IFRS 17 AND ITS EFFECTS ON FINANCIAL PERFORMANCE AND THE STATEMENT OF FINANCIAL POSITION: A COMPARATIVE ANALYSIS OF THE SOUTH AFRICAN INSURANCE COMPANIES INCLUDING BANKS

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MYNSIV003

Research dissertation presented for the approval of the University of Cape Town Senate in fulfilment of part of the requirements for the degree of Master of Commerce (Specialising in Financial Reporting, Analysis and Governance) in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

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DEDICATION

This work is dedicated to my family, with special recognition of:

My son, Pieces-of-Me, from the moment you were conceived, we were never sure of your safe arrival, just as I was unsure of completing this dissertation in time for 2024 submission. Your brave fight for life became my inspiration and the driving force behind my determination to keep pushing forward.

My wife, Ziyanda, for allowing me to use our family time and financial resources to complete this project. Your love and support have made this achievement possible. I must, however, apologise as I cannot promise this project to be the last academic project that takes time away from our family bonding sessions. Bambelela S'yajika.

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ABSTRACT

In the South African market, insurance plays an important role by enabling businesses to manage risks they could not manage individually, while also reinvesting some of the premiums in South Africa to drive economic growth and create jobs. For individuals, insurance provides important protection for valuable assets. The introduction of International Financial Reporting Standards (IFRS) 17 by the International Accounting Standards Board (IASB), effective from 1 January 2023, resulted in a change in the measurement requirements of insurance contracts compared to IFRS 4. This study investigated the impact of the transition from IFRS 4 to IFRS 17 on the financial performance and the statement of financial position of insurance service providers in South Africa. This study, grounded in the Rational Choice Theory, the Liquidity Preference Theory and the Pecking Order Theory, analysed twelve insurance service providers licensed by the FSCA and operating in South Africa. The results of the study revealed that IFRS 17 did not have a statistically significant impact on the financial performance of these insurance service providers. However, the statement of financial position experienced a statistically significant decrease in reported total assets and total liabilities, while the changes to the reported equity and insurance liabilities were not found to be statistically significant.

The decrease in the reported total assets and liabilities was noted to be due to the change in the measurement requirements for insurance contracts accounting such as the treatment of acquisition costs. Under IFRS 4, insurers were allowed to capitalise and defer acquisition costs as deferred acquisition cost assets on the balance sheet. The DAC asset was then expensed to the income statement over the life of the insurance contract. However, under IFRS 17, this DAC is included as part of the insurance service liability resulting in a decrease in reported total assets and total liabilities. Furthermore, the reported total assets and liabilities are impacted by the requirement to discount these balances using the IFRS 17 risk-adjusted approaches as well as the changes to the underlying assumption used in the measurement calculations.

This analysis and results may assist regulators, investors and other users of financial statements to better understand the impact IFRS 17 has had on the financial performance of insurance service providers in South Africa.

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Abbreviations

CSM-	Contractual Service Margin
DAC-	Deferred Acquisition Costs
FSCA-	Financial Sector Conduct Authority
FSV-	Financial Soundness Valuation
GMM-	General Measurement Model
IAS-	International Accounting Standard
IASB-	International Accounting Standards Board
IASC-	International Accounting Standards Committee
IFRS-	International Financial Reporting Standard
IFRS 4-	International Financial Reporting Standard 4
IFRS 9-	International Financial Reporting Standard 9
IFRS 15-	International Financial Reporting Standard 15
IFRS 16-	International Financial Reporting Standard 16
IFRS 17-	International Financial Reporting Standard 17
IMF-	International Monetary Fund
KZN-	Kwa-Zulu Natal
JSE-	Johannesburg Stock Exchange
PA-	Prudential Authority
PAA-	Premium Allocation Approach
SARB-	South African Reserve Bank
SASRIA-	South African Special Risks Association
UKEB-	UK Endorsement Board

Chapter 1: Introduction

1.1 Background

The International Accounting Standard Board (IASB) was founded in 2001, replacing the International Accounting Standard Committee (IASC). The IASB adopted all previous accounting standards issued by the IASC and published additional new accounting standards, commonly known as the IFRS Accounting Standards as issued by the IASB. Countries can voluntarily become IASB member nations, adopting its IFRS accounting standards (Akindejoye & Ilugbusi, 2019). South Africa has been an IASB member since 2005, requiring certain companies to apply IFRS Accounting Standards (JSE, 2007). Listed companies and state-owned companies must comply with IASB's International Financial Reporting Standards while private companies with a public interest score below 350 points and no public accountability can opt for simpler frameworks such as the IFRS for Small and Medium-sized Entities (South Africa, 2009).

The insurance accounting project was started in 1997 and has concluded with the Phase 2 issuance of IFRS 17 in May 2017. The International Financial Reporting Standard 4 (IFRS 4) was issued in March 2004 as an interim accounting standard for the insurance sector accounting practices, allowing insurers to use their national accounting standards, resulting in inconsistent financial reporting across different countries (IASB, 2020). IFRS 4 was applicable for financial years starting on or after 1 January 2005 and now will be replaced by IFRS 17 effective from 01 January 2023 (IASB, 2022).

In today's increasingly globalised marketplace, companies operate in different countries and continents, increasing the demand for universally accepted accounting standards. This demand is driven by the need for comparable financial statements from similar companies operating in different countries, because many large investors operate in international markets (Brüggemann et al., 2013). The establishing of globally recognised accounting standards requires extensive stakeholder engagement and participation, accommodating different legal and regulatory frameworks across different countries (Durocher et al., 2007). The development of IFRS 17 spanned over a decade, starting with Discussion Paper 1, followed by two Exposure Drafts and the

issuance of IFRS 4 as the conclusion to Phase 1. This lengthy process was adopted due to the expected substantial implications of the IFRS 17 accounting standard on profit, asset and liability valuations (Walton, 2020).

1.2 Problem Statement and contribution of the study

The IFRS 17 accounting standard is mandatory for financial year period starting on or after 1 January 2023 and no South African insurance service provider impacted by this accounting standard chose to early adopt ahead of schedule. Prior to the effective date, existing literature relevant to both South Africa and internationally has mainly focussed on the challenges insurance service providers are expected to face when transitioning to IFRS 17, considering this accounting standard's requirement for more granular information regarding the insurance contracts. This information might not be easily accessible for old active contracts and the existing data management systems might not be setup to accommodate such granular information (Dahiyat & Owais, 2021; Mignolet, 2017; PWC, 2020).

Owing to IFRS 4 allowing insurance companies to use their own practices to measure insurance contracts, one of the objectives for issuing the IFRS 17 accounting standard was to improve the comparability and transparency of financial reporting for insurance contracts (IASB, 2017b). As a result, many previous studies have focused on investigating the expected impact of the IFRS 17 transition on the quality of financial reporting to assess whether the objectives of the IASB to improve the quality of financial reporting were met (Rajala, 2020).

Unlike previous studies, this research study aimed to investigate the actual impact of IFRS 17 rather than its expected impact. Furthermore, the research focuses on understanding how this accounting standard has affected the financial performance of South African insurance service providers, as well as its impact on their financial position. For the purposes of this study, the term 'insurance service providers' includes both insurance companies and banks operating in South Africa. The researcher used statistical analysis to measure this impact in order to provide more scientific answers regarding how IFRS 17 has influenced the financial performance and financial position of the selected companies. The analysis is based on data from the selected companies' annual financial reports and integrated reports, if available and, if not, on

their interim financial statements. The inclusion of interim and annual reports in the analysis is supported by the findings of Oberholster et al. (2017), who investigated the value relevance of interim and annual financial statements. Their study revealed that the book value of shareholder's funds from interim financial reports is value relevant, whereas interim income statement results are not. However, by comparison, the income statement results reported in annual financial statements were found to be value relevant. Therefore, both the interim and annual financial reports are value relevant, useful to the users of financial statements and considered appropriate to include in this study's analysis. The findings of this study are expected to provide valuable insights to the insurance professionals, investors, analysts and regulators.

1.3 Research questions and objectives

Three research questions were formulated to address the objectives of this paper and are noted as follows:

1. What impact does IFRS 17 adoption have on the key financial performance ratios of insurance service providers in South Africa?

   Objective: To investigate the impact of IFRS 17 adoption on the key financial performance ratios of South African insurance service providers and evaluate its statistical significance.

2. What is the impact of IFRS 17 adoption on the total reported assets, liabilities and equity in the statement of financial position of South African insurance service providers?

   Objective: To investigate the impact of IFRS 17 adoption on the statement of financial position, specifically focusing on total assets, liabilities and equity, to determine whether the restatements resulting from IFRS 17 adoption are significant or not.

3. What impact does the adoption of IFRS 17 have on the reported insurance liabilities of South African insurance service providers?

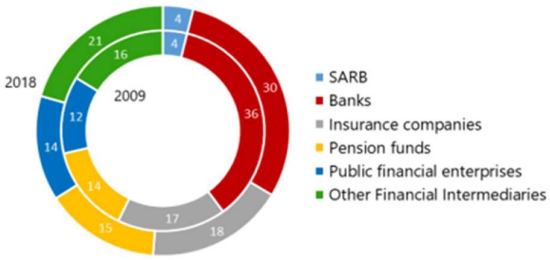
   Objective: To investigate whether the changes in the measurement requirements and assumptions related to insurance liabilities have resulted in a change in the reported balances that is significant or not.

Chapter 2: Literature review

2.1 The South African insurance industry: An overview

A few large and well-resourced local players dominate the insurance industry in South Africa and have maintained their positions for decades (Mugunzva, 2021). This continued dominance is attributable to the large capital expenditure required for entry, the complexity of the business models and the comprehensive regulatory requirements (Molloy & Ronnie, 2021). The insurance industry is a key component of South Africa's financial system due to its large volume of premium revenue, major investment scale and its important function in providing coverage against both individual and commercial risks, thus, serving as a key contributor to societal and economic development (Alagidede & Mangenge, 2016). According to the Financial Sector Conduct Authority (FSCA) (2022), South Africa accounts for 70% of the total insurance premiums across the African continent and these premiums constituted 13.7% of the country's GDP in the year 2020.

According to the International Monetary Fund (2022), "insurance companies account for 18% of South Africa's financial services industry, as illustrated in Figure 1 below, maintaining a consistent market share over the past few years. The sector consists of 170 insurance companies, divided into 67 life insurance companies, 70 non-life insurance firms, 9 reinsurance companies, 23 captive insurance companies, and one firm categorised under 'other'. The industry is highly concentrated, particularly in the life insurance segment, where the top five life insurers represent 72% of the life insurance market, while in the non-life insurance segment, the top five non-life insurers account for 48% of the market".



Source:(SARB, 2024)

Figure 1. South Africa: insurance sector size

Based on the above, the important role of the insurance sector cannot be overstated. Insurance is defined as a mechanism of transferring risk from one party to the next in exchange for a premium, establishing a mechanism that allows multiple parties to create and continue businesses that would otherwise be financially unfeasible if a single party assumed the risk alone (Rejda & McNamara, 2014).

In 2022, South African insurance companies faced unprecedented challenges, marking a period that will be remembered for decades. Specifically, severe flooding struck the KwaZulu-Natal province (KZN) in April 2022, leading to substantial property destruction (KPMG, 2023). Experts count this incident among the most significant catastrophic event losses within South Africa. Additionally, the financial performance of these insurance entities was further affected by the runoff losses from the 2021 KZN unrest, that resulted in substantial financial setbacks for both the insurance companies and the South African Special Risks Association (SASRIA), amounting to billions of rand in losses (KPMG, 2023). However, despite these setbacks and the paying out of large claims, the South African insurance service providers have proven to be resilient and able to play their role in helping society recover from catastrophic losses. The sector posted a 5.4% increase in profits, growing from R17 billion in the 2021 financial year to R26.1 billion in the 2022 financial year (KPMG, 2023).

The FSCA and the Prudential Authority (PA) closely regulate the South African insurance industry to ensure that insurance policyholders are protected and that insurance companies only offer policies for which they can afford to pay claims when they occur (SARB, 2024). The FSCA's mandate includes ensuring fair treatment of financial services provided to clients, maintaining financial stability and promoting market integrity (SARB, 2024). In addition, the PA, operating within the South African Reserve Bank (SARB), oversees prudential regulation, supervises insurers, safeguards policyholders' interests and maintains the stability of the insurance sector (SARB, 2024). These authorities implemented the first regulations after the collapse and liquidation of AA Mutual Assurance Society (AAM) in 1986, that resulted from financial difficulties, including mismanagement, inadequate reserves and mounting claims (Verhoef, 2012). The collapse of AAM had significant repercussions for

policyholders and the insurance industry, leading to reforms in insurance regulations and oversight to prevent similar occurrences in the future (Verhoef, 2012).

2.2 Identifying primary financial performance ratios

A company's performance can be evaluated by measuring its profitability that reflects its financial health (Chen & Wong, 2004). However, Ayele (2012) suggests that profitability alone is not a reliable measure of performance because it cannot be used to compare the profitability of different companies. Financial ratios, on the other hand, are better suited for comparing financial performance across companies (Ayele, 2012). Therefore, this study uses a combination of financial ratios to examine the impact of IFRS 17 adoption on the statement of financial position and financial performance of South African insurance service providers. The list of financial performance ratios selected for this study are outlined in Table 1 below and the rest of this section provides a justification for their selection.

Financial ratio grouping	Financial ratio	Numerator	Denominator
Leverage ratios	Debt Ratio	Total Debt	Total Assets
	Debt-Equity Ratio	Total Debt	Equity Book Value
	Times Interest Earned	Earnings Before Interest	Interest Expense
Liquidity ratios	Current Ratio	Current Assets	Current Liabilities
Profitability ratios	EBITDA Margin	Earnings Before Interest, Depreciation and Amortisation	Total Revenue
	EBIT Margin	Earnings Before Interest	Total Revenue
	Net Profit Margin	Net Profit After Tax	Total Revenue
	Return on Assets	Net Profit After Tax	Average Total Assets
	Return on Capital Employed	Net Profit After Tax	Average Total Capital Employed
Asset Management	Asset Turnover	Revenue	Average Total Assets
Insurance ratios (IFRS 4)	Commission Ratio	Commission Incurred	Earned Insurance Revenue (IFRS 4)
	Claims Ratio	Claims Incurred	Earned Insurance Revenue (IFRS 4)
	Combined Ratio	Total Loss Incurred	Earned Insurance Revenue (IFRS 4)
Insurance ratios (IFRS 17)	Commission Ratio	Commission Incurred	Insurance Revenue (IFRS 17)
	Claims Ratio	Claims Incurred	Insurance Revenue (IFRS 17)
	Combined Ratio	Total Loss Incurred	Insurance Revenue (IFRS 17)

(Dillon, 2014; Kinyanjui, 2020; Mazviona et al., 2017)

Table 1: List of financial performance ratios

2.2.1 Return on assets and return on equity

Abdullahi and Abubakar (2017) explain that financial ratios are numerical values calculated from accounting information and data in financial statements. These metrics help analysts assess how well a company uses its resources to make a profit and measure the overall financial health. Malik (2011) suggests that a company's financial performance is better measured by return on assets (ROA) and the return on equity (ROE) than by profitability alone. According to Do et al. (2020), ROA is a key metric for evaluating an entity's profitability relative to its total assets. Similarly, Ngweshemi and Isiksal (2021), define ROE as a financial performance measure that evaluates the efficiency with which the management has utilised the investors' money to generate earnings. Erdemr's (2019) research investigated the factors influencing the financial performance of 30 Turkish insurance companies and their findings supports the view that the ROA and ROE are better measures of financial performance than profitability alone. Erdemr's (2019) findings indicate that financial performance ratios such as ROA and ROE provide a more detailed assessment of a company's efficiency in using its resources to earn profits.

Oner Kaya (2015) studied 102 Turkish insurance firms from 2008 to 2013. This study examined how company-specific factors affected the financial results. The goal was to find the link between these factors and the firms' performance. The study evaluated the financial health of these insurance companies using ROA as a measure. The findings showed that greater company maturity and higher total gross written premiums positively affected ROA. In contrast, the research revealed that larger firm size, higher liquidity ratios, and higher insurance leverage ratios negatively impacted ROA.

According to Dillion (2014), "The ROA ratio is calculated by dividing net income after tax by the average total assets, whereas the ROE ratio is calculated by dividing net income after tax by the average total capital employed". This study used the ROA and ROE ratios to measure the impact of IFRS 17 adoption on the income statement of insurance service providers in South Africa. The use of these ratios as a systematic approach to evaluating the income statement impact of a new accounting standard aligns with Dillon's (2014) study, which investigated the expected income statement

impact of IFRS 16 adoption on South African companies. While IFRS 16 and IFRS 17 are different accounting standards, the choice of the ROA and ROE ratios is relevant because the methodology used in Dillon's (2014) study offers a framework for assessing the broader implications of any new accounting standard on financial performance.

2.2.2 Profitability ratios

Profitability ratios measure how well a company generates returns from its invested capital (Robinson et al., 2015). It also highlights the firm's competitive position and the effectiveness of its management practices. Profitability indicators, such as Net Operating Margin and Net Margin are used to assess a company's financial strength (Robinson et al., 2015). The Operating Margin, derived by deducting operating expenses from operating profit, is important because it shows the entity's ability to make a profit from its core operations. If this ratio decreases, it may indicate poor management of operating expenses. The Net Margin, on the other hand, represents the net amount the entity retains after paying all its expenses, including taxes. The Net Margin is calculated by deducting the total operating expenses from its total revenue (Anggraini et al., 2023; Robinson et al., 2015).

This study used the Net Operating Margin and the Net Margin to assess the influence of IFRS 17's transition on financial performance. These ratios are relevant for evaluating IFRS 17's impact because this accounting standard changes the recognition and timing of revenue and expenses, directly impacting profitability results. The use of profitability ratios aligns with Cape's (2019) methodology for assessing the financial impact of the new IFRS 16 accounting standard on financial performance. While IFRS 16 and IFRS 17 address different areas of accounting, they both result in changes to a company's revenue and expenses, directly impacting its profitability. Cape's (2019), approach, therefore, provides a framework for understanding how changes in revenue and expense recognition, as a result of a newly implemented accounting standard, impact financial performance.

2.2.3 Claims ratio, commission ratio and combined ratio

Kumar (2018) states that the combined ratio is a key profitability ratio used in the insurance industry, consisting of claims and expenses. The combined ratio is defined as a total of all insurance expenses expressed as a percentage of earned premium. This ratio consists of directly and indirectly attributable underwriting expenses plus losses incurred and helps determine an insurance company's profitability, with a ratio above 100% indicating an underwriting loss and a ratio below 100% indicating an underwriting profit (Kumar, 2018). The claims ratio represents the total claim payouts as a percentage of premium earned (Gao et al., 2017). Claim payouts make up a significant proportion of the expenses incurred by insurance companies, typically around 80% of their premiums. When claim payouts are high, the claims ratio increases, and the company becomes less profitable (Dar & Thaku, 2015; Harrington et al., 1995). The commission ratio is defined as an expense incurred by the insurer to acquire insurance contracts. Commission expenses are important for improving performance, because they can be managed and controlled. Effective management of these expenses can positively contribute to the performance of insurance firms (Mazviona et al., 2017).

Kinyanjui (2020) evaluated the impact of various financial ratios on the financial performance of general insurance businesses in Kenya. The study analysed the financial statements of insurance companies over a 10-year period from 2003-04 to 2012-13. Their study specifically examined the influence of the combined ratio, incurred claim ratio, operating ratio and management expense ratio on the financial performance of these businesses. The results indicated an inverse relationship between the financial performance of the analysed companies and the four examined ratios. Specifically, an increase in the investigated ratios was found to negatively affect the financial performance, highlighting their considerable effect on the operational efficiency and profitability of insurance firms.

This study evaluated the effect of IFRS 17 adoption on financial performance of insurance companies using the claims ratios, commission ratios and combined ratios. The use of these ratios to assess the impact on financial performance aligns with Kinyanjui’s (2020) approach when investigating how these ratios impacted the financial performance of Kenyan insurance companies.

2.2.4 Liquidity and Solvency

Several previous studies have examined the factors driving profitability in insurance companies (Ahmeti and Iseni, 2020; Berhe and Kaur, 2017). Adams and Buckle (2003) investigated the factors influencing profitability in Bermuda's insurance sector, identifying leverage and liquidity as key contributors to financial performance. Their findings revealed that leverage positively influences financial performance, whereas liquidity has a negative impact. Obi-Nwosu et al. (2017a), define liquidity as a company's capacity to efficiently convert assets into cash in order to fulfil its short-term liabilities in a timely manner. Liquidity is an important metric in the insurance industry, because it affects an insurer's ability to pay claims (Songe, 2015). The estimating of future claims often involves using historical data that can be uncertain. As a result, insurers with low liquidity have a high risk of being unable to pay large and catastrophic claims (Songe, 2015).

Emmanuel & Olufade (2023) investigated the influence of liquidity on the operational success of Nigerian insurance firms. They analysed 51 companies' financial statements from 2011 to 2020 and found that effective liquidity management positively and significantly influences financial performance. Mungule (2023) performed a similar study in Zambia, examining five life and five non-life insurance companies. Their findings revealed that liquidity is a key variable affecting the financial health of these firms. Their findings propose that insurance companies need to align short-term and long-term investments to improve performance.

Insurance companies must closely monitor their liquidity, as holding too much cash can mean lost investment income (Tesfaye, 2012). On the other hand, having too few liquid assets increases the risk of failing to fulfil claim payments, which can harm the insurer's reputation (Tesfaye, 2012). The solvency ratio, by contrast, assesses a company's capacity to liquidate all assets, including long-term assets, to satisfy financial debts over time. This ratio shows a company's capacity to use its resources effectively and maintain operations in the long term (McCue, 2016). In the insurance sector, the solvency ratio is important, because it ensures policyholders that the insurer has the financial stability to avoid insolvency and pay claims in the future (Alemu & Deyganto, 2019; McCue, 2016).

This study uses the current ratio as a measure of liquidity. If current liabilities exceed current assets, it signals a potential shortage of liquid assets, affecting the company's ability to honour claims (Houston & Brigham, 2007). According to Houston & Brigham (2007), “The current ratio is calculated by dividing total current assets by total current liabilities”.

2.2.5 Leverage

Loppies et al. (2022) define the leverage ratio as a mathematical tool used to assess the extent to which a company relies on external borrowings, as opposed to equity, to finance its assets, enabling analysts to assess the company's financial obligations to external lenders and the relationship between the value of fixed assets and available capital. An increased leverage ratio in an insurance company can correlate with its financial health, supported by the analysis of other profitability ratios (Loppies et al., 2022). However, a high leverage ratio may also highlight a deterioration in the financial stability of the insurance company, reflecting negative effects on its health (Hery et al., 2023). This situation illustrates the complex impact of leverage on the financial stability of insurance companies (Hery et al., 2023). Entities with heightened leverage face a greater risk of insolvency if the management fails to manage such financial structures properly. Leverage plays an important role in shaping the profitability of insurance companies, with evidence suggesting that higher levels of leverage are associated with reduced profitability (Hidayati & Shofawati, 2018; Nurlatifah & Mardian, 2016; Putra, 2015).

A study by Olulu-Briggs (2024) combined descriptive analysis, unit root and panel generalised method of moments to measure the effect of the company’s scale and leverage on the earnings Nigerian listed insurance companies. By analysing the financial statements of these companies from 2010 to 2022, the findings revealed a positive link between leverage and earnings. In contrast to the above findings of researchers such as Hidayati & Shofawati (2018), the findings of Olulu-Briggs (2024) suggest that insurance companies should consider increasing their long-term debt to enhance growth, boost their capacity to underwrite more policies and, ultimately, improve their performance in the long run.

In a South African context, Abdulraheem-Saheed (2022) investigated how various factors, including premium growth rate, firm size, liquidity ratio, leverage ratio and asset tangibility, influence the income statement results of insurance companies. The study analysed the financial statements of 36 non-life insurers listed on the JSE from 2008 to 2019. The study revealed that leverage and liquidity were the only factors that significantly influenced the income statement results of these insurers. Given the similar focus with the companies investigated in this current study, Abdulraheem-Saheed's (2022) study provides a useful reference point, and the findings of their study suggests that a comparable impact may result from the transition to IFRS 17. Therefore, building on Abdulraheem-Saheed's (2022) insights, it is anticipated that the adoption of IFRS 17 will significantly influence the income statement results of South African insurance service providers.

In this study, leverage is measured using three ratios: the Total Debt-to-Equity ratio, calculated by expressing total debt as a proportion of total capital employed; the Total Debt-to-Asset ratio, calculated by expressing total debt as a proportion of total assets; and the Times Interest Earned ratio, calculated by dividing profit before finance costs and tax by the finance costs (Dillon, 2014).

2.3 Theoretical frameworks

Hussey and Collis (2003), define a theoretical framework as a combination of theories and models that provide researchers with a solid academic foundation and justification for their study. This framework serves as a base for conducting research, guiding researchers throughout their journey. It enables researchers to draw on existing theories related to their topic, helping them develop initial hypotheses. A theoretical framework also provides a structured approach to exploring the subject matter and explaining how different factors are interconnected within the research (Hussey and Collis, 2003). The theories outlined below provided the academic background of this study.

2.3.1 Rational Choice Theory

The importance of this study is rooted in the Rational Choice Theory, as formulated by Smith. This theory offers a foundation for analysing and understanding social and economic behaviour. It suggests that individuals make decisions by evaluating the

possible outcomes of their actions and selecting the option that maximizes their benefits within the limitations they face (Rutar, 2019). The theory assumes that individuals are rational actors, capable of ranking their preferences and assessing the costs and benefits associated with different choices (Asikhia et al., 2021). This theory assumes that human behaviour can be explained by the rational pursuit of self-interest, whereby individuals are motivated by the desire to achieve the best possible outcome for themselves (Boudon, 2003; Rutar, 2019).

According to Krstić (2022), the Rational Choice Theory did not emerge until the early 20th century and, since then, its application in scholarly research has increased. The theory has gained increased acceptance in sociology studies (Loughran et al., 2016). Despite its increased application in recent research, Rational Choice Theory has faced numerous criticisms over the years. One criticism is that it oversimplifies complex human behaviour, reducing it to a mere calculation of cost versus benefit, ignoring the other factors that influence decision-making. These factors include emotions, cultural norms and social influences, that can substantially impact an individual's choices beyond a rational calculation (Krstić, 2022; Wittek et al., 2013).

In the insurance industry, understanding how policyholders make decisions about which insurance company to choose for their coverage is important. Insurance aims to provide protection against risks, particularly in times when policyholders rely on their insurers to meet their obligations and settle claims (Kinyanjui, 2020). The Rational Choice Theory is particularly useful in this context. The theory suggests that individuals prefer to purchase insurance policies from insurers achieving high performance (Cummins & Danzon, 1997). Individuals typically avoid purchasing policies from an insurer facing financial instability, recognising the potential risk of not receiving claim settlements under the policy when the losses occur (Cummins & Danzon, 1997). This analysis aligns with Rational Choice Theory by illustrating how policyholders use these metrics to make calculated choices, prioritising companies that showcase financial and operational excellence. A higher ROA or ROE signals to the policyholder that the insurer is good at converting assets and equity into profits, indicating that the company is in a sound financial position. This knowledge is particularly reassuring for policyholders, because financially stable insurers are seen as more reliable in meeting claim obligations (Kinyanjui, 2020).

2.3.2 Pecking Order Theory

The Pecking Order Theory provides a framework for understanding how companies prioritise their financing sources. This theory has made a fundamental contribution to corporate finance literature, offering insight into firms' financing behaviour (Frank & Goyal, 2007). Fundamentally, the theory suggests that companies prioritise financing new projects through retained earnings, followed by external funding options such as debt, and resort to issuing new equity only as a final option (Frank & Goyal, 2007).

Fadah (2019), conducted a study to explore how the Pecking Order Theory applies to the financing decisions of insurance companies listed on the Indonesian Stock Exchange. The study examined 10 out of 12 insurance companies, aiming to determine how closely they followed the theory. The results showed that only three companies adhered to the theory in their capital structure decisions, while the remaining seven companies did not. Ahmed & Shabbir (2014) conducted a similar study to examine the relevance of the Pecking Order Theory to how the insurance companies in Pakistan structure their source of funding between debt, equity and other financial instruments. Contrary to Fadah's findings, the outcomes of their investigation revealed that insurance companies in Pakistan adhere to the Pecking Order Theory. This difference in findings indicates that additional variables play a role in shaping the financing decisions of insurance companies, and that more profitable and liquid insurers are likely to conform to the Pecking Order Theory hypothesis.

Our study investigated variables related to the Pecking Order Theory by examining changes in total debt-to-equity, debt-to-asset and the times interest earned ratios resulting from the transition to IFRS 17, focusing on whether this transition significantly changes the financing methods of the selected companies.

2.3.3 Liquidity Preference Theory

The Liquidity Preference Theory, introduced by Keynes in the early 1930s, offers a model for understanding why companies opt to maintain certain cash reserves given prevailing market interest rates (Keynes, 1930). The theory proposes an inverse relationship between interest rates and cash reserves, meaning that as one increases, the other tends to decrease (Keynes, 1930). This suggests that when market interest rates are low, companies tend to hold higher cash balances, whereas higher interest

rates lead to a decrease in cash reserves and an increase in investments (Kipngetich, 2019). The transactions motive emphasises the necessity of maintaining cash reserves to meet routine operational expenses and facilitate daily business activities. The precautionary motive, on the other hand, highlights the importance of retaining cash as a safeguard to address unexpected financial emergencies. Lastly, the speculative motive pertains to holding cash to capitalise on advantageous opportunities, such as profitable investments or favourable shifts in market conditions. These motives collectively provide a comprehensive framework for understanding the rationale behind liquidity management strategies (Kipngetich, 2019). In the context of insurance, costs such as insurance acquisition costs, salaries and wages could link to day-to-day business transactions. Insurance companies might also keep cash on hand for precautionary motives to settle unexpected claims when they become due, or to acquire a broker or another insurance company as an investment for speculative motives.

The Liquidity Preference Theory recognises the role of expectations about future interest rates in shaping firms' decisions regarding cash holdings. Firms adjust their cash reserves based on their expectations about future interest rate movements. For instance, if firms anticipate a decline in interest rates, they may choose to hold more cash to take advantage of potential investment opportunities that arise when interest rates fall. However, the firm can view holding high cash reserves as incurring an opportunity cost, because it means foregoing potential interest or investment returns (Kipngetich, 2019; Tapang et al., 2022).

This study investigated how the application of the Liquidity Preference Theory changes when companies prepare financial statements on an IFRS 4 basis versus under an IFRS 17 basis.

2.4 Expected impact of IFRS 17 adoption and its challenges

IFRS 17 replaced IFRS 4 effective from 01 January 2023 (IASB, 2017b). IFRS 4 was introduced by the IASB in 2004 as a temporary measure for insurance sector accounting practices, allowing insurers to follow their national accounting standards, leading to inconsistent financial reporting across countries (IASB, 2020). The primary goal of IFRS 17, according to the IASB (2017), is to ensure accurate reporting of

accounting information for contracts within its scope, providing users of financial statements with a reliable basis to evaluate the income statement impact of these contracts. Although it is difficult to quantify the value of this accounting information, it plays an important role in helping users make economic, social and political decisions with substantial financial consequences (Awodiran, 2018).

2.4.1 Impact on transparency and comparability

The IASB (2020) states that it expects that IFRS 17 will enhance both the comparability and transparency of financial reporting for insurance companies. This observation is consistent with Deloitte's (2020) findings that identify the primary difference between IFRS 17 and the previous IFRS 4 accounting standard as the standardised requirements for accounting for premiums and insurance liabilities. Unlike IFRS 4, that allowed entities to establish their own interpretations of premium recognition and reserve calculation requirements, IFRS 17 prescribes specific rules (IASB, 2020). For instance, companies could previously choose to include or exclude risk adjustments in liabilities at their discretion, but IFRS 17 requires that these risk adjustments are now included (IASB, 2020).

Several other studies have investigated the anticipated influence of applying IFRS 17 on the integrity of financial reporting (Rajala, 2020; Mignolet, 2017; Dahiyat & Owais, 2021). These studies aimed to identify the potential benefits and drawbacks of the new IFRS 17 accounting standard, as well as its impact on the integrity of financial reporting in the insurance industry. A study by Dahiyat and Owais (2021) investigated the expected impact of IFRS 17 on the integrity of financial reporting in the Jordanian environment. The study used a qualitative approach to survey 120 employees from insurance companies in Jordan and found that IFRS 17 implementation is likely to enhance the integrity of financial reporting by making financial statements more comparable and transparent (Dahiyat & Owais, 2021). Similarly, a study conducted by Rajala (2020) found that IFRS 17's disclosure requirements will provide additional information about insurance companies' economic activities, enabling a detailed evaluation of insurance contract valuation and improving reporting quality. However, the complexity of implementing IFRS 17 and the required system changes means that improvements in comparability and transparency will likely only occur over time and may not be immediately noticeable (Rajala, 2020).

In another study, Mignolet (2017), employed a comparable qualitative approach by interviewing employees of insurance companies and scrutinising the feedback from the IASB revised Exposure Draft from 2013. The study found that IFRS 17 adoption is likely to enhance the financial reporting integrity by promoting the comparability of financial statements. However, Mignolet (2017) argues that achieving greater transparency in financial statements will likely prove challenging. The review of the above literature indicates that most researchers arrive at a similar conclusion: IFRS 17 will enhance the integrity of financial reporting.

Researchers such as Khudhir Shawkat and Alhasan (2024) have examined the impact of IFRS 17 on the financial reporting integrity of Iraqi insurance companies. Their study used a descriptive and analytical methodology, scrutinising empirical data calculated from the financial reports prepared on IFRS 17 basis. This study included conducting a survey involving 173 subject matter experts and an analysis of 154 valid responses using SPSS statistical software to extract meaningful insights. The findings provided compelling evidence that the implementation of IFRS 17 significantly enhanced the financial reporting practices of Iraqi insurance companies. By addressing the shortcomings associated with IFRS 4, IFRS 17 leads to better quality and reliability of financial reporting, leading to increased profitability and financial solvency. These improvements are important in fostering increased transparency and comparability in the financial reports of Iraqi insurance firms, thereby contributing to their overall financial stability and performance (Khudhir Shawkat and Alhasan, 2024).

2.4.2 Expected impact on financial performance and disclosures

IAS 8 requires companies to provide specific disclosures about the expected impact of all accounting standards that have been issued but are not yet required to be implemented (IASB, 2017a). This practice includes the change from IFRS 4 to IFRS 17, as this represents an expected change in accounting policy for the treatment of insurance contracts, as identified by the IASB in 2017 (IASB, 2017a). For financial years ended before 01 January 2023, all company applying IFRS were required to provide a disclosure of the expected impact of the upcoming IFRS accounting standards

Kumar and Rastogi (2023) conducted a study to evaluate the quality of disclosures made by insurance companies concerning their anticipated impact of adopting IFRS 17, as mandated by IAS 8. The purpose behind the disclosure requirements of IAS 8 is to enable users of financial statements to understand the financial implications of the upcoming accounting standard. Kumar and Rastogi (2023) used a sample of large insurance companies with a market value exceeding $650 billion, selected based on their high public interest scores and their rankings by the AM Best credit rating agency. The researchers used the entities' published annual financial statements for the year ending on 31 December 2022 to examine their compliance with the IAS 8 disclosure requirements, in anticipation of the forthcoming implementation of IFRS 17, set to take effect on 1 January 2023. Although all the insurance companies studied complied with IAS 8, the study found that the quality of these disclosures was questionable. This is due to the considerable uncertainty that surrounded the disclosures as the preparers recognised the disclosed expected impact of IFRS 17 was subject to change and also lacked details that would enable investors to understand the true impact of the new accounting standard on the financial performance of the companies (Kumar & Rastogi, 2023).

In the course of 2023, several insurance firms had to disclose and present their interim financial statements (EY, 2023). EY evaluated the impact of IFRS 17, using publicly available information disclosed by insurance companies, including investor presentations, 2022 annual reports and 2023 interim reports. Their study was based on the financial disclosures published by a panel of 30 global insurance companies and the aim was to assess the readiness and early adoption impact of these accounting standards on the insurers' financial reports and key performance metrics (EY, 2023). The analysis identified varying consequences of the changing to IFRS 17 and IFRS 9, particularly in relation to shareholder equity, operating income, Contractual Service Margin (CSM) and risk adjustments. One of the observations was the fluctuation in equity levels, showing a tendency towards reduced equity under IFRS 17 at the start of 2022, transitioning to increased equity by early 2023, that largely resulted from the impact of rising interest rates in 2022. The study also observed varied outcomes for operating profits, with some insurers noting declines when applying the new accounting standards in comparison to IFRS 4, linking these changes to the creation of a loss component for onerous contracts and discounting effect (EY, 2023).

2.4.3 Expected challenges of implementing IFRS 17

One of the key challenges of implementing IFRS 17 relates to technology and data management. The implementation of IFRS 17 will require technological upgrades for various components of the existing architecture including, but not limited to actuarial models, general ledger and other reporting tools (Deloitte, 2023; van den Berg, 2021). PWC (2020), conducted a survey to understand the challenges and progress made by South African insurers in IFRS 17 implementation projects. The findings indicated that 20% of the respondents expected their IFRS 17 implementation costs to be between R1 million and R50 million, 40% expected these costs to be between R50 million and R200 million, while the remaining 40% anticipated that these costs would exceed R200 million. These findings indicate that the market expects to incur substantial expenditure to achieve the successful implementation of the new accounting standard, a situation that represents a considerable challenge. Overall, the increase in upfront costs and resource demands for implementing IFRS 17 will reduce the profitability of insurers during the transition period.

Similarly, Jinga (2020), performed a qualitative study to investigate the influence of IFRS 17 on financial reporting in South Africa, as well as to identify potential gaps requiring close monitoring throughout its implementation. The study revealed that one of the primary challenges needing attention is the inadequacy of existing technological resources and systems. This issue is particularly significant due to the substantial impact anticipated from both legacy and active insurance contracts during the transition to the new accounting standard. Additionally, the study recommended that insurance companies invest in staff training to enhance employees' proficiency in applying IFRS 17.

2.4.4 Conclusion

This section begins by outlining the expected impacted impact of IFRS 17 adoption and its challenges. The adoption of IFRS 17 enhances comparability in financial reporting by ensuring that insurance contracts are accounted for consistently across jurisdictions and among different entities. These standard mandates a consistent approach to measuring insurance contracts, enabling comparability across companies internationally. Additionally, multinational corporations benefit from internal

consistency, as IFRS 17 requires them to apply the same measurement principles across all subsidiaries. This facilitates more meaningful comparisons of financial results across products and geographical regions, improving transparency and decision-making. Key findings from various studies support this view because they have suggested that IFRS 17 will likely lead to better financial reporting quality by standardising accounting practices. However, the expected improvements will only be reflected over time. Research highlights that while IFRS 17 mandates more consistent reporting standards, its implementation presents substantial challenges, particularly in terms of technology, data management and staff training.

2.5 Hypotheses development

According to Actuaries.org (2019), the introduction of CSM under IFRS 17 leads to a levelling effect on the earnings of the insurance business, because it aligns the release of earnings over time with the coverage period. This practice means that profits are initially recorded as zero when the insurance contract begins and then recognised over time. As Grant Thornton (2020) notes, this deferred recognition of profits may lead to reduced profitability, especially in regions in which profits from long-term insurance products are currently recognised upfront under IFRS 4. IFRS 17 changes this process by deferring these profits and recognising them over the coverage duration, leading to a substantial change in profit trends.

The adoption of IFRS 17 is not expected to change the overall level of profit or loss booked throughout the course of the insurance contracts. Instead, the pattern of recognition and the distribution of profitability among the various components of the Income Statement will likely change (Koskipalo, 2022). According to the IASB (2017), insurance revenue for short-term insurance contracts will not differ greatly from earned premiums currently presented under IFRS 4. However, for long-term insurance contracts, analysts anticipate that insurance revenue will differ significantly from the earned premiums reported under IFRS 4.

The above findings are consistent with those presented in the study by Chan et al. (2021), that examined the effects of IFRS 17 on the governance and regulation of life insurance companies in Taiwan. Using a mix of quantitative simulations and interviews, the researchers found that IFRS 17 would lead to greater volatility in profits

and losses, overall increased losses, increased solvency risk and an increase in liabilities for these companies.

Based on the above literature, the following hypotheses have been formulated to address the research questions stated in Section 1.3 above:

1. **In addressing Research Question 1:**

H1: The adoption of IFRS 17 has led to a significant decline in the financial performance ratios of companies licensed to provide insurance services in South Africa.

This hypothesis tests the impact of IFRS 17 on key financial performance ratios, assessing whether the adoption has statistically significant effects on these ratios among insurance providers in South Africa.

2. **In addressing Research Question 2:**

H2: The adoption of IFRS 17 has resulted in a significant decrease in the total reported equity balance among companies that provide insurance services in South Africa.

H3: The adoption of IFRS 17 has resulted in a significant increase in the total reported liabilities for companies offering insurance services in South Africa.

H4: The adoption of IFRS 17 has led to a significant decrease in the total reported asset balances in companies providing insurance services in South Africa.

These three hypotheses investigate the impact of IFRS 17 adoption on the statement of financial position of insurance service providers, particularly focusing on equity, total assets and total liabilities.

3. **In addressing Research Question 3:**

H5: The adoption of IFRS 17 has resulted in a significant increase in the total reported insurance liabilities for companies offering insurance services in South Africa.

This hypothesis directly addresses the impact of IFRS 17 on reported insurance liabilities, evaluating the changes in measurement and assumptions under the new IFRS accounting standard.

2.6 Insurance contracts accounting

2.6.1 IFRS 17 overview and comparison to IFRS 4

According to the IASB (2022), “IFRS 17 is applicable for the annual financial reporting periods starting from 1 January 2023”. However, entities that already apply IFRS 9 and IFRS 15 can opt to adopt IFRS 17 earlier. The next section will cover the initial recognition and measurement models under IFRS 17, including a high-level comparison with IFRS 4 accounting requirements.

The IFRS 17 accounting standard features three distinct measurement models. The General Measurement Model (GMM) also known as the "building block approach," is the primary framework suitable for most insurance contracts. As the model most insurance companies are expected to use (Dufrasne, 2020), this literature review focuses on its practical implementation to address the research questions stated in Section 1.3 above. The other two models are the Variable Fee Approach (VFA) and the Premium Allocation Approach (PPA), that are variations of the GMM. They apply only in specific scenarios to simplify insurance contract measurement (Dufrasne, 2020).

General Measurement Model

According to Grant Thornton (2020), the GMM requires companies to calculate insurance liabilities using projected future cash flows that are discounted and adjusted for financial risks. Additionally, companies must also include an additional adjustment for non-financial risks. Lastly, a CSM adjustment must be considered to reflect the unearned profit from the insurance contracts. Grant Thornton (2020) states that the CSM can only be a value of zero or a positive value. If the calculated CSM is negative, this situation leads to recognising an expense when the insurance contract is first recognised. One key change IFRS 17 introduces, compared to IFRS 4, is that companies can only recognise profits from insurance contracts after fulfilling their performance obligation (Rajala, 2020).

This study sought to investigate the adoption of IFRS 17 and its impact on the financial performance and financial position of South African insurance service providers. Therefore, it was important for the researcher to have a thorough understanding of

how insurance contracts are accounted for under IFRS 17 and IFRS 4 basis, as differences in these methodologies affect financial performance ratios and the financial position. Section 2.6.2 below provides a detailed discussion of these accounting methodologies and highlights their key differences.

2.6.2 IFRS 4 and IFRS 17 accounting comparison

2.6.2.1 Initial recognition

IFRS 4

The IFRS 4 accounting standard does not mandate specific accounting requirements for the initial recognition of insurance contracts. This practice allowed insurance companies to continue using their own methodologies that were established before IFRS 4 came into effect on 1 January 2005 (Dufrasne, 2020). Under IFRS 4, most insurance companies do not discount the value of their future insurance claim payments or premium inflows to present value (IFRS Foundation, 2017). This practice occurs because the IFRS 4 accounting standard does not specifically require cashflows to be discounted despite the IASB's view that the application of discounting to insurance liabilities improves the relevance and reliability of financial statements (IFRS Foundation, 2017). The IASB decided not to require discounting in the initial IFRS 4 phase, stating that this requirement is impractical due to the deferred discussion on discount rates and risk adjustments, that were later addressed in IFRS 17 (IASB, 2004). Nonetheless, IFRS 4 prevents insurance companies from switching from an accounting policy that takes discounting into account to one that does not (IASB, 2004).

IFRS 17

IFRS 17 provides detailed guidelines for the initial recording of insurance contracts. This accounting standard states that an insurer can only recognise an insurance contract for the first time on the date the premium is due, when the risk starts transferring, or when the contracts become onerous. This provision ensures that the recognition of insurance contracts aligns with the actual timing of risk assumption and the financial obligations contained in the contracts (IASB, 2022; PWC, 2017a). Furthermore, the accounting standard allows management to recognise a liability, or

an asset associated with the acquisition costs incurred in securing the contract. These costs are to be unwound systematically over the coverage period as the risk expires (Grant Thornton, 2017). Alternatively, entities can directly charge these costs to the Income Statement as expenses upon incurrence. This provision affords entities flexibility in managing the financial reporting of acquisition costs, aligning with the principle of matching costs with related revenues over the period of benefit (Grant Thornton, 2017).

Unlike IFRS 4, IFRS 17 introduces a new requirement for aggregation of insurance contracts at inception. Under this accounting standard, entities must aggregate insurance contracts into portfolios that share similar risks and that they manage together (IASB, 2017). However, IFRS 17 does not define "similar risks" or "managed together", and management can use their judgement in these determinations. This management discretion could result in differences in the accounting of similar contracts across different insurance companies (PWC, 2017a). However, this risk is reduced because the accounting standard requires a consistent application of the definitions of similar risks and their management together, ensuring a level of consistency across reporting periods (PWC, 2017a).

The differences in initial recognition accounting treatment between IFRS 17 and IFRS 4 are illustrated in Example 1 below.

Example 1: Difference in initial recognition between IFRS 4 and IFRS 17

Assume entity X entered an insurance contract with a coverage period of 5 years. At the beginning of the contract, the company incurred one-time acquisition costs of R10 000. The policy will generate a premium fee of R100 000 payable in full upfront after initial recognition. Assume a pre-tax discount rate of 6% per annum and a non-financial risk adjustment of R5 000. The insurance contract includes a claim limit of R100 000 per year. The entity expects to incur a once-off claim amount at the end of year five amounting to R70 000. Applying the pre-tax discount rate of 6% per annum, the present value of the expected future claims payable is determined to be R52 308.07. Therefore, the total expected future cash outflow at inception of the contract is R62 308.07 (R 52 308.07 + R10 000).

All amounts are in South African Rands (ZAR)	IFRS 4	IFRS 17
Present value of future cash inflow	100 000	100 000
Acquisition costs	(10 000)	
Present value of future cash outflow	0	(62 308.07)
Present value of net future cashflow	0	37 691.93
Unearned premium reserve	(100 000)	
Deferred acquisition reserve	10 000	
PV of risk adjustment	0	(5 000)
Fulfilment cash flows	0	32 691.93
Contractual service margin	0	(32 691.93)
Insurance contract liability on initial recognition	90 000	0

Source: Author, 2024

Table 2: IFRS 17 vs IFRS 4 initial recognition application

As illustrated in Example 1 above, the initial recognition of insurance contracts under IFRS 4 differs from that under IFRS 17. Under IFRS 4, companies typically recognise the R100 000 premium as revenue over the coverage period, based on the earnings pattern of the insurance contract. The full premium is first recognised as a liability, then as revenue over the five-year term. IFRS 4 also allows companies to defer and amortise acquisition costs directly related to securing an insurance contract over the period the related premiums are earned. In this case, companies defer and amortise the R10 000 upfront acquisition costs over the five-year coverage period as they earn the premium. Unlike IFRS 17, IFRS 4 does not require a risk adjustment (IASB, 2017). However, insurers may include a risk margin or adjustment in their liability adequacy testing or when determining additional liabilities if they believe the unearned premium reserve and deferred acquisition costs do not provide sufficient coverage for future claims and expenses (IASB, 2004). Another key difference is that IFRS 4 does not require companies to present value their future cash flows, so no discounting is applied in the calculation.

With the transition to IFRS 17, the accounting treatment of example 1 above undergoes a major change, introducing new concepts such as the CSM and risk adjustments (IASB, 2017). The calculation of the CSM involves subtracting acquisition costs, the risk adjustment and the present value of claims from the premium received (IASB, 2017). The CSM, similar to IFRS 4's unearned premium reserve, represents future profits that the company has not yet earned and will recognise over the five-year term of the contract, ensuring no profits are recorded upfront. Unlike IFRS 4,

IFRS 17 requires a risk adjustment and the discounting of estimated future cash flows, a practice that means all future cash flows under IFRS 17 must be present valued (IASB, 2017). This requirement marks a substantial change in the accounting of insurance contracts. Under IFRS 17, no liability for insurance contracts is recorded at initial recognition, whereas IFRS 4 records an insurance contract liability of R90 000. The calculated present value of the expected fulfilment cash flows amounts to R32 691.93. The incorporation of the CSM concept delays the recognition of profits or liabilities at the initial recognition stage until subsequent periods, ensuring such financial profits are realised over the policy duration (Deloitte, 2020).

IFRS 17 also introduces the concept of onerous contract accounting. Onerous contracts are those insurance contracts that are expected, at their inception, to result in a negative underwriting outcome for the insurers (IASB, 2017). In making this determination, insurance companies must consider internal information, including the expected effects of changes in assumptions (Grant Thornton, 2017; IASB, 2017b, 2022; KPMG, 2020). The onerous contract accounting concept highlights the importance of IFRS 17 in providing a transparent framework for insurance contract accounting whereby loss-making contracts are accounted for and disclosed upfront (Grant Thornton, 2017).

The illustrative example for the calculation of the onerous insurance contract is included in **Appendix A**.

2.6.3 Measurement

2.6.3.1 Subsequent measurement

IFRS 17

The IFRS 17 accounting standard introduces a unique concept, known as the CSM which must be recorded at the inception of insurance contracts that are modelled to result in a positive profit margin (IASB, 2017a). The CSM represents the expected future profits that are expected to be received from an insurance contract. As the insurer satisfies its performance obligation related to the insurance contract, it earns this future profit, measured in coverage units (EY, 2018). The IASB (2017a) defines the coverage units as the total number of benefits that the insured receives from the

insurance contract over the coverage period. The IASB defines a benefit under an insurance contract to be the risk protection that the insured enjoys over the period of the insurance coverage and not a once-off event such as the settlement of a claim when a loss occurs (IASB 2017b). Therefore, the accounting standard requires that the entity release the CSM recognised at initial recognition into profits in a manner that reflects how the insured enjoys risk protection, and the total volume of benefits provided by the insurance contract. The IASB further specifies that companies should not consider the pattern of fulfilment cash flows in the allocation of CSM to profits (EY, 2021; IASB, 2017b).

The release of the CSM into profits requires an equal allocation of the determined total coverage units between the current period and future coverage periods (IASB 2017b). However, IFRS 17 does not explicitly state whether entities should apply discounting when making this allocation or consider the timing of providing insurance services. The IASB concluded that each entity should exercise its discretion and judgement regarding these considerations (EY, 2021; IASB, 2017b).

An illustrative example for the calculation of the coverage units is provided in **Appendix B**.

Another new feature introduced by IFRS 17 is the requirement to discount the fulfilment cash flows to consider the time value of money, as well as the inclusion of a non-financial risk adjustment (IASB, 2017b). This discounting requirement extends to the CSM determined at initial recognition of the contract with no allowance for changes to the discount rate established at that point, as specified by the accounting standard (EY, 2018, 2021; IASB, 2017b). For illustrative purposes, it is necessary to consider the same facts as provided in Example 1 above, that assumes a discount rate of 6% per annum at contract inception. The initial recognition CSM is determined to be R32 691.93, and the insurance interest expense accrued in year one is calculated at R1 961.52 (R32 691.93 * 6%), and this amount will reflect as an Income Statement expense for the year. In the subsequent financial year, interest expense is calculated based on the opening balance of the CSM. Thus, the interest expense for year 2 is R1 386.14 (R23 102.30 * 6%).

The initial CSM is allocated into profits based on the risk protection provided to the insured in the current period. To determine the amount allocated to profit, the entity must consider both the CSM recognised at contract inception and any accrued interest for the year. This total is then distributed equally among the total coverage units available at the start of the year and the total future expected coverage units. For example, to illustrate this process, insurance companies calculate the CSM allocated to the Income Statement for year 1 at R11 551.15, using the formula (R32 691.93 + 1 961.52) * 500 000 / 1 500 000. Similarly, the CSM allocated to the Income Statement for year 2 is at R9 795.37, using the formula (R23 102.3 + 1 386.14) * 400 000 / 1000 000). Table 3 below outlines the allocation of the CSM to the Income Statement.

Reconciliation of CSM	Year 1	Year 2	Year 3	Year 4	Year 5
Opening	0	(23,102.30)	(14,693.06)	(7,787.32)	(2,751.52)
New business	(32,691.93)	0	0	0	0
Insurance finance expense	(1,961.52)	(1,386.14)	(881.58)	(467.24)	(165.09)
Current services release	11,551.15	9,795.37	7,787.32	5,503.04	2,916.61
Closing	(23,102.30)	(14,693.06)	(7,787.32)	(2,751.52)	-
Note: All amounts are in South African Rands (ZAR)					

Source: Author, 2024

Table 3: Allocation of the CSM to Income Statement

In addition to accounting for discounting and adjusting for financial risks, IFRS 17 requires insurance companies to make an additional adjustment to account for non-financial risks linked to the insurance contract (IASB, 2017). This adjustment accounts for uncertainty and timing risks, such as the insured failing to pay premiums. Under IFRS 17, insurance companies cannot adjust for non-financial risks when discounting cash flows, so they must measure this adjustment separately (IASB, 2017).

The IFRS 17 does not specify how to calculate the risk adjustment value, so similar contracts across different companies may have different values, reducing the comparability of financial performance across similar contracts (Deloitte, 2020). Over

time, as the entity fulfils its insurance obligation, the non-financial risk decreases due to reduced risk exposure. This reduction may also occur because the entity has received some premiums, reducing the variability and timing of cash flow risks (Deloitte, 2020; EY, 2021).

An illustrative example of allocating the risk adjustment to the Income Statement is included in **Appendix C.**

IFRS 17 has also introduced new accounting guidelines for insurance contracts' acquisition costs (IASB, 2017a). Companies must first differentiate between attributable and non-attributable acquisition costs. Non-attributable costs, such as marketing expenses, must be expensed directly to the Income Statement as they occur (IASB, 2017a). However, insurance companies have an option to defer attributable acquisition costs and factor them into the CSM calculation at contract inception. They are subsequently released to the Income Statement as the recovery of insurance acquisition cashflow under the insurance service revenue line (IASB, 2017a). The coverage units provided during the financial year determine the release of these deferred acquisition costs to the Income Statement. This treatment is similar to IFRS 4 accounting requirements whereby many insurers classify acquisition costs as assets and allocate them gradually in the Income Statement based on the earnings pattern of the insurance contract, typically during the coverage period (PWC, 2017b).

An illustrative example of allocating acquisition costs to the Income Statement is included in **Appendix D.**

Table 4 below presents a five-year summarised view of the Income Statement line items from illustrative Example 1 above. In year 1, the total insurance service revenue amounts to R17 595, comprising the release of CSM totalling R11 551, the release of the risk adjustment totalling R1 767, and the recovery of acquisition costs totalling R4 277. Under IFRS 17, all expected claims and expenses must be included in the insurance service revenue line, while actual claims and expenses are recorded under the claims incurred line. Any variance between expected and actual claims and expenses are immediately recognised and expensed.

The present value column shows that the total insurance service revenue over the five-year period, when discounted at 6% per annum, equals the R100 000 premium

paid upfront on the contract. The present value of insurance service expenses over the five-year period equals R62 308, matching the present value of expected cash outflows calculated at contract inception. This calculation results in a net insurance income, that when discounted, amounts to R37 692, matching the value of the expected fulfilment cash flows calculated at the contract inception.

Statement of profit or loss	Year 1	Year 2	Year 3	Year 4	Year 5		Present Value
Release of CSM	11,551	9,795	7,787	5,503	2,917		32,692
Release of risk adjustment	1,767	1,498	1,191	842	446		5,000
Expected claims	-	-	-	-	70,000		52,308
Recovery of acquisition cash flows	4,277	3,204	2,160	1,213	454		10,000
Insurance service revenue	17,595	14,497	11,138	7,558	73,817		100,000
Claims incurred	-	-	-	-	(70,000)		(52,308)
Amortisation of acquisition cash flows	(4,277)	(3,204)	(2,160)	(1,213)	(454)		(10,000)
Insurance service expense	(4,277)	(3,204)	(2,160)	(1,213)	(70,454)		(62,308)
Net insurance income	13,318	11,294	8,978	6,345	3,363		37,692
Other expense							
Insurance financial expense	(877)	(1,729)	(2,510)	(3,199)	(3,772)		(9,826)
Profit or Loss	12,441	9,565	6,468	3,145	(409)		27,866
Note: All amounts are in South African Rands (ZAR)							

Source: Author, 2024

Table 4: Five-year Income Statement - IFRS 17

IFRS 4

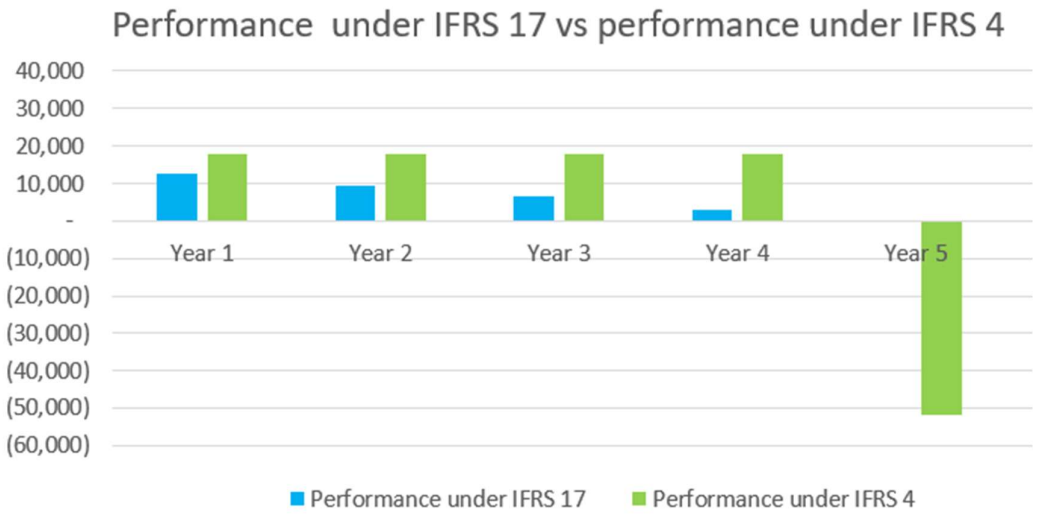
Table 5 below provides a summary of the Income Statement for the insurance contract under IFRS 4 basis over the five-year period. The accounting treatment for the insurance contract in example 1 above is relatively simple under IFRS 4. The R100 000 premium is earned evenly over the five-year coverage period, resulting in an annual earned premium of R20 000. Additionally, the company expenses the

deferred acquisition costs in profit or loss over the same five-year period, with an annual expense of R2 000. This approach results in a profit of R18 000 for each of the first four years and a loss of R52 000 in year 5.

Statement of Profit or Loss	Year 1	Year 2	Year 3	Year 4	Year 5
Earned premium	20,000	20,000	20,000	20,000	20,000
DAC incurred	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Claims incurred	-	-	-	-	(70,000)
Profit/ (Loss)	18,000	18,000	18,000	18,000	(52,000)
Note: All amounts are in South African Rands (ZAR)					

Source: Author, 2024

Table 5: Five-year Income Statement – IFRS 4



Source: Author, 2024

Figure 2: IFRS 17 vs IFRS 4 financial performance comparison

Figure 2 above presents a comparison of the financial performance under IFRS 4 preparation basis and under IFRS 17 basis. Under IFRS 4, the company's financial results show a stable profit of R18 000 for the first four years, followed by a large loss of R52 000 in the fifth year. This pattern suggests that the company is postponing the recognition of losses until the fifth year, despite expecting them at contract inception. The stable profits in the first four years may create a misleading impression of financial

stability, concealing underlying risks or liabilities. The large loss in the fifth year could damage stakeholder confidence, given the high profits reported earlier. In contrast, IFRS 17 shows a gradual decline in profits over the first four years, from R12 441 in year one to R3 145 in year four, followed by a loss of R409 in year five. This trend indicates that IFRS 17 may lead to a more prudent approach to profit recognition, reducing volatility over time and resulting in financial statements that better reflect the company's ongoing performance and risks. The difference in cumulative income statements results over the five-year period is due to the application of discounting under IFRS 17. However, as highlighted in the literature, the actual cash flows remain unchanged. Therefore, the underlying profitability of the insurance contract from a cash flow perspective stays the same.

2.6.3.2 Transition approach to IFRS 17

When transitioning to IFRS 17, insurance companies can choose to adopt the full retrospective approach (IASB, 2017b). This approach involves derecognising all existing insurance contract balances calculated under IFRS 4 and determining new opening balances for active insurance contracts, assuming they had applied IFRS 17 from the inception of these contracts. The difference between the derecognised net assets or liabilities and the newly recorded balances is adjusted through equity (IASB, 2017b).

To facilitate a seamless transition to IFRS 17, the accounting standard offers two alternative approaches to the full retrospective approach: the modified retrospective approach and the fair value approach (IASB, 2017a). In making this decision, the IASB recognised that some companies may not have the necessary historical data to make a full retrospective adjustment or that it might be impractical due to limited resources (PWC, 2017b). In such cases, insurance companies can opt for the modified retrospective approach, that allows them to adjust the opening balances of active insurance contracts from the transition date, considering the cumulative effect of initially applying IFRS 17. Alternatively, if the insurance contracts' fair values are more relevant than the IFRS 17 model, entities can measure them at fair value at the transition date, provided it is possible without undue cost or effort (IASB, 2017b; PWC, 2017b).

2.7 Conclusion

This chapter began with an overview of the South African insurance industry, revealing that a few large companies dominate the market. It is essential to understand this concentration of ownership, because it affects the target population under consideration. These large companies own many smaller insurance companies that are separately licensed by the FSCA, resulting in their consolidation within the larger entities. As a result, these smaller companies will not be analysed separately but are included in the broader analysis. This practice is due to the financial statements of these smaller companies not being published.

The key financial performance ratios for South African insurance service providers were examined. Research shows that the ratios listed in Table 1 above are the primary metrics used by financial statement users to assess the financial performance of insurance service providers. This study aims to summarise the actual impact of transitioning to IFRS 17 on the income statement of South African insurance service providers, using the selected ratios outlined in Table 1 above.

This chapter also reviewed the existing literature on the practical application of IFRS 17. Due to the complexity of the application of the IFRS 17 accounting standard, this chapter provided detailed illustrative examples aimed at simplifying the requirements of IFRS 17 for accounting for insurance contracts. The examples discussed showed that the transition to IFRS 17 will initially result in a decline in profits for insurance companies, but this is expected to smooth out over time and profits are anticipated to be less volatile under IFRS 17 compared to IFRS 4.

Finally, this chapter investigated the anticipated impact of IFRS 17 adoption based on available literature. Most available literature on IFRS 17 focuses on its expected effects on the quality of financial reporting and the challenges associated with implementing the accounting standard. Due to more stringent disclosure requirements under IFRS 17, the adoption of this accounting standard is anticipated to enhance the quality and comparability of financial reporting. The next chapter will outline the methodology followed to design, collect and test the data in relation to the study's objectives.

Chapter 3: Methodology

3.1 Introduction

The objective of this research paper was to investigate the impact of IFRS 17 adoption on financial performance and the statement of the financial position of South African insurance service providers. To achieve this objective, it employed a quantitative approach that involved collecting and analysing financial information obtained from the annual financial statements of selected companies. The target population included insurance companies and banks listed on the Johannesburg Stock Exchange (JSE), as well as private insurance service providers that have audited and published financial statements. The following sections provide a detailed explanation of the basis used to select the companies included in this research paper.

3.2 Target population and research design

This research used the target population approach to identify South African companies to which the research questions were applicable. A target population is defined by specific characteristics relevant to the research questions, such as age, gender and geographic location (Mugenda & Mugenda, 2003; Sekaran & Bougie, 2016). In the context of this study, the target population consists of all South African insurance service providers licensed by the FSCA to offer insurance contracts, that are affected by the IFRS 17 mandatory adoption requirement. This study specifically targeted licensed companies that offer insurance contracts and have their financial statements published because the researcher needed to study these published financial statements.

The sampling approach is applicable in contexts in which it is impractical, time-consuming or costly to study an entire population. Instead of collecting data from every individual in the target population, researchers select a subset that is representative of the population (Kimani, 2023). This practice allows the analysis of data that can be generalised to the entire population with a reasonable degree of accuracy (Kimani, 2023). Since there are a limited number of JSE-listed companies licensed to offer insurance contracts and affected by IFRS 17, the researcher found it practical to collect financial information from all impacted JSE-listed companies and non-listed

companies that publish their financial statements. Therefore, sampling was not conducted for this study.

Some insurance service providers licensed by the FSCA are private companies that do not disclose their financial statements, so these were excluded from the target population. The final selected target population is representative of the South African licensed insurance providers, because many of the excluded private companies are subsidiaries of the selected JSE-listed companies. These JSE-listed parent companies publish their financial statements, that include data relevant to their subsidiaries that do not publicly issue separate financial statements.

Since companies must adopt IFRS 17 for the financial years starting on or after 01 January 2023, there is limited existing knowledge and prior studies that statistically measure the actual impact of the change to IFRS 17 in South Africa (IASB, 2017a). Therefore, this study employed a quantitative research approach with a repeated measures design and analysed the data using non-parametric statistical analysis to help decrease this gap in current literature.

3.3 Data collection procedures

The total target population of this study included all South Africa insurance service providers that are licensed and listed as licensed by the FSCA on their public website. As the FSCA regulates all financial institutions in accordance with the Financial Sector Regulation Act 9 of 2017, every insurance service provider operating in South Africa must be registered and licensed by the FSCA (FSCA, 2023). Therefore, the FSCA's list of licensed insurance providers is considered valid, reliable and complete.

Insurance companies with financial years starting from 01 January 2023 had to present their financial results on the IFRS 17 basis for the first time during the 2023 interim and year-end annual results reporting periods. Comparative financial information for the preceding financial year under IFRS 4 will be presented with restated comparative information prepared under IFRS 17 (Old Mutual, 2022; Santam Limited, 2023). This study used these comparative disclosures to analyse the impact of IFRS 17 adoption and answer the research questions outlined in Section 1.3 above.

This analysis was based on data from the selected companies' annual financial reports and integrated reports, if available. If not obtainable, the researcher used their interim financial statements instead. The inclusion of interim and annual reports in the analysis is supported by the findings of Oberholster et al. (2017), who investigated the value relevance of interim and annual financial statements. Their study revealed that the book value of equity from interim financial reports is value relevant, whereas interim earnings are not. However, by comparison, the earnings reported in annual financial statements were found to be value relevant. Although interim earnings were found not to be value relevant, they offer timely and consistent insights that support forecasting and reduce information asymmetry (Givoly & Palmon, 1982). Interim reports are therefore widely accepted in research when annual data is unavailable, as they follow IAS 34 and reflect current firm performance (Krishnan & Booker, 2002). Therefore, both these reports are value relevant, useful to the users of financial statements and were therefore considered appropriate to include in the study's analysis. To enhance the data's credibility, only FCSA-licensed providers are included in the final target population. According to the Financial Advisory and Intermediary Services Act 37 of 2002, "all insurance service providers licensed by the FCSA must maintain comprehensive and accurate accounting records. Furthermore, these entities must undergo an independent audit of their financial statements, and they must submit the audit results to the registrar no later than four months following the conclusion of the entity's fiscal year" (FSCA, 2023).

The study's final target population also included non-listed insurance service providers licensed by the FSCA that publicly issue their interim or annual financial statements. This approach takes cognizance of the dynamics within the South African insurance sector that is dominated by a few major entities, as discussed in Section 2.1 above. The inclusion of smaller and unlisted companies ensured that the study's outcomes reflect the entire South African insurance service market's demographic, covering the full spectrum from large to smaller companies. This inclusivity is crucial since the adoption of the IFRS 17 accounting standard affects all companies offering insurance services, requiring a comprehensive analysis that accounts for the varied impacts across different company sizes and types.

The selected insurance entities provide their financial statements on their official websites, that relate to the financial year preceding (prepared in accordance with IFRS 4) and the most recent financial year (prepared in accordance with IFRS 17). The researcher extracted the necessary financial information from these statements to calculate the financial performance ratios separately according to the formulas outlined in Table 1 above.

3.4 Data collection checks

The dataset was reviewed for errors, such as missing values, duplicates or outliers, and appropriate corrective measures, such as median imputation, were applied. Additionally, the collected data was cross verified for completeness, consistency and accuracy, through comparison with original financial report sources. Lastly, a detailed record of all data collected was maintained on a cloud-backed OneDrive server to ensure the transparency and reproducibility of the study.

3.5 Normal distribution assessment

Normal distribution is a common tool in statistics and various fields such as finance, natural sciences, social sciences and engineering because many variables follow a normal distribution (Mugenda & Mugenda, 2003). Some of the most widely used methods for testing for a normal distribution include the statistical tests such as the Shapiro-Wilk test and Kolmogorov-Smirnov test (Mugenda & Mugenda, 2003). However, this study used a graphical method by plotting the data in a box plot, thus, allowing the researcher to visually assess whether the resulting box plot has the characteristics of a normal distribution. The analysis revealed that the dataset has outliers, the median line is not at the centre of the box and the whiskers are not symmetric, indicating that the dataset is not normally distributed.

Due to the non-normal distribution of the dataset, the researcher performed the analysis using the Wilcoxon signed rank test. The Wilcoxon signed-rank test is a non-parametric statistical method applied in place of the paired t-test when the data does not exhibit a normal distribution (Pallant, 2020). Furthermore, the pre and post IFRS 17 data were analysed using the median instead of the mean (Mishra et al., 2019). In the Wilcoxon signed-rank test, a significant difference is indicated when the p-value

(2-tailed) is less than 0.05. Otherwise, if the p-value (2-tailed) exceeds 0.05, researchers conclude that there is no significant difference (Widinata et al., 2024).

3.6 Conclusion

This chapter outlined the process for identifying the target population relevant to this research study. The IFRS 17 accounting standard determines the scope of transactions it covers, so only companies affected by this accounting standard and included within its scope are part of the final population. Additionally, the chapter outlined the data collection procedures that the researcher used to ensure the validity and reliability of the data, as well as the specific ratios calculated, and the methods used for the calculation. Finally, the chapter summarised the diagnostic test that the researcher performed to check the normality of the dataset, and based on the results, their use a non-parametric test.

Chapter 4: Data analysis, findings and discussion

4.1 Introduction

This chapter presents a summary of the results of the data analysis and answers the research questions outlined in Section 1.3 above. The main goal of this study was to assess how adopting IFRS 17 affects the financial performance and financial position of South African insurance service providers. Table 6 below presents the total list of companies that were selected and included in this study. The target population included all companies listed on the JSE and licensed by the FSCA to offer insurance services, except for Clientele Limited. The researcher excluded Clientele Limited due to the unavailability of its financial information, since the company had not published its June 2024 financial results at the time of data collection and analysis and the available interim results were unaudited. Furthermore, the target population included PPS and Assupol as the only unlisted companies, due to the lack of available data from other privately-owned companies licensed to offer insurance services in South Africa.

Company Name	Status	Sector
Santam Limited	Public: JSE Listed	Insurance sector
Sanlam Limited	Public: JSE Listed	Insurance sector
Old Mutual Limited	Public: JSE Listed	Insurance sector
PSG Limited	Public: JSE Listed	Insurance sector
Standard Bank Limited	Public: JSE Listed	Banking sector
Absa Bank Limited	Public: JSE Listed	Banking sector
Capitec Bank Limited	Public: JSE Listed	Banking sector
PPS	Private: Financials Statement published	Insurance sector
Momentum Holdings	Public: JSE Listed	Insurance sector
OUTsurance Group	Public: JSE Listed	Insurance sector
Discovery Limited	Public: JSE Listed	Insurance sector
Assupol Holdings Limited	Private: Financials Statement published	Insurance sector

Table 6: Companies included in the target population

4.2 Data analysis, findings and results

4.2.1 Descriptive Statistics

The transition to IFRS 17 resulted in a change in the financial performance ratios of companies included in the target population as presented in Table 6 above. The researcher tested the change in these performance ratios for statistical significance using the Wilcoxon signed rank test as outlined in Section 3.3 above. Table 7 below presents the descriptive results of the analytics performed and a discussion of these results in presented in Section 4.2.2 below.

In a quantitative study, testing data for normality is important because misjudging the normality of a dataset can result in an incorrect interpretation of the results. For instance, using the mean to interpret a dataset that is not normally distributed can lead to conclusions that do not accurately reflect the population (Mishra et al., 2019). To confirm the results of the graphical box plot (see Chapter 3 above) the normality of the data was re-tested using the comparison of the mean and median. As Batanero et al. (2004) state, in a normally distributed dataset, the mean and median are usually very close. However, as Table 7 below shows, the mean and median in this dataset are far apart, supporting the box plot conclusion that data is not normally distributed. The skewness of normally distributed dataset should be approximately zero (Kurambwi, 2018). According to Byrne (2010), a dataset is considered normally distributed if its skewness values fall between -2 and 2. Since some of the skewness values in the dataset exceed this threshold, it indicates that the dataset is not normally distributed.

Financial ratio	Pre IFRS 17			Post IFRS 17		
	Skewness	Mean	Median	Skewness	Mean	Median
Deb-Asset Ratio	1.8029	0.1871	0.0510	1.8184	0.1864	0.0492
Debt-Equity Ratio	11.2232	6.7157	0.2957	2.7189	1.4904	0.3190
Times Interest Earned	2.8325	20.2717	10.2705	1.8003	28.3559	12.6491
Current Ratio	1.1736	1.2768	1.0988	0.5867	1.3472	1.0283
EBITDA Margin	0.2157	0.1632	0.1567	0.1424	0.1725	0.1634
EBIT Margin	0.0278	0.1474	0.1429	0.1101	0.1557	0.1501
Net Profit Margin	0.1467	0.1032	0.1108	0.1099	0.1117	0.1145
Return on Assets	1.2281	0.0358	0.0163	1.1926	0.0408	0.0205
Return on Equity	-2.4019	0.1408	0.1591	0.1616	0.1738	0.1580
Asset Turnover	1.8149	0.2715	0.1881	1.6642	0.3126	0.1869
Commission Ratio	0.3012	0.1623	0.1488	-0.1550	0.1604	0.1512
Claims Ratio	-0.4107	0.6267	0.6085	0.5921	0.6667	0.6592
Combined Ratio	-1.5849	0.7889	0.8535	-2.1946	0.8271	0.8572

Source: Authors, calculated using STATA software

Table 7: Results of the descriptive statistics Pre and Post IFRS 17

4.2.1.1 Financial performance ratios

The analysis of the commission ratio, claims ratio and combined ratio before and after the adoption of IFRS 17, revealed that the adoption of this accounting standard results in changes to these financial performance ratios. The median value for the commission ratio prior to IFRS 17 is 0.1488 but increases to 0.1512 post-IFRS 17. This change suggests that when commission expenses are ranked in ascending order, R14.88 represents the median commission amount per R100 of premium written under the IFRS 4 basis, whereas this median value increases to R15.12 after IFRS 17 is implemented.

The median value for the claim's ratio increases from 0.6085 pre-IFRS 17 to 0.6592 post-IFRS 17. This increase indicates that, in an ordered distribution, R60.85 would be the median claims amount per R100 of premium written under IFRS 4 basis, with this figure increasing to R65.92 after the adoption of IFRS 17. Lastly, the combined ratio's median value increases from 0.8535 to 0.8572 after the implementation of IFRS 17. This increase implies that R85.35 would be the median amount per R100 of premium written pre-IFRS 17, that increases to R85.72 post-IFRS 17. These changes in median values suggest that the implementation of IFRS 17 leads to an increase in

the central tendency of commission, claims and combined ratios, indicating that the implementation of IFRS 17 may have resulted in increased losses or reduced profits.

The median ROA shows an increase following the implementation of IFRS 17, whereas the median ROE reflects a decrease in the median ratio. The pre-IFRS 17 EBITDA margin has a median of 0.1567 and the post-IFRS 17 EBITDA margin median increases to 0.1634. The pre IFRS 17 EBIT margin has a median of 0.1429 and the post-IFRS 17 median increases to 0.1501. The pre-IFRS 17 net profit margin median is 0.1108 and the post-IFRS 17 net profit margin increases to 0.1145 post-IFRS 17. These general upward movements in the median profitability ratios suggest that the IFRS 17 adoption leads to an increase in profitability for the companies analysed, contrasting with the increases observed in the commission, claims and combined ratios that increased losses.

4.2.2 Hypothesis testing and discussion of findings and results

	Financial Ratio	Median Pre-IFRS 17	Median Post IFRS 17	Median Absolute Change	Median Relative change	V.V	p-value
Insurance ratios	Commission ratio	0.1488	0.1512	0.0024	2%	21	0.306556
	Claims ratio	0.6085	0.6592	0.0507	8%	39	0.624835
	Combined ratio	0.8535	0.8572	0.0037	0.4%	37	0.755658
Leverage ratios	Debt ratio	0.0510	0.0492	-0.0018	-3%	39	0.624664
	Debt-equity ratio	0.2957	0.3190	0.0232	8%	21	0.306556
	Times interest earned	10.2705	12.6491	2.3787	23%	30	0.824098
Liquidity ratio	Current ratio	1.0988	1.0283	-0.0705	-6%	42	0.449804
Profitability ratios	EBITDA margin	0.1567	0.1634	0.0067	4%	29	0.755658
	EBIT margin	0.1429	0.1501	0.0072	5%	28	0.689084
	Net profit margin	0.1108	0.1145	0.0037	3%	28	0.689084
	Return on assets	0.0163	0.0205	0.0042	26%	40	0.563318
	Return on capital employed	0.1591	0.1580	-0.0012	-1%	21	0.306556
Asset management	Asset turnover	0.1881	0.1869	-0.0012	-1%	47	0.230024

Source: Authors, calculated using STATA software

Table 8: Impact of IFRS 17 adoption on financial performance ratios

H1: The adoption of IFRS 17 has led to a significant decline in the financial performance of companies licensed to provide insurance services in South Africa.

4.2.2.1 Financial performance based on insurance ratios

The results of this study indicated that the adoption of the IFRS 17 accounting standard leads to a 2% relative increase in the commission ratio median, increasing from 0.1488 to 0.1512. This increase partly results from the reclassification of binder fees, that the pre-IFRS 17 framework fully recognised and recorded as administrative costs. Under IFRS 17, however, companies must recognise and expense the portion of binder fees related to sales activities as commissions, contributing to the observed increase in the commission ratio (Santam Limited, 2023). IFRS 17 provides a clearer distinction between directly attributable and non-attributable costs, that results in the reallocation of certain expenses from administrative expenses to commission. Despite these changes, the increase in the commission ratio lacks statistical significance. The results of the Wilcoxon signed-rank test confirm this fact because the significance level of 0.3066 exceeds the 0.05 threshold.

The median claims ratio increases from 0.6085 before the implementation of IFRS 17 to 0.6592 afterwards. Among the 12 companies analysed for this study, the adoption of IFRS 17 led to an increase in the claims ratio for 8 companies. A key concept introduced by IFRS 17, as outlined in Section 2.6.2.1 above, is onerous accounting. This principle requires companies to immediately expense contracts that they expect will result in losses. The immediate recognition of these future expected losses contributes to an overall increase in reported claim losses and, thus, increases the claims ratio. In addition, IFRS 17 requires a remeasurement of expected fulfilment cashflows considering all available information. This remeasurement contributes to the increase in claims ratio but its impact is offset by the new requirement to discount claims (Discovery Limited, 2023; OUTsurance Group Limited, 2023).

The median combined ratio increases from 0.8535 under the IFRS 4 framework to 0.8572 after the implementation of IFRS 17. This growth represents a relative increase of 0.4%. In relative terms, this increase is smaller compared to the percentage increases observed in the claims and commission ratios. The combined ratio is expected to align with both the claims and commission ratios in most cases. However,

the box-and-whisker plot for the combined ratio indicated that a few outliers affected it, as confirmed in Figure 3 below, whereas no such outliers appeared for the claims and commission ratios. The Wilcoxon signed-rank test produced significance levels of 0.6249 for the claims ratio and 0.7557 for the combined ratio, both of which are above the threshold for statistical significance. These results indicated that the transition to IFRS 17 produced changes in these insurance performance ratios that lacked statistical significance.

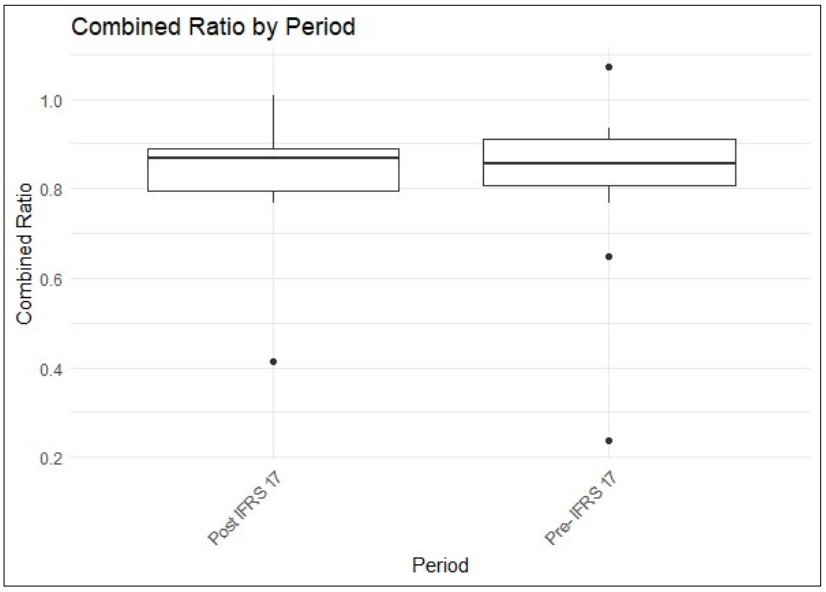


Figure 3. Combined ratio box and whisker results

4.2.2.2 Financial performance based on leverage ratios

The debt-asset ratio shows a 3.46% relative decrease when transitioning from the IFRS 4 basis to the IFRS 17 basis, decreasing from 0.0510 to 0.0492. However, the Wilcoxon signed-rank test shows a p-value of 0.6246, which indicates that this decrease lacks statistical significance. The median debt-to-equity ratio reveals a relative increase of 7.86%, increasing from 0.2957 to 0.3190 following the transition to IFRS 17. This increase in the debt-equity ratio is due to changes in equity balances of the analysed companies following the implementation of IFRS 17. This situation occurs because when companies first adopt the IFRS 17 accounting standard, they can adjust their equity balances to reflect the impact of the transition according to their chosen transition approach. Among the twelve companies analysed in this study, seven experienced a decrease in equity balance because of this transition. For

instance, Discovery (2023), disclosed a decrease in its leverage ratios, noting in its financial statements that this reduction is due to the inclusion of the CSM in the equity balance, which lowered the denominator of the debt-to-equity ratio. However, the results of the Wilcoxon signed-rank test, that yielded a value of 0.3065, exceed the 0.05 threshold, indicating that the transition to IFRS 17 has not led to a significant change in the leverage ratios. These findings contradicted the findings of Abdulraheem-Saheed (2022), who reported that leverage substantially influenced the income statements results of insurance companies in South Africa.

The median times interest earned ratio increased by 23.16% after the implementation of IFRS 17; however, this change lacks statistical significance ($p = 0.8240$). The increase in this ratio is due to the increase in net profits caused by the usage of lower risk margins under IFRS 17 and the better alignment of revenue recognition with the provision of coverage by the companies. By 'smoothing out' earnings, IFRS 17 leads to higher EBIT, thus, improving the ability of the companies to cover interest obligations. The increase in EBIT is further explained in Section 4.2.2.4 below.

The median debt-asset ratio showed a decrease following the transition to IFRS 17. In the context of the Pecking Order Theory, a decrease in the debt-asset ratio suggests that a company has chosen to finance its activities through own retained earnings rather than using external debt. According to this theory, companies prefer using retained earnings before using external debt and, as a last resort, issuing new equity (Frank & Goyal, 2007). Therefore, a lower debt-asset ratio suggests that the firm has sufficient retained earnings to meet its financing needs, reducing the reliance on external debt. Times Interest Earned ratio assesses a firm's capacity to fulfil its finance costs obligations, calculated as net income divided by finance costs. An increase in this ratio suggests that the company's earnings have grown relative to its interest obligations, meaning that the company is in a better position to cover its interest expenses. The movement in this ratio supports the conclusion that the companies have reduced their reliance on external debt and, as a result, are able to better manage their interest payments. In addition, the increase in earnings discussed in Section 4.2.2.4 below contributes to the entity being better able to manage these interest payments. The study used cross sectional data analysis captured at a point in time, limiting the ability to observe trends and changes in behaviour over time and therefore,

the changes in these ratios are attributed to accounting adjustments rather than the company's strategic decisions. Furthermore, the statistical insignificance of these changes further suggests that the findings do not provide conclusive evidence of substantive shifts in the financial behaviours of the reporting entities.

In contrast, the debt-equity ratio has increased. An increase in this ratio suggests that the company's internal resources may not be enough to meet its financing needs and, therefore, the company has resorted to external debt as the next preferred option. This is consistent with the Pecking Order Theory's preference for debt over issuing new equity. As the companies have observed an increase in total earnings due to IFRS 17 adoption, taking on more debt relative to equity is viewed to indicate that management believes that it can leverage debt effectively for further earnings growth and are comfortable to do this due to the company's ability to better manage interest payments as discussed above. Based on the above, while there were observed movements in the capital structure of South African insurance service providers following the adoption of IFRS 17 that align with the Pecking Order Theory, these observed movements were not statistically significant. Therefore, the results should be interpreted with caution and do not provide conclusive support for the theory.

4.2.2.3 Financial performance based on liquidity ratio

Following the transition to IFRS 17, the median liquidity ratio decreases from 1.0988 to 1.028, reflecting a relative decrease of 6.4% in the liquidity position of the companies analysed. The Wilcoxon signed-rank test produced a result of 0.4498, that exceeds the 0.05 significance threshold. This result indicated that the transition to IFRS 17 does not have a statistically significant influence on liquidity ratios. These findings are consistent with those of previous studies on the relationship between liquidity and profitability in insurance companies and banks. For example, Obi-Nwosu et al (2017a) and Zainudin et al (2018) found that liquidity did not have a statistically meaningful impact on the income statement results of the companies they analysed. This study's findings supported this conclusion, indicating that changes in liquidity ratios resulting from IFRS 17 implementation lack statistical significance, since the adoption does not affect financial performance, as detailed in Section 4.2.2.4 below. This conclusion supports the observation that liquidity is not a key factor influencing profitability in insurance companies and banks.

The decline in the financial liquidity status of the companies analysed, compared to the improvement in financial performance based on profitability ratios discussed in Section 4.2.2.4 below, indicates an inverse correlation between liquidity and financial performance. This finding suggests that as companies improve their liquidity position, they hold more liquid assets, such as cash, at the opportunity cost of forgoing potential higher returns from investing that cash. Kimani (2023) defines liquidity as a measure of a firm's ability to settle short term debts as they become due. According to Kipngetich (2019), the Liquidity Preference Theory suggests that people prefer to keep their money available and easily accessible, rather than tying it up for a long time. To convince them to invest in longer-term options, they need to be offered higher returns as a reward for the extra risk and reduced flexibility.

The observed decline in the financial liquidity status of the companies analysed in this study can be linked to their increase in profitability as discussed in Section 4.2.2.4 below. This increase in profitability encourages the management of the companies to invest more in the business through longer term options rather than holding more liquid assets such as cash to earn interest. Based on the above, this study found that through the transition to IFRS 17, the South African insurance service providers have adhered to the Liquidity Preference Theory.

4.2.2.4 Financial performance based on profitability and asset management ratios

The findings of this study suggested an improvement in profitability for the companies analysed when transitioning from IFRS 4 to IFRS 17. The median EBITDA increases by 4%, from 0.1567 under IFRS 4 to 0.1634 under IFRS 17. The median EBIT margin increases by 5%, from 0.1429 to 0.1501, and the median net profit margin increases from 0.1108 under IFRS 4 to 0.1145 under IFRS 17. This improvement in profitability is attributable to IFRS 17's application of lower risk margins compared to IFRS 4. Moreover, the mandatory release of discretionary and compulsory margins under IFRS 4 leads to improved profitability at the transition, although it results in lower future earnings for existing contracts. Additionally, the improvement in profitability ratios is due to IFRS 17's faster recognition of earnings from new business, owing to its different approach to the treatment of acquisition costs, such as commissions and the requirement for lower risk margins at contract inception (Old Mutual, 2023).

Among the twelve companies analysed during this study, the transition to IFRS 17 led to an increase in ROA for seven companies. The median ROA increased from 0.0163 pre-IFRS 17 to 0.0205 post-IFRS 17 implementation, marking the largest relative increase among all the ratios investigated. This increase in ROA was mainly the result of the decrease in reported asset balances, as discussed in Section 4.2.3.2 below. The statistically significant decrease in asset balances drove the increase in ROA, however, the median increase in the ROA ratio itself does not achieve statistical significance, as suggested by a p-value of 0.5633, that exceeds the threshold for significance.

Kinyanjui (2020) states that, according to Rational Choice Theory, individuals tend to prefer purchasing insurance policies from insurers demonstrating strong performance. Based on this theory, one would expect that companies experiencing improved performance following the implementation of IFRS 17 would gain market share over those with declining performance. However, an analysis of JSE market trends shows no changes to the market capitalisation rankings of the South Africa insurance service providers after the transition to IFRS 17, implying that the market share remained largely unchanged (JSE, 2024).

The statistically insignificant impact of IFRS 17 on financial performance explains the absence of changes in market share, indicating that the hypothesis based on Rational Choice Theory does not apply in this case. The adoption of IFRS 17 does not significantly affect financial performance; therefore, no substantial changes to market share are expected. The analysis of the ROE and the asset turnover ratio suggest a decline in profitability following the implementation of IFRS 17, with ROE decreasing from 0.1591 to 0.1580, and the asset turnover ratio from 0.1881 to 0.1869. This decline in performance highlights the varied effects of IFRS 17 on the profitability of insurance service providers in South Africa, that can differ depending on the insurance contract accounting practices applied by each company under the IFRS 4 accounting standard. The results of the Wilcoxon signed-rank test show p-values of 0.3065 for ROE and 0.2300 for the asset turnover ratio, both of which exceed the threshold for statistical significance. This outcome indicated that these decreases lack statistical significance and would not result in changes in market share.

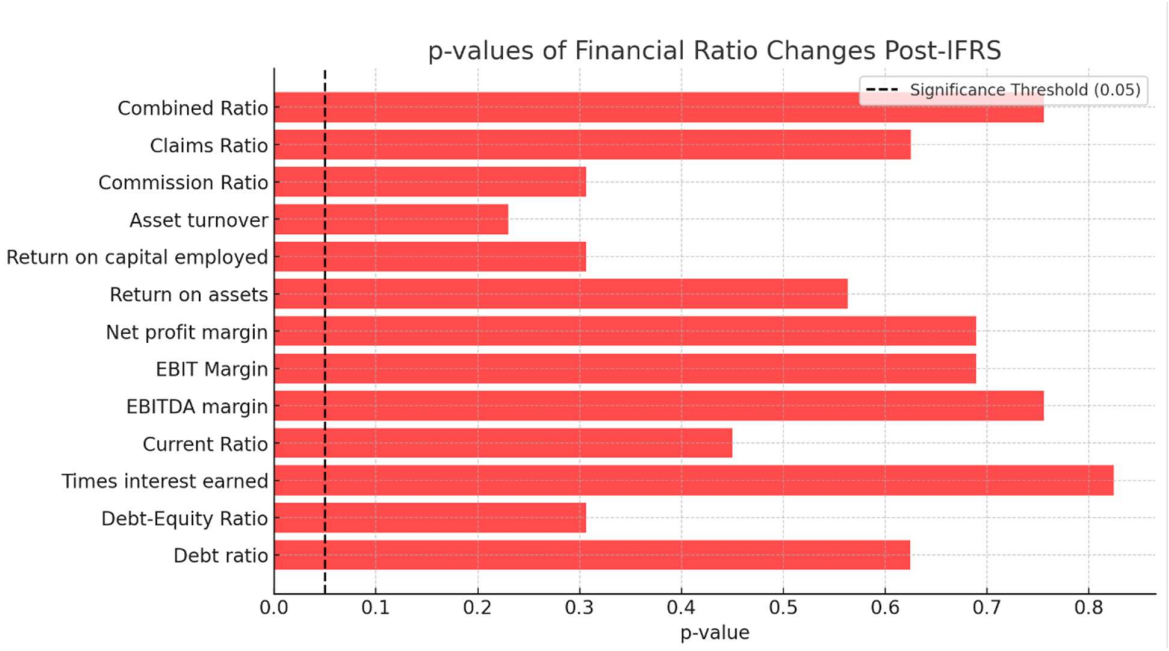
The findings of this study contrast with those of Seyam et al. (2024) who investigated the effects of the transition to IFRS 17 on the valuation of insurance liabilities, reserve estimates and financial performance. Their research concluded that IFRS 17 had a significant positive income statement impact on insurance firms in Egypt. In contrast, our study found no statistically significant improvement in the income statement results of insurance service providers in South Africa. A key difference between the two studies is that this study used data collected from the published annual results of the selected companies impacted by IFRS 17 in South Africa, whereas Seyam et al. (2024) based their findings on the analysis of responses from professionals working at various insurance companies in Egypt. This difference in methodology and countries analysed could explain the difference in conclusions reached.

The methodology of this study aligns with that of khudhir Shawkat & Alhasan (2024), who used published financial information from insurance companies, in their case in Iraq. Their study found that the adoption of IFRS 17 led to a significant improvement in the financial performance of Iraqi insurance companies. Despite the similarities in analytical approach and methodology, there are also important differences in the methodology of these two research studies. The key difference is that in addition to the analysis of the published financial statements, khudhir Shawkat & Alhasan (2024) incorporated a survey of insurance accounting experts to gather opinions on the impact of IFRS 17 adoption, that likely influenced their conclusion. The researcher attributes the difference in the current study's conclusions regarding the significance of IFRS 17's impact on financial performance to their inclusion of this survey data. The difference in conclusions reached may also result from these studies analysing companies operating in different countries, that applied different IFRS 4 practices and, therefore, are impacted differently by the change to IFRS 17.

4.2.2.5 Conclusion: IFRS 17 impact on financial performance

This section evaluates how the adoption of IFRS 17 affects a selected group of companies licensed to provide insurance services in South Africa, specifically to address hypothesis H1. The analysis, as shown in Figure 4 below, reveals that IFRS 17 did not significantly impact the overall income statement results of these companies. The p-values of all ratios analysed support this conclusion, because they are all higher than the 0.05 threshold, indicating a lack of statistical significance. While

insurance-related ratios reveal a decline in performance, most profitability ratios suggest an improvement in performance. These mixed results highlight the varied impact of IFRS 17 on financial performance, that appears to depend on the existing accounting methodologies for insurance contracts employed by each company as previously allowed under the IFRS 4 framework. Based on its findings, this study rejects H1 and finds that the implementation of IFRS 17 did not result in a significant decline in the income statement results of insurance services providers in South Africa.



Source: Author, 2024

Figure 4: Summary of p-value movement in financial ratios

4.2.3 Impact on Statement of Financial Position

This subsection aims to examine the actual impact of IFRS 17 on the selected balances of the Statement of Financial Position for companies licensed to offer insurance services in South Africa. The target population included the 12 companies listed in Table 7 above. The analysis compiled a summary of median pre-IFRS 17 total equity, total assets, total liabilities and total insurance liabilities for these selected companies and compares it to the median post-IFRS 17 figures disclosed in the financial statements of the respective companies. Table 9 below presents the results of the calculated median balances.

Financial ratio	Median Pre-IFRS 17 (ZAR, billions)	Median Post IFR 17 (ZAR, billions)	Median Absolute Change	Median Relative Change	V.V	p-value
Total Equity	R65.26	R62.09	-3.17	-5%	29	0.755658
Total Assets	R821.69	R816.78	-4.91	-1%	2	0.006692
Total Liabilities	R765.65	R752.91	-12.73	-2%	7	0.006692
Total Insurance Liabilities	R129.48	R107.77	-21.70	-17%	26	0.918813

Source: Authors, calculated using STATA software

Table 9: Impact of IFRS 17 adoption on the Statement of Financial Position

4.2.3.1 Total Equity

H2: The adoption of IFRS 17 has resulted in a significant decrease in the total reported equity balance among companies that provide insurance services in South Africa.

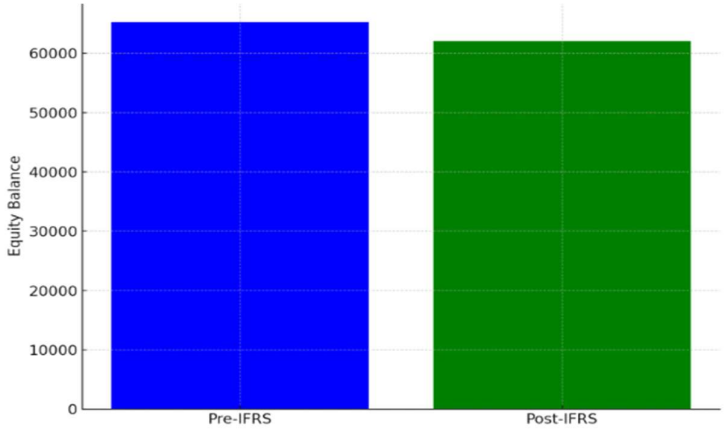


Figure 5: Movement in reported equity balances

The median of the equity balance of the population of companies analysed amounts to R65.26 billion under IFRS 4 basis while this average balance reduces to R62.09 billion under IFRS 17 basis, and this figure represents a 5% relative reduction in equity. The analysis of the twelve companies found that seven companies experienced a decrease in reported equity balance due to the adoption of IFRS 17, representing a relative decrease of 63%. This reduction in equity is attributed to the derecognition of goodwill associated with insurance contracts acquired through business combinations, mergers or acquisitions. IFRS 4 permitted the recognition of goodwill related to purchased insurance contracts. However, IFRS 17 prevents this practice, resulting in the derecognition of such goodwill. This derecognition causes a direct decrease in the company's equity because the company must write off goodwill, that was previously

recorded as an intangible asset on the balance sheet. As a result, this adjustment reduces the overall asset base without a corresponding decrease in liabilities, thereby reducing the company's equity. The reduction in equity reflects the removal of previously recognised future economic benefits that the companies expected from the goodwill associated with these insurance contracts, aligning the financial statements with the stricter requirements of IFRS 17. It is important to note that goodwill not arising from insurance contracts is excluded from the scope of IFRS 17 and falls within the scope of IAS 38, Intangible Assets, and was not impacted by the requirement to derecognise goodwill as described above (IASB, 2022).

The initial adoption of IFRS 17 also decreases total equity because IFRS 4, the previous accounting standard for insurance contracts, allowed insurance companies to reduce negative liability amounts to zero. This practice meant that they did not recognise any liability when the calculated value of the liability was negative. Such a situation could arise in certain measurement models or under specific contract terms under which the contract is expected to be profitable and for which the insurer has received the premium but not yet earned it because it has not yet fulfilled its performance obligation of providing insurance coverage for the full policy period. This situation results in the insurer having a liability relating to the received premium which IFRS 4 allowed to be zeroed. In contrast, IFRS 17 mandates a consistent methodology for measuring all insurance contracts, requiring the recognition and reporting of negative liabilities where applicable. As a result, this shift in accounting practice reduces total equity because previously unrecognised negative liabilities now need to be accounted for (Capitec, 2024).

The literature review revealed an expectation that the transition to IFRS 17 would lead to a decrease in equity, primarily due to the requirement to defer profits over the coverage period, as opposed to the earlier recognition of profits as permitted under IFRS 4 (Actuaries.org, 2019; Grant Thornton, 2020). The results of this study are consistent with the findings from the literature review and demonstrate that the reported median equity balance of companies providing insurance services in South Africa has reduced with the adoption of IFRS 17. The review of the disclosures from the selected target population indicated that this reduction in equity is attributable to the early release of margins into profit under IFRS 4, in contrast to the more gradual

and delayed recognition of margins under IFRS 17 (Capitec, 2024; Discovery Limited, 2023).

The findings of this study are consistent with the research conducted by EY (2023). EY investigated how the transition to IFRS 17 influenced the reported equity value of 30 insurance firms worldwide and found that most companies reported a decrease in equity value, attributing this decrease to the recognition of CSM and RA. Similarly, KPMG (2024) conducted an analysis of 57 insurance companies globally and found that IFRS 17 adoption led to a decrease in equity balance for the majority of the insurance companies analysed. Existing literature indicated a decrease in equity balances, and this study similarly observed this trend in the equity balances of the companies analysed. However, the decrease is not statistically significant because the p-value of 0.7556 exceeds the threshold for significance. Based on these findings, H2, therefore is rejected.

4.2.3.2 Total Assets and Liabilities

H3: The adoption of IFRS 17 has resulted in a significant increase in the total reported liabilities for companies offering insurance services in South Africa.

H4: The adoption of IFRS 17 has led to a significant decrease in the total reported asset balances in companies providing insurance services in South Africa

Eleven of the twelve companies analysed reported a decrease in total asset balances. These decreases ranged from 0.05% relative decrease for Standard Bank to 11% decrease for Santam Limited. Similarly, the reported total liabilities for these companies also experienced a reduction, with decreases ranging from 0.01% decrease for Standard Bank to 14% decrease for Santam Limited, a pattern observed in nine of the twelve companies analysed. Furthermore, in nine of the twelve companies analysed, the changes in total assets and total liabilities moved in the same direction, showing a consistent relationship between the two balances. This trend indicated that IFRS 17 aligns the reported total asset balances with the reported total liabilities.

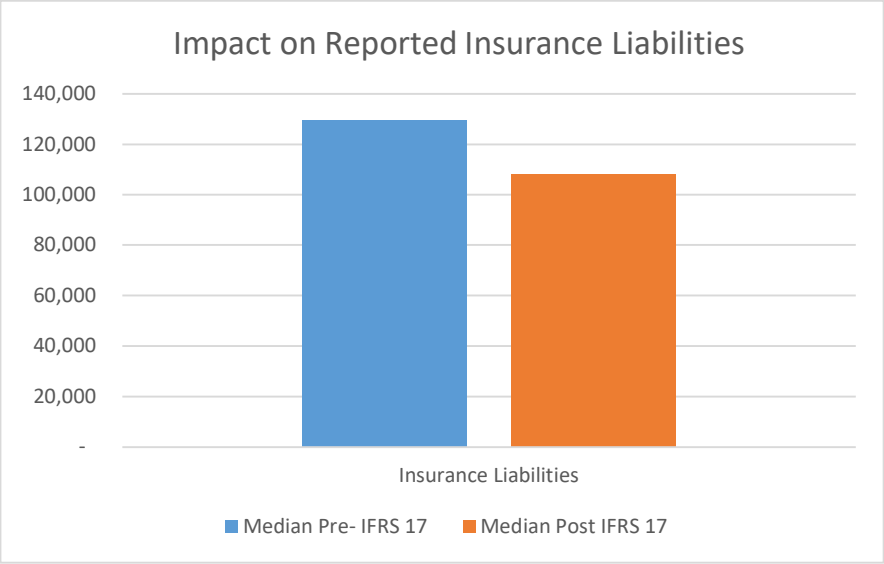
The median of the reported total assets analysed amounts to R821.69 billion under the IFRS 4 basis. This figure decreased to R816.78 billion under IFRS 17 basis,

representing a 1% relative decrease in the reported total asset balance. Similarly, the median of the reported total liabilities is R765.65 billion under IFRS 4, decreasing to R752.91 billion under IFRS 17, that constitutes a 2% decrease. Although these decreases appear minor based on relative percentage movements, the reductions in reported total assets and total liabilities are both statistically significant, as indicated by a p-value of 0.0066, that is below the 0.05 threshold for both.

The decrease in total assets and liabilities is attributable to the change in the measurement requirements for insurance contracts accounting such as the treatment of acquisition costs. Under IFRS 4, insurers were allowed to capitalise and defer acquisition costs as deferred acquisition cost assets on the balance sheet. The DAC asset was then expensed to the income statement over the life of the insurance contract. However, under IFRS 17, this DAC is included as part of the insurance service liability resulting in a decrease in reported total assets and total liabilities. Furthermore, the report total assets and liabilities are impacted by the requirement to discount these balances using the IFRS 17 risk-adjusted approaches as well as the changes to the underlying assumption used in the measurement calculations.

4.2.3.3 Insurance Contract Liabilities

H5: The adoption of IFRS 17 has resulted in a significant increase in the total reported insurance liabilities for companies offering insurance services in South Africa.



Source: Author, 2024

Figure 6: Summary of reported insurance liabilities

This section focuses on analysing the impact of IFRS 17 adoption on insurance contract liabilities. Insurance contract liabilities relate to the insurance service providers' obligations to their policyholders. The calculation of these liabilities is complex and subject to a few substantial actuarial assumptions and, therefore, the reported balances are expected to be significantly impacted by the transition to IFRS 17.

Amongst the companies analysed, six out of twelve companies revealed a decrease in the value of insurance contract liabilities. The median total insurance liabilities decreased from R129.48 billion pre-IFRS 17 to R107.78 billion post-implementation, representing a 17% relative decrease. This decrease can be attributed to the effects of discounting, particularly in the context of high interest rates in South Africa. The application of discounting reduces the present value of reported insurance contract liabilities, especially for long-term contracts. However, based on the results of the Wilcoxon signed-rank test, this decrease in total insurance liabilities is not statistically significant because the p-value of 0.9188 is greater than the 0.05 threshold for significance. The statistically insignificant impact on reported insurance liabilities is attributed to South African insurance companies following the Actuarial Society of South Africa's guidance under the IFRS 4 framework, particularly the Financial Soundness Valuation (FSV) basis. This guidance emphasises principles and practices for valuing insurance liabilities and assets, thus, requiring insurers to maintain adequate reserves to meet their policyholder obligations (khudhir Shawkat & Alhasan, 2024). A key component of the valuation of liabilities under FSV is the requirement to use best estimate assumptions, considering all relevant factors, that is similar to IFRS 17's requirement to measure the value of insurance liabilities using the best estimate of future net cash flows. The similarity in these requirements contributes to the valuation of insurance liabilities under IFRS 4 not being significantly different to the values calculated under IFRS 17 basis because the values are calculated from similar "best" estimates.

The FSV guidance mandates that discount rates used in valuing insurance liabilities should reflect the risk-free interest rate curve, adjusted for the nature and term of the liabilities. This requirement resembles the IFRS 17 requirement that companies discount future net cash flows using either the 'top-down' or 'bottom-up' approach. Similar to the adjusted risk-free interest rate curve, the application of the bottom-up approach starts with a risk-free interest rate (e.g., government bonds) and then adds an appropriate adjustment for illiquidity, depending on the characteristics of the insurance contract. This similarity in the process of determining the discount rate used for insurance contracts contributes to the absence of the statistically significant impact of IFRS 17 on the reported insurance liabilities. Additionally, FSV requires that a discretionary margin be reserved for adverse deviations to provide a cushion against unforeseen circumstances. This requirement is similar to the IFRS 17 application of the CSM, that requires insurance companies to defer the recording of profit over the period during which risk protection services are provided to policyholders. Similar to the margin required under the FSV, the CSM serves to align the earnings of premium to the provision of insurance coverage and cushions against unexpected movements to profits.

The findings of the study differ from that of do Nascimento (2022), who investigated the anticipated effect of IFRS 17 on the measurement of non-life insurance service providers. His study concluded that the transition to IFRS 17 leads to an increase in the reported balance of insurance liabilities. One of the key differences between the two studies is that our research analyses companies offering both life and non-life insurance contracts, whereas do Nascimento's (2022) study focused exclusively on non-life insurers. Additionally, the difference in findings may be attributed to differences in the measurement methods applied, as non-life insurers typically use the PAA, while life insurers use the GMM. The studies also investigated companies operating in different countries, and therefore, the difference in results could be influenced by the different national accounting standards applied under IFRS 4.

The difference in findings, therefore, is attributed to the differing scopes of the companies analysed as our study analyses both life and non-life insurance service providers. Based on the above findings, H5 is rejected.

4.2.3.4 Conclusion: IFRS 17 impact on the Statement of Financial Position

In summary, this section examined the impact of IFRS 17 on insurance contract liabilities, highlighting the decrease observed in the median insurance liabilities of six out of twelve companies, attributed to discounting in the context of high interest rates in South Africa. Despite this decrease, statistical analysis revealed no significant changes in the reported liability values post-IFRS 17 adoption. The insignificant impact is due to insurers applying the FSV methodology under IFRS 4, that closely aligns with IFRS 17 in its use of best estimate assumptions and discounting. Additionally, it is probable that the current findings differed from those of do Nascimento (2022) owing to the broader scope of our study, that included both life and non-life insurers, thereby suggesting that the effects of IFRS 17 may vary depending on the nature of the insurance contracts analysed.

Chapter 5: Conclusion and recommendations

5.1 Introduction

This chapter provides a summary of the findings from the analysis of results discussed in Chapter 4. The primary goal of our study was to investigate the impact of IFRS 17 adoption on the income statements results of South African insurance service providers as well as its effect on their statement of financial position. This chapter will provide a summary of the conclusions reached and provide answers to the research questions outlined in Section 1.3 above. In addition, it will also provide a summary of the limitations experienced during this research project as well as recommendations for future research.

5.2 Summary of findings

Impact on financial performance ratios

This study used selected financial performance ratios to measure the impact of IFRS 17 adoption on the income statement results of South African insurance service providers. This approach aligns with the methodology used in studies by Dillon (2014) and Cape (2019) which used selected ratios to measure the impact of IFRS 16 adoption on the income statement results of South African companies. In this current study, the selected ratios were calculated based on financial performance reported under IFRS 4 and recalculated using restated financial information prepared under IFRS 17 basis. For the analysis, the selected ratios were grouped into insurance ratios, leverage ratios, asset management ratios, liquidity ratios and profitability ratios.

The analysis of the insurance ratios showed that IFRS 17 adoption negatively impacted the income statement results of the South African insurance service providers. However, the results of the profitability and asset management ratios analysis revealed a different conclusion, suggesting that IFRS 17 adoption led to an improved financial performance. These varied results reveal that IFRS 17's impact on financial performance depends on how different each company's existing IFRS 4 practices are from the IFRS 17 requirements. Based on these results, it was found that IFRS 17 adoption did not significantly impact financial performance as all selected ratios analysed have a p value that exceeds the 0.05 significance threshold.

This study was grounded in three theoretical frameworks: the Rational Choice Theory, Pecking Order Theory and Liquidity Preference Theory. Based in the study's findings it was concluded that the companies analysed adhere to the Liquidity Preference Theory, because their liquidity positions decrease as profitability increases. The higher earnings under IFRS 17 are seen as an incentive for management to invest in the business through longer-term options rather than holding more liquid assets such as cash. Lastly, the analysis of leverage ratios revealed that the companies analysed follow the Pecking Order Theory, preferring to use retained earnings over external debt and external debt over issuing new equity.

Impact on statement of financial position

This study investigated the impact of IFRS 17 adoption on the statement of financial position of South African insurance service providers, focusing on total assets, total liabilities, total equity and total insurance liabilities. The findings indicated that eleven of the twelve companies analysed reported a decrease in total assets, while nine companies showed a decrease in total liabilities. The Wilcoxon signed-rank test results revealed that these decreases are statistically significant. The decrease in the reported balances is due to the change in assumptions used to measure these balances from IFRS 4 to IFRS 17 as well as the impact of discounting the reported balances to present value.

The reviewed literature suggested that IFRS 17 adoption would lead to a decrease in reported equity due to the CSM impact on equity. The result of our study supports this suggestion, with seven of the twelve companies analysed showing a decrease in reported equity balance. However, the Wilcoxon signed-rank test results revealed that this decrease in equity is not statistically significant. Lastly, this study examined how adopting IFRS 17 affected the reported insurance liabilities. Since IFRS 17 establishes the principles for accounting for insurance contracts, and accounting for the related insurance contract liabilities is complex, the literature review suggested the transition to IFRS 17 will significantly increase reported insurance liabilities due to the change in the assumptions used. However, the current study found that only half of the companies analysed showed an increase in reported insurance liabilities. Furthermore, the median reported insurance liabilities decreased by 17% after IFRS 17 was implemented, decreasing from R129.48 billion to R107.78 billion. Although the

median insurance liabilities decreased, the results of the Wilcoxon signed-rank test revealed that this decrease is not statistically significant as the p value exceeded the 0.05 threshold for significance. The lack of statistical significance is attributable to the similarities in the measure of insurance liabilities between IFRS 17 and IFRS 4.

5.3 Limitations experienced during the research

One of the limitations that was experienced during this study related to data collection. The researcher had to complete the research within a specific time frame and, therefore, used interim financial statements if the annual financial statements and integrated reports were not yet available.

The annual financial statements and integrated reports usually provide more detailed information and the impact of IFRS 17 contained in those reports, therefore, is expected to be more detailed than in the interim reports used in this research.

Additionally, the research made use of published interim and annual financial statements, while disregarding the effects of prior year error restatements on both the financial performance ratios analysed and the movements in the statement of financial position.

5.4 Recommendations for future research

One of the primary limitations of this study is its focus on South African companies licensed to provide insurance services, limiting the scope of the analysis to a single country. This approach is similar to that of khudhir Shawkat & Alhasan (2024) as well as Seyam (2024) who limited their studies to companies operating in Iraqi and Egypt respectively. Future research could expand on these studies by examining the impact of IFRS 17 adoption on companies offering insurance services in different countries. This approach would provide a more comprehensive understanding of how IFRS 17 affects companies across various countries considering that IFRS 4 permitted insurance service providers to use their country specific accounting standards to account for insurance contracts. Additionally, this study examined a relatively small target population. Hence, broadening the research to include companies from other countries would not only increase the sample size and the target population but it would also allow for more insightful analysis, such as comparing the effects of IFRS

17 on life versus non-life insurers and exploring its impact on non-insurance companies, such as banks, that are licensed to sell insurance.

This study focused on the financial performance ratios presented in Table 7 above. The analysis found that IFRS 17 did not significantly impact the financial performance of the companies in all the examined financial performance ratios. Future studies could extend on these selected financial performance ratios because other users of financial statements might find different ratios useful. Additionally, using different or additional financial performance ratios to the ones used in this study might provide additional insights into the actual impact of IFRS 17 that this research has not identified.

Companies that sell insurance generate net profits from both their underwriting results and the returns on their invested insurance funds. This practice means that they are also impacted by the accounting standards, such as IFRS 9 – Financial Instruments, that govern the accounting of these investments. It would be valuable to conduct research on how the recent amendments to IFRS 9, including how the interaction between IFRS 17 and IFRS 9 impacts the profitability of insurance companies. Lasty, the study used cross sectional data analysis captured at a single point in time, limiting the ability to observe trends and changes in individual company's strategic behaviours. Future research could benefit from using longitudinal data analyses, which would allow for the observation of trends and the differentiation between accounting effects and actual strategic shifts over time.

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Appendices

Appendix A: Onerous contracts

Example 2 offers an illustration of the contrasting accounting treatment between an onerous contract and a non-onerous contract.

Example 2: Onerous contract accounting

Assume the same facts as applicable above except now the entity expects to incur a once-off claim amount of R120 000 at the end of year 5. By applying the pre-tax discount rate of 6% per annum, the present value of the expected future claims payable is determined to be R89 670.98. Therefore, the total expected future cash outflow at inception of the contract is R99 670.98 (R89 670.98 + R10 000).

All amounts are in South Africa Rands (ZAR)	**IFRS 17**
Present Value of Future Cash **Inflow**	100 000
Acquisition Costs	
Present Value of Future Cash **Outflow**	(99 670.98)
Present Value of **Net Future Cashflow**	329.02
Unearned Premium Reserve	
Deferred Acquisition Reserve	
Risk Adjustment	(5 000)
Fulfilment Cash Flows	(4 670.98)
Contractual service margin	(0)
Insurance contract (asset) / liability on initial recognition	**(4 670.98)**
Insurance service expenses	**(4 670.98)**

Source: Author, 2024

Table 10: Onerous contract accounting

Example 2 presents a case of onerous insurance contract accounting. Initially, this contract was expected to bring in a positive cash inflow of R329.02. However, after incorporating a risk adjustment of R5 000, the resulting cash flows from fulfilling the contract turns into a negative outflow of R4 670.98. This result indicates that the contract is expected to produce a negative underwriting margin. The negative fulfilment cash flow of R4 670.98 represents the onerous contract amount and must be recorded as a loss in the Income Statement upon the contract's initial recognition. This is another area that is expected to drive the key difference in results between IFRS 17 and IFRS 4 because companies were not required to recognise losses on

initial recognition. The magnitude of the difference will depend on the current practices used by the different insurance companies under IFRS 4 basis (PWC, 2017a).

Appendix B: Determining the coverage units

Given the same scenario as described in example 1 (see Section 2.6.2.1 above), in which the insurance contract has a claim limit of R100 000 per year, the total coverage units of the insurance contract can be determined by summing the claim limits available to the insured over the five-year period. Therefore, the total coverage units would be calculated as 500 000 over the coverage period with 100 000 units lapsing each year as service is provided by the insurance company. Table 11 below outlines the total coverage units applicable to this illustrative example and how these will lapse each year until the expiry of risk. Furthermore, this illustrative example does not consider any discounting on the coverage units.

Coverage units	Year 1	Year 2	Year 3	Year 4	Year 5
Opening	500 000	400 000	300 000	200 000	100 000
Lapsed	100 000	100 000	100 000	100 000	100 000
Closing	400 000	300 000	200 000	100 000	0

Source: Author, 2024

Table 11: Coverage units

Appendix C: Allocation of risk adjustment costs to the Income Statement

The risk adjustment value of R5 000, calculated at contract inception in example 1 (see Section 2.6.2.1 above) is released through the Income Statement based on the coverage units provided each year. This calculation results in an insurance service expense of R300 and a current service risk adjustment release of R1 766.67 in year 1. While there is no specific requirement to disaggregate the risk adjustment release between the insurance finance expense and the current service release, if no disaggregation has been performed, the accounting standard requires recognition of the full net amount as part of the insurance service revenue.

Reconciliation of risk adjustment (	Year 1	Year 2	Year 3	Year 4	Year 5
Opening					
New business	(5,000.00)	(3,533.33)	(2,247.20)	(1,191.02)	(420.83)
Insurance finance expense	(300.00)	(212.00)	(134.83)	(71.46)	(25.25)
Current services: release	1,766.67	1,498.13	1,191.02	841.65	446.08
Closing	(3,533.33)	(2,247.20)	(1,191.02)	(420.83)	0
Note: All amounts are in South African Rands (ZAR)					

Source: Author, 2024

Table 12: Allocation of the risk adjustment to the Income Statement

Appendix D: Allocation of deferred acquisition costs to the Income Statement

IFRS 17 does not require the explicit deferral and discounting of acquisition cash flows. The company incorporates these cash flows and subsequently releases them to the Income Statement as part of CSM, as demonstrated in the illustrative example in Table 4 above. Although Table 13 below is not explicitly required by the IFRS 17 accounting standard, it has been included in this research to provide a detailed understanding of the cash flows that comprise the insurance service revenue. When assessing the impact of acquisition costs from the CSM in isolation, a current service release of R4 276.82 is calculated for year 1. This amount is included as part of the insurance service revenue in Table 3 above.

Acquisition costs	Year 1	Year 2	Year 3	Year 4	Year 5
New business	10,000.00	6,323.18	3,498.94	1,549.12	428.72
Insurance finance expense	600.00	379.39	209.94	92.95	25.72
Current services: release	(4,276.82)	(3,203.63)	(2,159.76)	(1,213.35)	(454.44)
Closing	6,323.18	3,498.94	1,549.12	428.72	-
Note: All amounts are in South African Rands (ZAR)					

Source: Author, 2024

Table 13: Allocation of deferred acquisition costs to the Income Statement