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Readiness and Challenges for Applying IFRS 17 (Insurance Contracts): The Case of Jordanian Insurance Companies

Walid Omar OWAIS[1], Ahmad Abdelrahim DAHIYAT[2]

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Abstract

This paper examines the readiness of Jordanian insurance companies to apply the International Financial Reporting Standards (IFRS 17), and the challenges of its application. The study developed a questionnaire based on prior related studies, and in the light of IFRS 17, the study used different statistical methods and techniques such as means, standard deviation, and t-test to achieve its goals. The results indicate that Jordanian insurance companies are not ready to apply IFRS 17, for several reasons. Most importantly, insurance companies have a low level of ability to define the scope of IFRS 17, study the impact of IFRS 17 application to financial reports, and develop new internal monitoring methods to apply IFRS 17. As for the challenges for applying IFRS 17, the biggest is the data challenge, followed by the challenges of first-time implementation, systems, and results and presentation. Finally, this paper advocates that it has become important for Jordanian insurance companies and supervisory bodies to enhance their readiness to apply IFRS 17 within a scheduled time framework and by taking several preparatory steps: performing simulations consisting of procedures to deal with IFRS 17 requirements and the impact on financial reports, and helping human resources with familiarization and application of IFRS 17.

Keywords: IFRS 17, Insurance Companies, Readiness, Challenges, Jordan

JEL Classification Code: M40, M41, F10

1. Introduction

The International Financial Reporting Standards IFRS 17 (Insurance Contracts) was issued on 18/5/2017, which replaced IFRS 4. Insurance companies must apply IFRS 17 for annual periods beginning on or after 1/1/2021, and the standard was delayed to be applied on 1/1/2023. The standard can be applied before that date if the company also applies IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts with clients) at the same time (IFRS Foundation, 2020).

It is expected that IFRS 17 will significantly affect financial reporting in the insurance sector, especially since IFRS 4 allowed different accounting treatments to be followed; the new treatments to be applied by IFRS 17 will require preparations in different aspects such as software, risk management, accounting and tax laws, instructions, and regulations and legislation. It also will create challenges that need to be faced, such as first-time application, conceptual challenges, and challenges associated with measurement approaches. During the time lag between the issuance of the standard and its application date, companies are supposed to create certain requirements related to systems, employees, processes, and data, in order to be able to properly apply the standard.

This study examines the readiness of Jordanian insurance companies to apply IFRS 17, and to shed light on the challenges of implementing IFRS 17 in Jordanian insurance companies.

2. The Importance of the Insurance Sector in the Jordanian Economy

The insurance industry developed in Jordan through the establishment of the first insurance agency in 1946 that was

[1]First Author and Corresponding Author. Associate Professor, Accounting and Accounting Information System Department, Amman University College for Financial and Managerial Science, Al-Balqa Applied University, Amman, Jordan [Postal Address: P.O. Box 960958, Amman, Jordan] Email: waliiidowais@bau.edu.jo
[2]Associate Professor, Accounting and Accounting Information System Department, Amman University College for Financial and Managerial Science, Al-Balqa Applied University, Amman, Jordan. Email: adahiyat@bau.edu.jo

affiliated with the Egyptian Al-Sharq Insurance Company, while the first national insurance company appeared in 1951, as the Jordanian Insurance Company. The number of companies increased in subsequent decades, eventually reaching 24 companies. At the same time, laws were issued to regulate the insurance market (Insurance Law No. 30 of 1984 and Law No. 9 of 1995), in addition to the establishment of the Jordan Insurance Federation in 1989, which replaced the Jordan Association for Insurance companies (founded in 1956) (Jordan Insurance Federation, 2020).

In spite of the difficult conditions surrounding Jordan, the wheel of the local economy started to turn quickly, and the growth numbers are witness to an increase in many areas during recent years. But the emergence of the COVID-19 pandemic in 2019 and 2020 has had an impact on the insurance sector in Jordan, and this is evident through a report by the Jordan Insurance Federation on studies conducted through the first half of 2020. The following are the most important indicators of the study (Jordan Insurance Federation, 2020):

Insurance premiums: The past year has seen a decrease in written premiums of 3%, as 2020 total premiums reached $432 million, compared to the same period in 2019, which amounted to $446 million.

Insurance compensation: There was a decrease in the total compensation paid to the insurance market of 21.6%, from $328 million in 2019 to $257 million in 2020.

As for the market value of insurance companies listed on the Amman Stock Exchange, according to the latest aggregate information available at the Amman Stock Exchange (2020), it reached more than $412 million in 2018, while the volume of sector assets reached $1,040 million in that year.

3. Literature Review and Hypotheses

3.1. Literature Review

The draft of IFRS 17 was initiated in April 1997 by the International Accounting Standards Committee, the predecessor of the International Accounting Standards Board (IASB). The result of the project was the issuance of IFRS 4 in March 2004 as an interim standard that did not achieve consistency in the accompanying financial reports and disclosures as required by investors and analysts worldwide (International Accounting Standards Board, 2017).

It becomes clear when studying IFRS 17 that new requirements regarding accounting for insurance contracts, issued reinsurance contracts, and retained reinsurance contracts were imposed. Regarding the grouping of insurance contracts, Standard 17 requires that insurance contracts be grouped into portfolios where each portfolio represents contracts that involve similar risks and are managed together. Insurance companies are expected to consolidate contracts for specific insurance products in the same portfolio.

Standard 17 also changed the presentation of the results of insurance operations in the statement of financial position and the statement of comprehensive income. For example:

- Insurance and reinsurance contracts can have assets or liabilities that are presented separately in the statement of financial position.
- Acquisition costs can either be an expense when incurred, if the contract period is less than or equal to the year, or they should be deferred and deducted from the remaining coverage obligations.
- Insurance premiums and claims will be exchanged for insurance services revenues and insurance services expenses, with the reinsurance results shown separately.
- Insurance contract financing expenses and income will be presented separately in the income statement.

Among the most important changes introduced by the standard are the basic approaches to accounting for insurance contracts that are presented by the standard. The initial recognition to measure a group of insurance contracts will be at the total of the fulfilment cash flows (FCFs) and the contractual service margin (CSM). FCFs contain estimates of future cash flows with an adjustment to reflect the time value of money and to reflect financial risks related to future cash flows, and the risk adjustments related to non-financial risks (IFRS 17:32), while CSM represents the recognition of “unearned profit of contacts” on the assumption that the entity will provide service in the future (IFRS 17:38). The subsequent measurement of carrying amount at the end of the period, according to article 40 of IFRS 17, should be the sum of the liability for remaining coverage according to FCFs for future services and the CSM of the contracts’ group at date, and the liability for incurred claims which comprise the FCFs of the past service allocated to the group at that date.

IFRS 17 also permits a simplification of the measurement of the liability related to remaining coverage of contracts’ group by using the Premium Allocation Approach (PAA).

3.2. Previous Studies and Development of Hypotheses

In general, in order to study the readiness of insurance companies to apply IFRS 17, researchers have divided this into two aspects: application requirements and challenges.

For the application requirements, a study by Mahmoud and Al-Shammari (2020) dealt with the application of IFRS 17 in the Iraqi environment using a model of input, process, and output. The stage of input contained standards of the database and its requirements for the use of procedures and programs to prepare it for work. This included the programs and systems, which include the creation of modern programs that help in the accounting treatment of insurance contracts, human resources, and their rehabilitation through training courses and familiarizing them to the new standard. Hermawan et al. (2020) emphasized the importance of employees' engagement as a driver of employee performance; engagement will not be achieved without rehabilitation; funding, including material resources, which can be reduced through participation with similar companies and accounting and tax laws, instructions, regulations, and legislation; and the requirements for making amendments to comply with the conditions of the new standard. The stage of process included actual application of accounting for insurance contracts and the encompassing application of the new standard approaches. The stage of output was the outputs of insurance work from the financial reports and the related increase in disclosure requirements. Another study by PricewaterhouseCoopers (2019) examined Bulgarian insurers' readiness to apply IFRS 17. It posed the following questions regarding standards: Are interested parties able to define the scope of IFRS 17? Are software solutions sufficient to apply the IFRS17? Will application of IFRS 17 lead to the development of new internal monitoring methods? Will the application of IFRS 17 be a source of improvement in risk management and performance monitoring? And are insurance companies ready to apply IFRS 17 within the allowed time?

A study by Hobern et al. (2019), supported by Milliman Inc., measured the readiness to apply IFRS 17, covering the following dimensions: IT infrastructure, valuation methodology, valuation assumptions, transition methodology, actuarial models, accounting systems, governance processes, data quality requirements, reporting, disclosure templates, and strategic considerations.

A study conducted by KPMG (2017) used strategic and operational considerations. Strategic considerations included options for the transition to applying the new standard and their impact on the financial position statement, how to conduct business and measure it in the future, considerations that will be relevant to measuring executive performance, and the type of information that the new disclosures will reveal to competitors and external stakeholders. Operational considerations included communications required for analysts and regulators, in addition to the procedures followed, the relationship with the time frame for financial reporting for the purpose of accommodating accounts and disclosures, the scope of coverage of implementation of processes and their efficient presentation, the adequacy of resource management requirements, changes to the nature of work to produce stronger work, the impact of the new standard on industrial variables, and finally the actions that competitors may take.

This study will adopt the following criteria to measure the readiness of insurance companies to apply IFRS 17, based on previous studies and what it deems appropriate for the work environment in Jordan: how interested parties are able to define the scope of IFRS 17; how human resources will be prepared through training courses to familiarize them to the new standard; how funding, including material resources applying to IFRS 17, will lead to the development of new internal monitoring methods; changes to the nature of work to produce stronger work; the programs and systems, including the creation of modern programs that help in the accounting treatment of insurance contracts; and strategic considerations, including options for the transition to applying the new standard and their impact on financial reports.

Researchers believe that the availability of these criteria for Jordanian insurance companies will answer the main hypothesis of the study, which is this:

***H1:** Jordanian insurance companies are ready to apply IFRS 17 within the specified time for the application.*

The other section of the study concerns the challenges to inform the willingness of insurance companies to implement the new standard IFRS 17. A study by Al-Mashhadani and Malik (2020) dealt with the challenges of applying IFRS 17 in the Iraqi environment. It categorized the challenges into conceptual challenges, which include accounting concepts and variation in the bases in terms of recognition, measurement, presentation, and disclosure; the conviction of senior management in applying the new standard (which it is in line with the result of a study by Nguyen, (2020) that environmental awareness of senior managers is one of five factors that influence on environmental accounting implementation); knowledge among the executive management of the steps and procedures for implementing the new standard; and cultural values (conservatism) in the accounting community (that harmony with a result of a study made by Astuti et al. (2020), which states that work motivation and job satisfaction became essential factors on work culture that affect employee performance), and the disclosure requirements required by the new standard.

Challenges associated with the recognition criteria under IFRS 17, and challenges associated with measurement approaches according to IFRS 17. A study by Heijnen (2018) used the following criteria for challenges: reducing the transition time to IFRS 17 implementation; differences in the measurement approaches that will appear between the insurance contracts and the reinsurance contracts held; clarification and management of risk adjustments; whether directors will be allowed to give their opinions; difficulty in adhering to financial reporting schedules; technical problems and their effect on the areas of actuarial systems and other systems such as tax performance; the shifts that are required in the way data is collected, stored, analysed, and presented; and increased internal resources to manage risks. A report issued by Milliman Inc. (2016) relating to challenges in applying IFRS 17 (IFRS 4, phase II), used the following criteria: necessary data such as for calculating the level of insurance contracts; systems, which include the effect on actuarial systems; the new system for calculating the margin of contractual service; and the impact on the accounting system. First-time application includes the use of standardized and fair value measurement approaches. And results and presentation include basic changes to the income statement as well as major changes in financial position and the comprehensive income statement.

The researchers believed that the criteria set by the Milliman Inc. report (2016) would be appropriate for handling the challenges in the Jordanian insurance company environment. This leads to the second main hypothesis of the study:

H2: *There are no challenges for Jordanian insurance companies to apply IFRS 17 within the specified time for the application.*

4. Research Method

The study relied on the descriptive approach, and this approach is concerned with collecting data through a sample, then organizing and describing it quantitatively, then presenting it in frequency tables. This approach summarizes the data and analyses it through measures of central tendency and dispersion (Donald & Schindler, 2014:134).

4.1. Sample and Data Collection

The study population represents all 24 Jordanian insurance companies, for which 144 questionnaires were distributed to employees of the financial department using the simple random sample method, with six questionnaires sent to each company. Of these, 129 questionnaires were retrieved (89.6% response rate), and six questionnaires were excluded as incomplete. Thus, the final sample comprised 123 questionnaires valid for statistical analysis (85.4% of the distributed questionnaires).

4.2. Data Validity and Reliability

An initial questionnaire was presented to Jordanian university professors with specialized expertise in order to verify the validity, and the questionnaire was modified according to their observations. By extracting the value of the correlation coefficient (Pearson correlation), it was found that the value for dimension A (corporate readiness) ranged between 0.536 and 0.932, and the value for dimension B (challenges) ranged between 0.693 and 0.913. This is an acceptable indicator of the structural integrity and validity, because the correlation coefficient is not less than 0.30 and the direction of the relevant sections is direct and on the correct axis (Linn & Gronlund, 2012:136).

To measure the stability of the internal consistency of the paragraphs of the study dimensions, Cronbach's Alpha was used, the results of which are shown in Table (1).

The value of Cronbach's Alpha ranged between 76.4% and 89.8%. Sekaran and Bougie (2016:325) indicated that the minimum internal consistency constancy of the Cronbach's Alpha factor is 0.70, and the closer the value is to 1, i.e. 100%, this indicates higher degrees of stability for the study tool. Accordingly, all internal consistency factors (Table 1) indicate good stability of the study tool and its reliability for statistical analysis.

4.3. Normal Distribution Test

A test of the normal distribution of the participants' answers was performed to verify whether the data fall under the normal distribution or not; results are shown in Table 2. The skewness test value was extracted, to determine whether the value falls outside the range (±1), which would indicate a large skewness of distribution; the kurtosis test value was extracted to determine whether the distribution is normal (kurtosis value not in excess of ±2.58 (at 0.01 level) and ±1.96 (at 0.05 level) (Hair et al., 2018:69).

Based on the test data (Table 2), the data distribution was normal, as the skewness values did not fall outside the range (±1) and the Kurtosis value did not exceed ±1.96.

5. Results

5.1. Descriptive Results

The means, standard deviations, rank, relative weight, and relative importance were calculated to determine the direction of the opinions of the study sample, as the study tool was divided to determine the relative importance of each of its sections, using a 5-point Likert scale to judge the study results according to the following equation (Subedi, 2016): Class Length = Upper Limit Alternative – Substitute Minimum / Number of levels. = (5–1)/3 = 1.33

Table 1: Cronbach's Alpha

Readiness to implement IFRS 17	Criterion one	Criterion two	Criterion three	Criterion four	Criterion five	Criterion six	Criterion seven
No. of Paragraphs	5	5	3	3	4	3	3
Cronbach's Alpha	0.851	0.857	0.826	0.833	0.807	0.866	00.796
Challenges	**Criterion one**		**Criterion two**		**Criterion three**		**Criterion four**
No. of Paragraphs	5		4		3		4
Cronbach Alpha	0.898		0.822		0.797		0.764

Table 2: (Skewness) (Kurtosis) Test

Readiness to implement IFRS 17	Criterion one	Criterion two	Criterion three	Criterion four	Criterion five	Criterion six	Criterion seven
Skewness	0.590	–0.596	–0.248	–0.219	0.220	0.016	–0.039
Kurtosis	1.093	–0.293	–0.700	0.589	–0.811	1.255	–0.890
Challenges	**Criterion one**		**Criterion two**		**Criterion three**		**Criterion four**
Skewness	–0.830		–0.625		–0.616		0.588
Kurtosis	1.723		0.379		0.395		1.656

5.2. The Readiness to Apply IFRS

Table 3: Descriptive Analysis of Readiness

Paragraph No.	Paragraph	Relative Important	Relative Weight%	Rank	Standard deviation	Mean
1	Classifying contracts according to the different measurement Approaches for IFRS 17.	Low	37.2	4	0.705	1.86
2	Creating portfolio of insurance contracts & split them according whether they are profitable or onerous at initial recognition.	Low	36.8	5	0.706	1.84
3	Performing simulation for the application of IFRS 17 on representative portfolios for general or premium allocation approaches.	Low	39.8	2	0.683	1.99
4	Performing simulation for the application of IFRS 17 on representative portfolios for participation contracts: the variable fee approach or general approach.	Low	38.6	3	0.698	1.93
5	Considering usage of the other comprehensive income option for liabilities for contracts valued according the different approaches.	Low	40.4	1	0.701	2.02

Table 3: (Continued)

Paragraph No.	Paragraph	Relative Important	Relative Weight%	Rank	Standard deviation	Mean
1	The ability of insurance companies to define the scope of IFRS 17.	Low	39.4	7	0.632	1.97
6	The availability of skilled-qualified human resources.	Moderate	66.8	3	0.815	3.34
7	The availability of skilled-qualified management.	Moderate	72	2	0.885	3.60
8	Employees participated in training program to apply IFRS 17.	Low	43	5	0.666	2.15
9	Planning to attend employees in specialized training courses about IFRS 17.	Moderate	65	4	0.972	3.25
10	Planning to hire new skilled employees to apply IFRS 17.	High	76	1	0.964	3.80
2	Human resources Familiarization and rehabilitation to apply IFRS 17.	Moderate	64.6	1	0.692	3.23
11	Sufficiency of resources to manage the finance function under IFRS 17.	Moderate	71.8	1	0.922	3.59
12	Sufficiency of resources to manage the risk function under IFRS 17.	Moderate	64.2	2	0.994	3.21
13	Estimation of total costs of IFRS implementation.	Moderate	48.8	3	0.691	2.44
3	Funding including material resources.	Moderate	61.6	2	0.757	3.08
14	Redefining the function & responsibilities to deal with the impact of IFRS 17 implementation on finance and risk functions.	Low	45.8	1	0.569	2.29
15	Developing new internal monitoring methods that are complied with IFRS 17 to achieve the company's objectives.	Low	44.8	2	0.529	2.24
16	Developing risk management & performance monitoring tools to deal with IFRS 17.	Low	44.6	3	0.509	2.23
4	Develop new internal monitoring methods.	Low	45	5	0.464	2.25
17	Realize the scope of coverage of processes implementation and their efficient presentation.	Low	45.2	4	0.441	2.26
18	Reshaping program for finance & risk management.	Moderate	66.8	1	0.848	3.34
19	Expecting the limitation in order of implementation tasks to meet the requirements of IFRS without going beyond.	Low	45.6	3	0.520	2.28
20	Studying if implementation tasks will rely more on software.	Low	45.8	2	0.491	2.29
5	Changes to the nature of work	Moderate	50.8	3	0.475	2.54
21	Engaging in study the consistent between the current software and IFRS 17.	Low	41.8	2	0.747	2.09

Table 3: (Continued)

Paragraph No.	Paragraph	Relative Important	Relative Weight%	Rank	Standard deviation	Mean
22	Planning to build a suitable system to connect all existing systems, while communicating upstream & downstream and manage large data.	Low	36.8	3	0.814	1.84
23	Planning to purchase a suitable system to connect all existing systems, while communicating upstream & downstream and manage large data.	Moderate	68.2	1	0.922	3.41
6	Technical infrastructure.	Moderate	48.8	4	0.738	2.44
24	Determining the new chart of accounts.	Low	42.2	1	0.777	2.11
25	Defining the accounting schema-approach.	Low	41.4	3	0.781	2.07
26	Defining the new IFRS 17 disclosures.	Low	41.4	2	0.759	2.07
7	Studying the Impact on financial reports.	Low	41.6	6	0.651	2.08

5.3. The Challenges of IFRS 17 Implementation

Table 4: Descriptive Analysis of Challenges

Paragraph No.	Paragraph	Relative important	Relative Weight%	Rank	Standard deviation	Mean
27	Calculating the level of insurance contracts.	High	80	3	0.747	4.00
28	Dividing the contracts by group of onerous contracts and other types.	High	79.6	4	0.730	3.98
29	Dividing the contracts by annual generation of contracts.	High	79	5	0.745	3.95
30	Contractual service margin's release based on coverage units.	High	80	2	0.736	4.00
31	The whole processing of the contractual service margin.	High	80.4	1	0.701	4.02
1	Data	High	79.8	1	0.617	3.99
32	The effects of IFRS 17 implementation on actuarial systems.	Moderate	71	3	0.643	3.55
33	Deal with a new system for calculating the margin of contractual system.	High	82.2	1	0.546	4.11

Table 4: (Continued)

Paragraph No.	Paragraph	Relative important	Relative Weight%	Rank	Standard deviation	Mean
34	Impact on accounting system.	Moderate	69.6	4	0.694	3.48
35	Acquiring a software to manage and process large volume of data under IFRS 17.	High	77.8	2	0.630	3.89
2	Systems	High	75.2	3	0.509	3.76
36	Using the standardized and fair value measurement approaches.	High	78.6	2	0.680	3.93
37	People who can deal with a more complex calculation under IFRS 17.	Moderate	70	3	0.534	3.50
38	The variety of the valuation model of portfolio.	High	79	1	0.745	3.95
3	First Time Implementation	High	75.8	2	0.556	3.79
39	changes to the income statement.	Moderate	68.2	2	0.598	3.41
40	changes in the financial position statement.	Moderate	70.4	1	0.645	3.52
41	changes in comprehensive statement Income.	Low	45.6	4	0.835	2.28
42	The presentation of the accounts that should be disclosed by annex.	Low	45.6	3	0.805	2.28
4	Results and presentation	Moderate	57.4	4	0.557	2.87

Table 5: Hypotheses Test

Hypothesis	*T* Sig	*T* table	*T* calculated	DF	Standard deviation	Result
H1	0.00	–1.9799	–16.911	1	0.31823	Companies are not ready to apply IFRS 17
H2	0.00	1.9799	19.268	1	0.34749	There are challenges for companies to apply IFRS 17

5.4. Hypotheses Test

H1: *Jordanian insurance companies are ready to apply IFRS 17 within the specified time for the application.*

H2: *There are no challenges for Jordanian insurance companies to apply IFRS 17 within the specified time for the application*.

As shown in Table 5, the mean of the first hypothesis is 2.5148, with a standard deviation of 0.31823, and the value of the calculated T is 16.911, in a reverse direction and with a significant level (0.00). This result is an indication that Jordanian insurance companies are not yet ready to apply IFRS 17.

As for the second hypothesis, the results (Table 5) indicate that the calculated value of T (19.268) is greater than its tabular value and with a significance level of 0.00. This result is an indication that Jordanian insurance companies have challenges in applying IFRS 17.

6. Conclusions

This study had two main goals: to determine the readiness of Jordanian insurance companies to apply IFRS 17, and to explain if there are any challenges facing Jordanian insurance companies in applying IFRS 17. The results showed that Jordanian insurance companies are not ready to apply IFRS 17, and there are challenges in applying the standard.

We found that, the ability of insurance companies to define the scope of IFRS 17 is low, as a result of not focusing on creating a portfolio of insurance contracts and splitting them according to whether they are profitable or risky at initial recognition, and on classifying contracts according to the different measurement approaches for IFRS 17 and focusing on conducting simulation for the application of IFRS 17 on representative portfolios for different approaches and for participation contracts. Furthermore, there is low readiness to consider usage of the other comprehensive income options for liabilities for contracts valued according to the different approaches.

Also, the companies have a low level of readiness in studying the impact of applying IFRS 17 in their financial reports, and a low readiness in developing new internal monitoring methods.

The study showed a moderate level of readiness for technical infrastructure, changes to the nature of work, funding including material resources, and human resource familiarization and rehabilitation to apply IFRS 17.

As for the challenges for applying IFRS 17, the biggest is the data challenge, followed by the first-time implementation challenge, the systems challenge, and results and presentation.

These conclusions lead to what distinguishes this study from previous studies, by limiting it to the Jordanian community, and that despite the need to apply the standard, beginning in 2021 and then extending it in 2023, the insurance sector is still not ready. This study can thus be helpful if the conclusions are circulated to the insurance sector, urging the sector to start preparing in advance to implement IFRS 17 and informing the sector of the challenges it may face.

It is recommended that Jordanian insurance companies and supervisory bodies enhance their readiness to apply IFRS 17 within a scheduled time framework by performing simulations, consisting of procedures to deal with IFRS 17 requirements and the impact on financial reports, and by starting the development of internal monitoring methods, focusing on technical infrastructure, changes to the nature of work, funding including material resources, and human resources familiarization and rehabilitation to apply IFRS 17.

The challenges of applying IFRS 17 should be faced by insurance companies in order to apply IFRS 17 in the specified time.

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