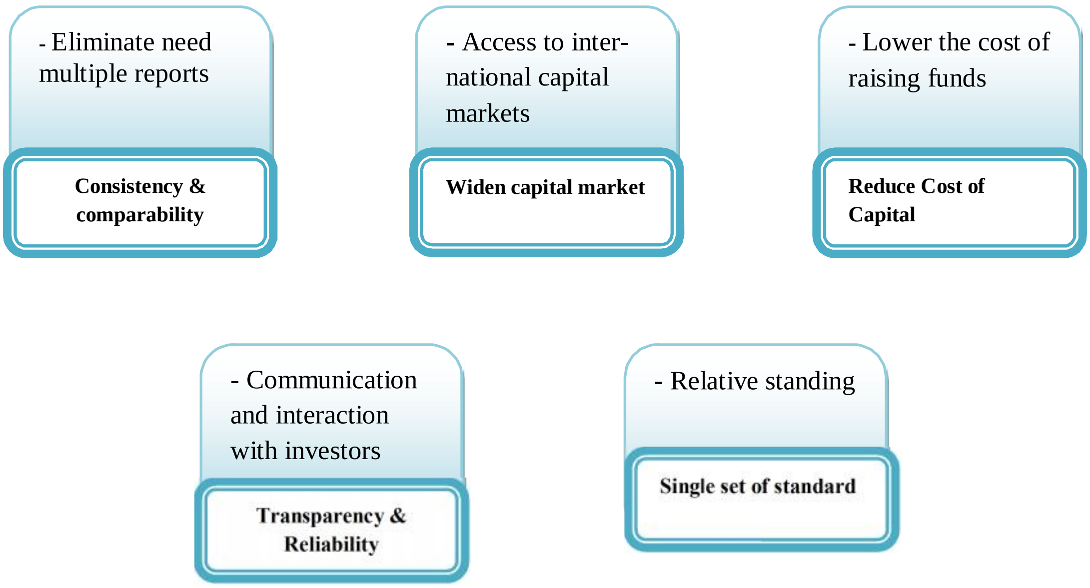
Solvency:-

Even though, IFRS does not explicitly deal with solvency, it provides a more market consistent figure which in turn may help insurers to identify the area where potential excess capital lie or short of its requirements. Once insurance companies well aware of their capital requirements, they make informed decision on how to invest. IFRS is based on fair value accounting which facilitates full disclosure in book of accounts and makes stakeholder & management to take rational decision about their solvency positions.

BENEFITS OF IFRS

Consistency and comparability:-

One of the most cogent arguments for the adoption of IFRS in various countries was that it would improve comparability between different reporting entities. In present globalised era, where the borders are dissolving and there is an increased interdependence of nations on each other; a need was felt for homogeneity in the preparation and presentation of financial reports. International Financial Reporting Standards (IFRSs) ensure certain uniformity and reliability in preparation of reports rather than just complying with formality. Convergence to IFRS by all group entities will also equip company officials to get all components of the group on one financial reporting platform. This will eliminate the preparation of multiple reports and significant adjustment for preparing consolidated financial statements or filing financial statements in different stock exchanges.



Widen capital market:-

The past few decades have seen the significant change in global arena. Head on this, many entities are expanding or making significant presence in the global market for which huge capital is required. All such entities are facing the compliance requirements imposed by various stock exchanges for financial information. Today, majority of stock exchanges across world capital market will accept or require financial statements prepared following IFRS. IFRS is assumed as a global language for accounting that is understood by all and remove information barriers. Thereby, adoption of IFRS in India will allow Indian entities to have access to international capital markets without having to go through the cumbersome conversion and filing process that is currently required.

Reduce Cost of Capital:-

IFRS will eliminate multiple reporting and related costs, as the same set of financial statements can be used both for reporting at the entity level and at the consolidated level. It is widely accepted that the use of a single set of accounting standard will exalt the efficiency of capital allocation and help to reduce the cost of capital. In addition to this, insurance companies would have to low cost fund which will further reduce their cost.

Transparency & Reliability:-

The use of IFRS is likely to ensure the reliability and transparency in financial reporting by Indian industry, since it will be based on a global accounting standard. Furthermore, the use of XBRL will reinforce data management practices and bring transparency by providing timely and adequate information to creditors, board, investors and other stakeholders. IFRS would also provide a single set of accounting standard based on the principle of fair value which is perceived to improve communication and interaction among investors, analysts and companies. Indian entities may be able to initiate new relationships with investors, customers and suppliers internationally, since IFRS provides a globally accepted reporting platform.

Broad based standard (singe set of standard):-

Adoption of IFRS will enable Indian entities to gain a broader and deeper understanding of the entity's relative standing by looking beyond country and regional milestones. Further, adoption of IFRS will facilitate companies to set targets and milestones based on global business environment, rather than merely local ones. Large business houses in India like TATA, BIRLA, and AMBANI have some firms registered in India and also firms registered outside India in European and American capital markets. Firms registered in India prepare their accounts as per Indian Accounting Standards whereas firms registered in other countries prepare their financial statements as per the Reporting standards of the respective country. Adoption of IFRS ensures the elimination of multiple financial reporting standards by these firms as they are following single set of financial reporting

CONCLUSION & SUGGESTIONS:

We may conclude from above discussion that IFRS has significantly affected product design and offering, investment management, risk management, assets and liabilities management, merger and acquisition, claim management, reinsurance and solvency. To ensure hassle free implementation of IFRS and smooth convergence, the ICAI and regulatory bodies have to take several measures. There is a need to have a systematic approach to make the corporate entities and the investors to adopt the standards. Professionals and regulators should bring necessary changes in the existing laws and implement efficient monitoring system of regulatory compliance with IFRS. The adoption might lead to short term investments and initial challenges but the long term benefits are strong enough to justify the initial hassles of implementation and adoptability. In addition to this, to bring transparency, maintain investors' positive sentiments, and also strengthen their faith and credibility in the Indian market, it becomes more pertinent for a country like India to adopt it as soon as possible.

It is clear from above discussion that IFRS is going to affect every area of insurance. Hence there are some suggestions pertaining to insurance sector:

1- The changeover to IFRS brings about significant changes in terms of complexities of accounting standards and requiring significant use of judgment in applying new and complex requirements, hence staff training should be provided to enable them to tackle the conversion exercise with confidence and minimize the risk of material errors.

2- It became evident that the disclosure requirements of IFRS are far more extensive than those of GAAP. Therefore, IRDA has to work out the likely changes in the financial statements submitted by the insurers so that the regulator, the market and policyholders (both current and prospective) could use the standards effectively and at the same time reasonable degree of transparency is ensured.

3- In order to comply with the disclosure requirements, significant changes would be required to IT systems to capture additional information.

4- Learn from countries where it implemented, it would give an impressive idea on its consequences.

5- Management would need to spend significant time and efforts in order to educate the investors, lenders, analysts and board of directors regarding the impact of IFRS on the financial position and performance.

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