Targeted improvements for long-duration contracts: Redesigning the financial reporting process to optimize compliance

The Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI), prescribes significant changes to the US GAAP accounting model for certain long-duration insurance contracts. The ASU amends insurers' measurement, presentation, and disclosures for long-duration contracts. Implementation of the standard will require insurers to make fundamental changes along their end-to-end processes, from data origination through reporting.

As part of this journey, finance teams will play a pivotal role in ensuring that existing financial reporting systems and processes are adapted to manage the complexities introduced by the standard. Teams looking to implement an effective process will need to consider implications for their general ledger's (GL) chart of accounts, accounting rules, and back-end reporting applications.

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Many insurers in the middle of their implementation are realizing that these changes represent a more significant effort than previously anticipated. In response, companies are seeking opportunities to accelerate their efforts and meet the standard's fast-approaching effective date. For insurers that have yet to begin their LDTI journey, careful evaluation of financial reporting impacts can lay the groundwork for an effective implementation. Either way, addressing the following key reporting considerations can offer companies a starting point to build toward success.

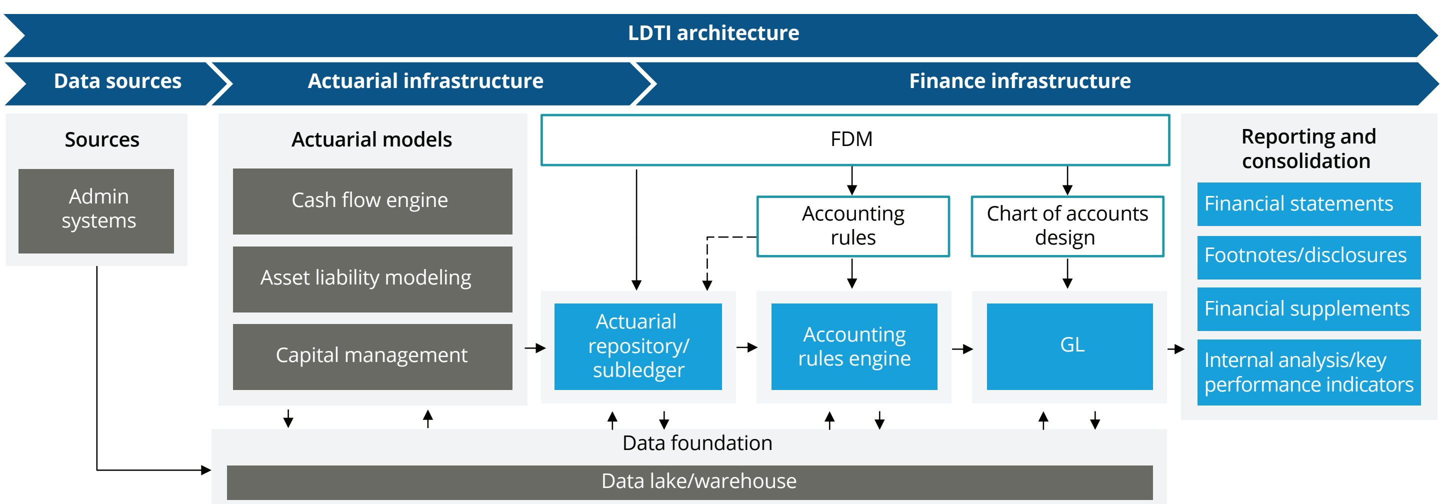
Reporting strategy

A foundational step for finance teams beginning their implementation journey is to define their overall reporting strategy. The ASU prescribes fundamental changes to the presentation and disclosure of key insurance balances. Beginning with the end in mind, insurers need to assess how the existing financial reporting architecture and the finance data model (FDM) should be enhanced to manage these changes. From there, insurers will have a solid foundation to assess implications for upstream processes, drive the implementation forward, and enable an effective financial reporting process.

The bottom line

ASU 2018-12 significantly changes the accounting and reporting framework for long-duration insurance contracts. Insurers seeking to accelerate or kick off their implementations can position themselves for success by considering the following four guiding principles when redesigning their financial reporting processes:

- Define a reporting strategy. Begin with the end of the reporting process and work upstream to identify and address key challenges introduced by the standard.
- Carefully consider changes to the FDM. This forms the backbone of the financial reporting process and will help in understanding the data that will be needed to manage the business prospectively.
- Effectively defining required changes to the chart of accounts and accounting rules will help to record, analyze, and report results in an efficient manner.
- Maximizing the use of reporting tools and accelerators can help insurers proactively manage the increased volume of disclosures and analysis that may be required to report results under the standard.



Insurers should first assess their system capabilities and process flows to consider the data needed to support LDTI calculations, reports, and analyses. As LDTI will significantly increase the volume and granularity of data that must be captured, the company's IT capabilities and processes may require enhancements to manage the increased workload.

One common gap that insurers face in their current-state architecture is around the actuarial repository. Many insurers do not have a tool in place that captures results at a sufficiently granular level to support LDTI reporting. Implementing a strong solution can drive significant time savings in the reporting process, as the time required to manually compile and process data will be exponentially higher in the face of the increased volume of data. Many insurers have therefore recognized that implementing a strong solution represents the backbone of a strong financial reporting architecture and are deploying a solution to facilitate a smooth production run and minimize the operational risk of generating robust disclosures. Insurers that do not have a strong repository in place should begin by defining their strategy for managing this actuarial data and assess in-house and vendor alternatives that may fill this gap.

LDTI also will require changes to accounting rules, GL structure, and back-end reporting tools to support LDTI requirements. Beyond just achieving compliance, insurers may leverage LDTI as an opportunity to make strategic enhancements to these technologies that improve close-process efficiency and accuracy. If deployed strategically, the redesign may yield a host of benefits, including improved business partnering, increased automation, reduced IT cost, greater finance organizational flexibility, proficient regulatory compliance, increased financial integrity, and improved auditability.

FDM

The FDM is a multidimensional structure that governs how data is managed and stored across financial reporting applications. Changes required to existing FDMs will vary from organization to organization. Most companies will need a plan to address the following:

- A lower level of disaggregated information
- A generation of rollforwards and other new disclosures
- Analytic capabilities

Companies enhancing their FDM for LDTI may begin by first aligning to a set of design principles based on the organization's goals, considering both the external reporting requirements prescribed by the ASU and management's desired changes to key internal metrics.

Defining the appropriate granularity at which information will be captured within the FDM is a critical step in the design process. Subsequently adding additional detail to historical data is often a very significant effort. Careful evaluation of the FDM can therefore minimize the risk that insurers need to subsequently undertake costly data enhancements. One of the key reporting changes prescribed by the ASU is the requirement to present disaggregated tabular rollforwards across several key insurance balances. These rollforwards contain granular attributes of reserve changes at a disaggregated grouping level, which may be defined as a product or coverage, geographic region, or market. At a minimum, insurers should ensure that their data models can support these external disclosures. However, companies should also consider the additional details that may be needed to support internal analysis. Many insurers are looking to retain more granular cohort-level information beyond the externally presented disaggregated groupings. Maintaining this granularity within financial reporting applications will enable finance teams to better identify and assess unexpected changes in reserve movements. Additionally, this will provide finance teams with the flexibility to adjust how data is aggregated for the purposes of external reporting if they later change the definition or composition of disaggregated groupings.

Insurers should also ensure their FDMs capture adequate information to analyze and report detailed components of the changes in these insurance balances. The ASU provides illustrative examples outlining the components of these rollforwards that companies may disclose externally, though many insurers are considering preparing more granular attributes to support internal analysis. For example, many insurers are seeking to retain data for deviations in policyholder behavior and experience due to underlying drivers—such as mortality, morbidity, policyholder behavior, and more—rather than simply calculating the total impact of policyholder experience on reserve changes. Having this type of information readily available may better enable finance organizations to understand how key macro factors are driving changes in their underlying reserves or earnings patterns. Wherever insurers land on the issue, desired granularity should be a key consideration when defining the prospective FDM.

Beyond the prescribed rollforward disclosures, the ASU also requires insurers to present several nonrollforward disclosures within their financial statements. These include exhibits around liability interest rates and durations, guaranteed minimum crediting rates for policyholders' account balances, and other metrics. As insurers enhance their FDM, they should ensure these nonrollforward disclosures and externally reported metrics can be produced and stored in an efficient and well-controlled manner.

Many insurers have also come to recognize that LDTI may significantly affect earnings patterns, book value, and other financial indicators upon adoption. In response, these companies are carefully considering the internal metrics and analysis that will be prospectively produced to understand performance and drive business decisions. Many have found that analyses on reserve and earnings sensitivities, breakage, reserve margins, and available capital will be instrumental to effectively understanding and communicating performance under LDTI. In addition, some companies are implementing or enhancing a source of earnings analysis as a powerful tool to better explain key drivers of earnings. While some of these may represent entirely new metrics, many insurers are considering LDTI an opportunity to also enhance definitions and drive organizationwide consistency on existing metrics that will be retained upon adoption. As insurers consider implementing these new or enhanced metrics, they should carefully evaluate the data model that will support this collective analysis.

GL design

As insurers seek to comply with these new requirements, they should evaluate adjustments required to adapt existing GL processes for these changes. While these impacts will vary by company, two of the areas that are generally most affected include the underlying chart of accounts and accounting rules.

Chart of accounts

Insurers' reporting strategies will influence the role that the GL plays in supporting internal and external reporting. As noted above, many insurers are planning to leverage subledgers or actuarial repositories to compile detailed disclosure data. However, some insurers may wish to carry additional information downstream into their GL as well, creating a need for additional granularity within the chart of accounts or other GL dimensions to appropriately maintain the desired detail.

As insurers evaluate the impacts LDTI will have on their chart of accounts, they should consider GL use across reporting functions. Two common design strategies are to maintain either a "thick" or "thin" design, which may be generally defined as follows:

- **Thick GL:** The GL serves as the central reporting repository, retaining detailed data to satisfy many internal and external reporting needs. A thick GL tends to capture several dimensions of information (e.g., reinsurance types, product- or business-level information) within the account structure and may contain granular accounts that capture specific components of broad balances and classes of activity.
- **Thin GL:** The GL holds summary-level financial data required for financial statement reporting only, while a business analytics solution, data warehouse, or data mart supports focused management and operational reporting. These data mart-type solutions will typically then rely on subledgers to gather detailed data and additional data dimensions.

Classification as a "thick" or "thin" GL may fundamentally be defined by the volume of data that resides within and the extent of analysis performed using the GL. A thick GL may be preferable if the GL serves as the primary source of significant granular internal and external reporting information. Furthermore, the use of a thick GL may minimize both maintenance costs and the number of discrepancies that arise from leveraging multiple data sources.

Alternatively, a thin GL may be preferred if data is consolidated in a subledger system or repository that supports internal analysis. By having only key data elements passed to the GL for the creation of financial statements, companies may be able to streamline their period-end close by minimizing the number of dimensions used to post transactions and the number of reconciliations needed. From an LDTI standpoint, the primary decision point for insurers' chart of accounts design relates to the rollforward granularity they retain within the GL. For example, insurers adopting a thick GL approach may seek to capture granular drivers of reserve changes within their GL, such as the changes specifically arising from a mortality assumption unlock or a morbidity experience variance. However, others may limit the information retained in the GL to the total changes in their reserves and rely on alternate financial applications to support the reporting of more granular attributes.

As insurers consider LDTI's impacts on their chart of accounts, the following questions may help inform the best approach to satisfy their organizational objectives:

- What is the purpose of the GL? Should it be used only for financial statement reporting or also serve as the source for additional internal and external reporting data?
- How much data does the company wish to retain within the GL, as compared with other applications in the broader system architecture?
- What is the company's desired close duration? How will changes affect the close cycle?
- What organizational-specific complexities should be considered in the design, including impacts on upstream systems and related account mappings?

Accounting rules

Applying the correct accounting rules is a critical step in an effective financial reporting process, where a defined set of rules converts source-system transactional data into detailed, auditable journal entries. Once insurers have defined their reporting strategy and chart of accounts, they should begin to evaluate changes to their accounting logic. LDTI will create significant impacts on insurers' underlying accounting rules, prescribing fundamental changes to how insurers measure and record their liabilities for future policyholder benefits, amortize insurance-related assets, and treat market risk benefits. These collective changes will give rise to new or different accounting events than those recognized under historical GAAP accounting.

Defining the rules that properly reflect accounting changes can be a challenge whenever organizations implement new policies or methodologies. For that reason, companies implementing these types of large-scale accounting changes may sometimes rely on manual processes to record journals as either a short-term fix or as a long-term solution. Given the magnitude of changes prescribed by the ASU and the additional granularity at which accounting events may be defined, insurers adapting to these changes may realize additional errors and processing time throughout their booking process. To alleviate this incremental pressure on the period-end close, insurers may automate the posting of these new LDTI entries either within their LDTI subledger or a dedicated rules engine. Timely automation will help insurers capture results in a more effective and efficient manner. Insurers should prioritize this effort to minimize the cost and resource implications of manually posting journals under an increasingly complex accounting framework.

Reporting considerations

Given the significant impacts LTDI has on internal and external analyses and disclosures, insurers will need to evaluate the implications for back-end reporting processes to ensure an effective implementation. Many insurers rely on heavily manual processes to execute elements of this back-end reporting. However, insurers leveraging LDTI as a catalyst for change may recognize long-term benefits by seeking automation opportunities across a range of the following reporting processes:

- **Manual disclosure processes:** Many insurers' back-end reporting processes involve significant manual processing or intervention. Due to the increased number of disclosures and data required under LDTI, the time required to execute these manual processes will be significantly greater than needed today. For this reason, insurers may consider the implementation as an opportunity to streamline or automate manual back-end processes to better facilitate an effective LDTI environment.
- **Reconciliation tools and processes:** Insurers may need to implement changes to existing account reconciliation and certification processes given the changes to the related chart-of-accounts structure. Companies should use this as an opportunity to review existing account assignments and clearly define the owners responsible for reconciling and certifying accounts within the LDTI hierarchy. Furthermore, insurers with highly manual procedures may consider this yet another opportunity to leverage LDTI to enhance business processes. Many reconciliation tools offer the functionality to perform automated reconciliations and certifications, which can mitigate the impact that increased volumes of accounts have on close timelines.
- **GAAP financial statement reporting tools:** Changes will be needed to the processes and technologies used to create insurers' GAAP filings as a result of the ASU's prescribed presentation and disclosure changes. As insurers begin their journey, they should begin by defining the disclosures that must be presented externally, the disaggregated groupings that will be applied in those disclosures, and the structure that will be presented externally. From there, insurers should develop structural mock-ups and build those templates into drafts of the GAAP filings. Once built, insurers may then develop the infrastructure that will enable them to efficiently and effectively populate the required disclosures. This presents another opportunity for automation, as many reporting technologies can be directly integrated into upstream financial applications. In this manner, GAAP filings can be automatically updated with required disclosure data once results are available and certified. This can provide companies significant time savings and free resources to conduct more detailed analyses on the increasingly complex LDTI results that emerge.
- **Other reporting solutions:** In addition to the changes needed for SEC filings, insurers should similarly think through the changes needed to support their internal and external analyses under LDTI. These may include internal analysis packages for senior leadership, quarterly financial supplements, press releases, analyst packages, and other significant exhibits. Insurers seeking to automate their GAAP reporting may consider leveraging some of those same data flows, tools, and solutions to bring long-term efficiencies to their other reporting processes.

Getting started

LDTI will create meaningful changes across insurers' entire financial reporting process. Carefully assessing these impacts can help insurers better understand the challenges, pain points, and risks the standard presents. That understanding can then inform strategic investments to alleviate pressure on key areas of the reporting process. In this manner, companies can shift their implementation from a compliance-focused effort to a value-added delivery. For insurers that have not yet begun that assessment—or those looking to accelerate their implementation—the time is now.

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