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Revenue Recognition for Insurance Business Activities in Vietnam

[1] **Thuy Vinh Nguyen,** [2] **Thi Nhung Ha**
[1, 2] University of Labour and Social Affairs, Hanoi, Vietnam

Corresponding Author: **Thuy Vinh Nguyen**

Abstract
Determining when and how revenue is recognized is an important aspect of financial accounting. For insurance businesses, revenue recognition is even more complicated due to factors such as insurance contracts, insurance premiums, unearned insurance premiums, and compensation reserves. At the same time, the insurance business is one of the sensitive business fields. Therefore, information about business performance results in general and revenue in particular has a great impact on customers and determines the existence and development of insurance businesses. The article provides principles for recognizing revenue from insurance business activities based on the legal basis that insurance businesses in Vietnam are applying. Based on the challenges that insurance businesses in Vietnam are facing and will face in the future, the authors make several recommendations to ensure more accurate and consistent revenue recognition.

Keywords: Revenue, Revenue Recognition, Insurance Businesses, Insurance Business Activity, Insurance Contract

1. Overview of Insurance Business Activities

For the purposes of Law Insurance business Law No. 08/2022/QH15, terms used herein are construed as follows:

1. *Insurance business industry (also insurance industry)* covers a range of such sectors as insurance, reinsurance, cession and others related to insurance business, including insurance agent, broker and insurance ancillary services.
2. *Insurance service (also insurance business sector)* refers to an activity of an insurer, non-life insurer's foreign branch, mutual providing microinsurance product that insures the risk of the insured. That activity is performed by the policyholder's paying insurance premiums in order for the aforesaid entity to pay indemnity or insurance coverage in case of any policy event that occurs under terms and conditions of an insurance contract.
3. *Reinsurance service* refers to the practice whereby an insurer, a reinsurer or an insurer's foreign branch in Vietnam is paid a sum of reinsurance premium by another insurer, reinsurer or insurer's foreign branch in Vietnam; by a foreign insurer, reinsurer or foreign insurance organization to undertake to cover the insured liability.
4. *Cession* refers to the practice whereby an insurer, a reinsurer or an insurer's foreign branch in Vietnam transfers a portion of their insured liability and pay reinsurance premium to another insurer, reinsurer or insurer's foreign branch in Vietnam; to a foreign insurer, reinsurer or foreign insurance organization.
5. *Insurance agent service* refers to one or several fiduciary duties assigned by an insurer, a foreign non-life insurer's branch or a mutual providing microinsurance product, including giving advice or counsels on insurance products (also insurance plans or schemes); introducing insurance products; marketing insurance products; making arrangements preparatory to the conclusion of insurance contracts; collecting insurance premiums; gathering related documents necessary for settlement of claims and payment of insurance.
6. *Insurance brokerage* refers to the practice of providing a policyholder with information and advice or counsel on type of insurance, line of insurance business, insurance product, insurance schemes, terms and conditions, insurance premium, insurer, reinsurer, foreign insurance branch in Vietnam; other service activities related to the negotiation, arrangement for conclusion and execution of insurance or reinsurance contracts or policies.
7. *Ancillary insurance service* covers a range of activities, such as insurance consulting, underwriting, actuary, loss assessment, and facilitation for settlement of insurance claims. Ancillary insurance service does not comprise any service that an insurer, a reinsurer, a foreign insurance branch in Vietnam or a mutual providing microinsurance product renders on their own account to do their insurance or reinsurance business.

8. *Insurance contract (also insurance policy)* refers to an arrangement between a policyholder and an insurer or a foreign non-life insurer's branch or a mutual providing microinsurance product whereunder the policyholder is bound to pay insurance premiums; the insurer, the foreign non-life insurer's branch or the mutual providing microinsurance service is bound to pay indemnity or insurance benefits or coverage under contractual terms and conditions.

According to Vietnamese Accounting Standards No. 19 (VAS19), an insurance contract is a contract in which an insurance enterprise agrees on an amount of money (called an insurance premium) and accepts significant insurance risks from customers. (Policy owner) by agreements to compensate the policy owner if a future event occurs that causes loss to the policy owner. From this definition of the standard, it shows that insurance contracts include life insurance contracts (term life insurance and whole life insurance), health insurance contracts, and property insurance contracts, damage insurance contract, liability insurance contract. This classification will determine how and when to recognize revenue for each type of contract that the insurance enterprise issues.

Principles of entering into and implementing insurance contracts:

- Principle of absolute honesty: Parties to an insurance contract must provide information and exercise rights and obligations in the most honest way, on the basis of absolute trust in each other during the contracting process. and execute insurance contracts;
- According to the principle of insurable interest, a policyholder must be entitled to the insurable benefit varying according to specific types of insurance contract under this Law;
- According to the principle of indemnity, the amount of coverage or indemnity that the insured can get shall not exceed the actual loss incurred in a policy event, unless otherwise agreed upon in an insurance contract;
- According to the principle of subrogation, the insured shall be responsible for giving the insurer or foreign non-life insurer the right to claim the amount of loss from the third party responsible for such loss if such amount falls within the permissible loss limit. This principle shall not apply to life and health insurance policies;
- According to the principle of unpredictable risk, in order for a risk to be covered or insured against, it must be an unexpected and unanticipated one.

2. Principles of Accounting for Revenue from Business Activities in Vietnam

Regarding the legal basis, insurance businesses in Vietnam comply with Accounting Standards and Accounting Regime in Vietnam including:

- Circular no 232/2012/TT-BTC on guiding the accounting applicable to non-life insurance companies, reinsurance companies and branches of foreign non-life insurance companies issued by the Ministry of Finance on December 28, 2012;
- Circular no 199/2014/TT-BTC on accounting for life insurance companies and reinsurance companies issued by the Ministry of Finance on December 19, 2014;
- Circular no 200/2014/TT-BTC on guidelines for accounting policies for enterprises issued by the Ministry of Finance on December 22, 2014;
- Circular no 133/2016/TT-BTC on accounting for small and medium enterprises issued by the Ministry of Finance on August 26, 2016;
- Circular no 50/2017/TT-BTC on guidelines for the government's decree no 73/2016/ND-CP dated July 1, 2016 on details of the implementation of the law on insurance business and the law on amendments to certain articles of the law on insurance business by the Ministry of Finance on May 15, 2017;
- Circular no 01/2019/TT-BTC on amendments and supplements to certain articles of circular no.50/2017/TT-BTC dated May 15, 2017 of Ministry of Finance, providing instructions on implementation of government's decree no.73/2016/ND-CP dated July 1, 2016, elaborating on implementation of law on insurance and law on amendments or supplements to certain articles of law on insurance business by the Ministry of Finance on January 2, 2019;
- Vietnamese accounting standards in which VAS No. 19 - Insurance contracts based on IFRS 4. However, because the Ministry of Finance has not issued any specific instructions for implementing VAS 19, insurance enterprises only apply accounting instructions according to Circular No. 232/ 2012/TT-BTC and Circular No. 199/2014/TT-BTC.

According to the roadmap by 2025, financial reporting standards will be mandatory for businesses in Vietnam. In particular, the International Accounting Standards Board (IASB) has issued International Financial Reporting Standards no 17 (IFRS 17) to replace IFRS 4, officially effective from January 1, 2023. This standard will have a comprehensive impact on the business processes of insurance enterprises.

Revenue from insurance business activities includes revenue from original insurance premiums, reinsurance fees, and reinsurance cession commissions. Based on the above legal basis, insurance enterprises in Vietnam record revenue based on the following accounting principles: Revenue is recognized when the insurance enterprise is capable of receiving economic benefits that can be reliably determined. Revenue is determined at the fair value of the amounts received or to be received after deducting trade discounts, sales rebates and sales returns.

✓ Original insurance premium revenue

For life insurance: Insurance premium revenue is recognized when the insurance contract has been concluded and the insurance buyer has paid the premium in full. In case the life insurance enterprise has an agreement with the insurance buyer to pay insurance premiums according to the period specified in the insurance contract, the insurance premium revenue is accounted corresponding to the period or premium periods. Insurance has arisen. Fees due after the reporting date but received before the end of the fiscal period will be recorded as "Unearned Revenue" on the Balance Sheet. Except in cases where the insurance contract has a minimum premium payment clause, revenue from the universal life insurance contract is recognized by the life insurance enterprise when the premium is collected. The value of the universal life fund is calculated by actuarial experts and recorded through "Operational reserves" on the Balance Sheet.

For non-life insurance: Original insurance premium revenue is recognized when the following conditions are met:

- The contract has been signed between the insurance business and the insurance buyer, and the insurance buyer has fully paid the insurance premium;
- There is evidence that the insurance contract has been concluded and the insurance buyer has paid the full insurance premium;
- When the insurance contract has been concluded, the non-life insurance enterprise has an agreement with the insurance buyer on the insurance premium payment period (including the extension period). The insurance premium payment deadline must be specified in the insurance contract. The insurance premium payment term is no more than 30 days from the effective date of the insurance contract. In case of paying insurance premiums periodically, the insurance enterprise accounts the insurance premium revenue of the first premium payment period when the insurance contract takes effect and only accounts the insurance premium revenue of the premium payment periods. Subsequent insurance when the insurance buyer has fully paid the insurance premium as agreed in the insurance contract. In case the insurance buyer does not pay the insurance premium in full by the premium payment deadline, the insurance contract will automatically terminate at the end of the premium payment deadline.
- Insurance premiums received before they are due at the end of the accounting period are recorded in "Short-term unearned revenue" on the Balance Sheet.
- Refunds or reductions in original insurance premiums are revenue deductions and are tracked separately. At the end of the period, they are transferred to the original insurance premium revenue account to calculate net revenue.

✓ Reinsurance premium revenue is recognized when liability arises, based on the reinsurance notice sent to the Corporation by the reinsurers and confirmed by the insurer. Insurance enterprises record reinsurance ceded fees based on the amount of fees ceded to reinsurers, corresponding to the original insurance premium revenue recorded during the year.

✓ Reinsurance ceding commissions are recorded corresponding to reinsurance ceding fees incurred during the year. During the year, all reinsurance commission revenue under reinsurance contracts concluded according to the provisions of the financial regime is reflected in the item "Reinsurance commission revenue". At the end of the fiscal year, the insurance enterprise must determine the unearned reinsurance commission revenue corresponding to the unearned reinsurance cession fee during the year to transfer to the following years according to the method of allocation. Fee reserve mentioned above.

3. Challenges in Revenue Recognition for Insurance Business in Vietnam

Insurance contracts: Although IFRS 17 - Insurance Contracts promises to increase transparency and comparability of information for businesses, implementing the standard is complex. IFRS17 directly affects the determination of business plans and results of enterprises. According to PwC's survey "Assessing the roadmap for applying IFRS 17 - 2021: Asia-Pacific Region", 70% of survey participants are worried about practical difficulties in implementing IFRS 17 even though although more than half of them have reached the detailed design stage. Also, according to this survey, the expected time to implement IFRS 17 has increased from 3.5 years to 3.8 years, especially for life insurance companies. Prolonged time may cause implementation costs to be higher than the initial budget. Therefore, implementing IFRS 17 remains a major challenge for many insurance companies.

- Regarding how to manage insurance contracts: IFRS 17 requires classifying insurance contracts into homogeneous categories based on characteristics, type, risk or level of profitability. With this requirement, businesses need to take steps to evaluate the characteristics of the insurance contract portfolio, select accounting policies to classify contracts and appropriate models. Not only that, businesses also need to estimate the profitability of the contract right from the time of signing.
- Regarding measurement models: IFRS 17 has 3 measurement models including general model, insurance premium allocation model, and fluctuating premium model. The generic model is a standard rating model that can be applied to all insurance contracts. To apply the model, businesses must understand two concepts first mentioned in IFRS 17: Contractual service margin (CSM) and fulfilment cash flows. The premium allocation model is often chosen by insurance businesses for insurance contracts of less than one year. The fluctuating fee model applies to insurance contracts that feature direct profit and loss sharing. Each measurement model will be suitable for different groups of insurance contracts. Applying the models will impact items on the financial statements, mainly insurance premiums and professional reserves.

Premiums: Recognition is no longer based on premiums or premiums received but will primarily include changes in liability for remaining insurance and the release of insurance cash flows. Insurance premium includes the total insurance premium receivable for the validity period of contracts arising in the accounting period and is recorded on the date the insurance contract arises for liability. Insurance premiums include any adjustments arising during the accounting period for insurance premiums receivable for operating contracts in previous accounting periods. Insurance contract term from short-term to long-term affects the timing of insurance premiums and the need for periodic adjustments.

Unearned insurance premiums: Unearned insurance premiums are the portion of insurance premiums that have been exploited related to risk periods after the date of the financial position statement. Unearned insurance premiums are calculated and recorded deferred as a reserve for subsequent periods, so businesses have difficulty determining when to recognize revenue.

Compensation reserve: Compensation reserve includes compensation reserve for losses that have been claimed but have not been resolved at the end of the year and reserves for losses that have incurred insurance liability but have not yet been claimed. The claim reserve for claims that have not been resolved at the end of the year is determined on the basis of estimates of each compensation case under insurance liability that has been notified to the insurance enterprise or customer who claims failure, however, it was not resolved at the end of the year. This may affect the timing and revenue recognized.

4. Some Recommendations

Vietnam's insurance market is on the rise. The need for integration as well as investment attraction of insurance businesses requires perfection in accounting, especially revenue accounting. To solve the complexity of revenue recognition in insurance business activities, need to:

For insurance businesses,

- Firstly, with the goal of improving transparency and comprehensiveness in reflecting the business efficiency of each insurance contract to the overall profit of the enterprise, according to experts, IFRS 17 is an important and complex standard. IFRS 17 requires a detailed classification of insurance contracts based on expected profit over the entire contract term. For insurance businesses that have applied IFRS need to evaluate an insurance contract at the initial recognition date in terms of total completed cash flows including estimated future cash flows, time value of money adjustments and financial risk. Regarding future cash flows, financial risks are not included in the estimate of future cash flows and adjustments for non-financial risks. Insurance contracts must be measured at the present value of future cash flows including premiums, claims and actuaries. Measurements should be periodically updated to reflect changes in estimates and assumptions. At the same time, insurance businesses need to evaluate insurance products, learn about models, methods and data of insurance contracts according to the requirements of IFRS 17. From there, it helps provide intelligent information. Be more transparent about the financial situation as well as the financial risks of insurance enterprises. For insurers that have not yet adopted IFRS, create a detailed plan and comprehensively assess gaps in existing data, models and processes, understand the financial implications and explain the implications. This action for stakeholders.
- Secondly, step by step approach how to measure and record insurance reserves according to IFRS. All insurance reserves are set aside for estimates of losses claimed but not yet settled at the cut-off date and losses incurred but not yet claimed. At the end of the accounting period, provisions are not allowed for contracts that do not yet exist, such as provisions for large fluctuations or provisions to ensure balance.
- Thirdly, the insurance company's information technology system must be strong enough to collect, store and retrieve large and detailed data volumes. At the same time, the information technology system must integrate with the calculation and reporting system to help streamline the revenue recognition process and reduce the risk of errors and inconsistencies in the recognition process. Therefore, insurance businesses need to invest in technology infrastructure such as digitizing insurance processes and products; Deploying OCR (Optical Character Recognition) with AI applications to increase labor productivity; deploying eKYC (electronic Know Your Customer); Applying Bigdata technology for analysis and decision-making; Applying robotic process automation (RPA) software, application programming interface (API)... to automate business processes. At the same time, strengthen the review and evaluation of information technology systems periodically to update, handle and prevent security holes.
- Fourthly, recruit and train finance and accounting experts with expertise in IFRS and understanding of information technology. According to PwC's survey "Assessing the roadmap for applying IFRS 17 - 2021: Asia-Pacific Region", one of the top three challenges when applying IFRS is the lack of human resources (21%). To meet the IFRS application roadmap, businesses in general and insurance businesses in particular need to train and develop accounting human resources with IFRS expertise such as: Establishing a project board to implement IFRS, accounting personnel taking courses and getting certifications on IFRS.

For State management agencies:

- **Insurance policies:** State management agencies need to regulate information disclosure and financial reports for insurance enterprises.
- **Tax policy:** State management agencies specifically regulate revenue to calculate taxable income for insurance and reinsurance business activities.
- **Accounting policy:** Need to add new conceptual terms according to IFRS to accurately reflect insurance premium revenue and insurance business costs. At the same time, the Ministry of Finance needs to have specific instructions on how to calculate and record revenue from insurance business activities.

5. Conclusion

Recognizing insurance business revenue is a complex process that requires compliance with general accounting principles and a deep understanding of the industry's unique business characteristics. In addition, by 2025, businesses in general and insurance businesses in particular in Vietnam will compulsorily apply financial reporting standards. This is a huge challenge not only for the accounting department but also for all insurance businesses. By implementing synchronous solutions, insurance businesses can improve the transparency of financial reporting and maintain a solid financial foundation in a competitive market.

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