

# **Insurance Contracts in the Public Sector**

Comments to the AASB by 8 June 2022



**Australian Government**

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**Australian Accounting  
Standards Board**

## Commenting on this AASB Exposure Draft

Comments on this Exposure Draft are requested by 8 June 2022.

## Formal Submissions

Submissions should be lodged online via the “Current Projects – Open for Comment” page of the AASB website ([www.aasb.gov.au/current-projects/open-for-comment](http://www.aasb.gov.au/current-projects/open-for-comment)) as a PDF document and, if possible, a Word document (for internal use only).

## Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: [standard@aaasb.gov.au](mailto:standard@aaasb.gov.au)

Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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## Introduction

### Australian Accounting Standards

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The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards. The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

### Exposure Drafts

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The publication of an Exposure Draft is part of the due process the AASB follows before making a new Australian Accounting Standard or amending an existing one. Exposure Drafts are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

### Why we are making these proposals

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The AASB developed the proposals in this Exposure Draft jointly with the New Zealand Accounting Standards Board. Public sector entities in Australia and New Zealand engaging in arrangements that are regarded as being 'insurance contracts' are currently applying:

- (a) AASB 4 *Insurance Contracts* and AASB 1023 *General Insurance Contracts* in Australia; and
- (b) PBE IFRS 4 *Insurance Contracts* in New Zealand.

The combined content of AASB 4 and AASB 1023 is the same as the content of PBE IFRS 4 (including Appendix D) as it applies to general insurance contracts. Accordingly, the accounting requirements applied to arrangements that are regarded as insurance contracts in both jurisdictions are currently aligned.

AASB 17 *Insurance Contracts* issued in 2017, when applied, replaces AASB 4, AASB 1023, AASB 1038 *Life Insurance Contracts* and Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations* in respect of Australian for-profit entities in the private and public sectors.

NZ IFRS 17 *Insurance Contracts* was issued in 2017 (revised 2020) and supersedes NZ IFRS 4 *Insurance Contracts* in respect of private sector entities.

AASB 17 and NZ IFRS 17 incorporate IFRS 17 *Insurance Contracts*, which applies to annual reporting periods beginning on or after 1 January 2023.

Consistent with the policies of both Boards, the new Standards are being considered for application by public sector entities, including the possible need for modifications to facilitate that application. The proposed guidance and modifications in this ED have been developed based on the Boards' policy frameworks set out in [AASB Not-for-Profit Entity Standard-Setting Framework](#) and [New Zealand Accounting Standards Framework](#).

### What we are proposing

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This Exposure Draft proposes the following modifications to AASB 17:

- (a) an exemption from sub-grouping onerous versus non-onerous contracts at initial recognition;
- (b) an exemption from sub-grouping contracts issued no more than a year apart;
- (c) an amendment to the initial recognition requirements so that they do not depend on when contracts become onerous;
- (d) guidance on coverage periods, which has consequences for assessing eligibility for the premium allocation approach in a public sector context;
- (e) indicators for identifying the transactions to which AASB 17 should apply in a public sector context; and
- (f) guidance on determining the cash flows within the contract boundary.

The NZASB's Exposure Draft 2022-3 *Insurance Contracts in the Public Sector* proposes identical modifications to PBE IFRS 17 as described in (a)–(f). In addition, the NZASB is proposing to require risk adjustments for non-financial risks in measuring insurance liabilities to be measured at a rebuttable 75% confidence level.

To the extent feasible, the Boards will endeavour to achieve a consistent accounting outcome across both jurisdictions. This aligns with the general principles of the Protocol for Co-operation between the Boards.<sup>1</sup>

## Application date

It is proposed that public sector entities would apply AASB 17 to annual periods beginning on or after 1 July 2025, with earlier application permitted. This is later than the application date of AASB 17 to entities that are not public sector entities, which is annual periods beginning on or after 1 January 2023.

## What happens next

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The AASB will consider feedback on this Exposure Draft at future meetings and, based on the information received, will determine whether the proposals should be implemented, with or without amendment. Depending on the nature and extent of the feedback, the AASB may publish a Fatal-Flaw Review Draft to enable further consultation with stakeholders.

## We need your feedback

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Comments are invited on any of the proposals in this Exposure Draft by 8 June 2022. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue (whether an issue specifically identified below or another issue).

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to comment on only those questions, or issues that are relevant to you.

## Specific matters for comment

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The AASB would particularly value comments on the following proposals made specifically in respect of public sector entities.

### Sub-grouping of contracts [paragraphs Aus16.1 and Aus22.1 and paragraphs BC19 to BC45]

1. Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.
2. Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.

### Initial recognition when contracts are onerous [paragraph Aus25.1 and paragraphs BC46 to BC50]

3. Do you agree with the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.

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<sup>1</sup> The *Protocol for Co-operation between: the Australian Accounting Standards Board, the Australian Auditing and Assurance Standards Board, the Australian Financial Reporting Council, and the New Zealand External Reporting Board* (2019). Although the Protocol's objective is generally limited to minimising any differences between Standards applying to Tier 1 for-profit entities in each jurisdiction, minimising differences across all sectors is consistent with this objective.

**Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA) [paragraphs Aus34.1 to Aus34.3 and AusB64.1 and paragraphs BC51 to BC85]**

4. Do you agree with the proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context? In particular, do you agree with the proposals to provide guidance that:
- (a) assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;
  - (b) a public sector entity's monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity's practical ability to fully price for risks or benefits;
  - (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;
  - (d) arrangements would not be regarded as failing to meet the criterion in AASB 17 paragraph 34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:
    - (i) risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or
    - (ii) a broad government policy framework that includes considering general economic circumstances and community needs.

Please provide your reasons.

5. Do you agree with the proposals to:
- (a) require disclosure of information about the nature of the pricing process, including:
    - (i) the manner in which pricing/benefits are determined;
    - (ii) the timeframes for which they are typically determined; and
    - (iii) any other relevant constraints under which an entity operates;when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period; and
  - (b) permit the disclosure to be located either:
    - (i) in the notes to the financial statements; or
    - (ii) by reference to an authoritative source that is available to users of the financial statements on the same terms as the financial statements and at the same time?

Please provide your reasons.

**Risk adjustment [paragraphs BC86 to BC122]**

6. The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

In contrast, the NZASB is proposing a modification to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.

The proposed paragraph 37.1 in the NZASB's Exposure Draft states:

37.1 Notwithstanding paragraph 37, for a public sector entity, there is a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk is an adjustment to achieve a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

- (a) Do you support:
  - (i) the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or

- (ii) the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims?

Please provide your reasons.

- (b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.

**Scope [paragraphs AusB16.1 to AusB16.25 and paragraphs BC123 to BC211]**

7. The Boards propose that the public sector arrangements to which AASB 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AusB16.1 to AusB16.25]:
- (a) similarity of risks covered and benefits provided;
  - (b) identifiable coverage;
  - (c) enforceable nature of arrangement;
  - (d) source and extent of funding;
  - (e) management practices and assessing financial performance; and
  - (f) assets held to pay benefits.

Do you agree with these proposed indicators? If you disagree with the proposed indicators, which of them would you exclude?

8. Whether or not you agree or disagree with some or all of the indicators, do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning.
9. The proposed paragraph AusB16.2 requires that the indicators outlined in paragraphs AusB16.3 to AusB16.25 are considered collectively so that a balanced judgement can be made. The Boards considered that the proposed indicators should not be ranked or be assigned a relative significance because their relative significance is expected to depend on the circumstances. Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:
- (a) which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?
  - (b) would you identify some indicators as pre-requisites for applying AASB 17 and, if so, which ones, and why?

**Application date [paragraph AusC1.1 and paragraphs BC212 to BC215]**

10. Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 July 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons.

Please note that the AASB also issued a Fatal-Flaw Review version of an Amending Standard AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities* for comment. Since for-profit public sector entities are currently required to apply AASB 17 for annual periods beginning on or after 1 January 2023, the AASB issued that consultation document to propose amendments to relevant Australian pronouncements so that for-profit public sector entities would be permitted to continue applying AASB 4 and AASB 1023 until a Standard making public-sector-specific modifications to AASB 17 is effective or applied.

**Other modifications**

11. Do you consider there should be any further modifications to AASB 17 in respect of public sector arrangements? If so, what modifications would you suggest and on what basis would you justify them?

Please provide your reasons.

Please note that the Boards considered, but rejected, proposing modifications to AASB 17 in respect of public sector arrangements on the following topics:

- (a) specifically exempting ‘captive’ public sector insurers from applying AASB 17 in their separate general purpose financial statements [paragraphs BC215 to BC223];
- (b) discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC224 to BC246];

- (c) the measurement of investments backing insurance liabilities [paragraphs BC247 to BC252]; and
- (d) classification and presentation of risk mitigation program and other similar costs [paragraphs BC253 to BC260].

## **General matters for comment**

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The AASB would also particularly value comments on the following general matters, to the extent they have not already been provided in response to specific matters for comment above.

- 12. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?
- 13. Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?
- 14. Whether, overall, the application of AASB 17, modified as proposed, would result in financial statements that would be useful to users?
- 15. Whether the proposals are in the best interests of the Australian economy?
- 16. Unless already provided in response to specific matters for comment above, the costs and benefits of the application of AASB 17, modified as proposed, relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the Boards are particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements (AASB 1023).

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PREFACE

**[DRAFT] ACCOUNTING STANDARD  
AASB 2022-X AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – INSURANCE CONTRACTS  
IN THE PUBLIC SECTOR**

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**[DRAFT] AASB BASIS FOR CONCLUSIONS**

[Draft] Australian Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector* is set out on pages 10–16. All the paragraphs have equal authority.



## **Preface**

### **Standards amended by AASB 2022-X**

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This [draft] Standard makes amendments to AASB 17 *Insurance Contracts* (July 2017) for application by public sector entities.

### **Main features of this Standard**

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#### **Main requirements**

This [draft] Standard makes the following modifications to AASB 17 for application by public sector entities:

- (a) an exemption from sub-grouping onerous versus non-onerous contracts at initial recognition;
- (b) an exemption from sub-grouping contracts issued no more than a year apart;
- (c) amending the initial recognition requirements so that they do not depend on when contracts become onerous;
- (d) guidance on coverage periods, which has consequences for assessing eligibility for the premium allocation approach in a public sector context;
- (e) indicators for identifying the transactions to which AASB 17 should apply in a public sector context; and
- (f) guidance on determining the cash flows within the contract boundary.

#### **Application date**

This [draft] Standard applies to annual periods beginning on or after ... [1 July 2025], with earlier application permitted.

## [Draft] Accounting Standard AASB 2022-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector* under section 334 of the *Corporations Act 2001*.

Dated ... [date]

Keith Kendall  
Chair – AASB

## [Draft] Accounting Standard AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*

### Objective

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1. This Standard amends AASB 17 *Insurance Contracts* (July 2017) for application in the public sector.

### Application

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2. The amendments set out in this Standard apply to entities and financial statements in accordance with the application of AASB 17 set out in AASB 1057 *Application of Australian Accounting Standards*.
3. This Standard applies to annual periods beginning on or after ... [1 July 2025]. This Standard may be applied to annual periods beginning before ... [1 July 2025].
4. This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Amended paragraphs are shown with deleted text struck through and new text underlined. New paragraphs are also underlined. Ellipses (...) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

### Amendments to AASB 17 *Insurance Contracts*

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5. Paragraphs Aus16.1 and Aus22.1 are added. Paragraphs 16 and 22 are not amended but are included for reference.

#### **Level of aggregation of insurance contracts**

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...

**16** An entity shall divide a portfolio of insurance contracts issued into a minimum of:

- (a) a group of contracts that are onerous at initial recognition, if any;
- (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- (c) a group of the remaining contracts in the portfolio, if any.

**Aus16.1** **Notwithstanding paragraph 16, a public sector entity is not required to sub-group a portfolio of contracts based on whether, at initial recognition, they are:**

- (a) **onerous; or**
- (b) **have no significant possibility of becoming onerous subsequently; or**
- (c) **are neither (a) nor (b).**

...

22 An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21.

Aus22.1 Notwithstanding paragraph 22, a public sector entity is not required to sub-group insurance contracts within a portfolio based on when they are issued.

6. Paragraph Aus25.1 is added. Paragraph 25 is not amended but is included for reference.

## Recognition

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25 An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- (a) the beginning of the coverage period of the group of contracts;
- (b) the date when the first payment from a policyholder in the group becomes due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

Aus25.1 Notwithstanding paragraph 25, a public sector entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- (a) the beginning of the coverage period of the group of contracts; and
- (b) the date when the first payment from a policyholder in the group becomes due.

7. Paragraphs Aus34.1–Aus34.3 are added. Paragraphs 33 and 34 are not amended but are included for reference.

## Measurement (paragraphs B36–B119F)

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### Estimates of future cash flows (paragraphs B36–B71)

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33 An entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group (see paragraph 34). Applying paragraph 24, an entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contracts. The estimates of future cash flows shall:

- (a) incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows (see paragraphs B37–B41). To do this, an entity shall estimate the expected value (ie the probability-weighted mean) of the full range of possible outcomes.
- (b) reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables (see paragraphs B42–B53).
- (c) be current – the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future (see paragraphs B54–B60).
- (d) be explicit – the entity shall estimate the adjustment for non-financial risk separately from the other estimates (see paragraph B90). The entity also shall estimate the cash flows separately from the adjustment for the time value of money and financial risk, unless the most appropriate measurement technique combines these estimates (see paragraph B46).

34 Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with insurance contract services (see paragraphs B61–B71). A substantive obligation to provide insurance contract services ends when:

- (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks;
- (b) both of the following criteria are satisfied:

- (i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio;
- (ii) the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

Aus34.1

In respect of paragraph 34(a) and (b)(i):

- (a) assessing a public sector entity’s practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;
- (b) a public sector entity’s monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity’s practical ability to fully price for risks or benefits; and
- (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits.

Aus34.2

Notwithstanding paragraph 34(b)(ii), a public sector entity would not be regarded as failing to meet the criterion in paragraph 34(b)(ii) simply because its premium pricing for coverage up to the date when the risks are reassessed takes into account risks that relate to periods after the reassessment date, due to having a policy of determining prices and benefits based on a medium to long term view.

Aus34.3

When a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period, it shall disclose information about the nature of the pricing process; including information about:

- (a) the manner in which pricing or benefits are determined;
- (b) the timeframes for which they are typically determined; and
- (c) any other relevant constraints under which an entity operates;

either in the notes to the financial statements or by reference to an authoritative source that is available to users of the financial statements on the same terms as the financial statements and at the same time.

8. Paragraphs AusB16.1–AusB16.25 and related headings are added to Appendix B *Application guidance*.

...

## **Definition of an insurance contract (Appendix A)**

...

### **The distinction between insurance risk and other risks**

...

#### **Identifying insurance contracts in a public sector context**

AusB16.1

The guidance in paragraphs B7 to B16 on distinguishing between insurance risks and other risks applies equally to public sector entities. However, because public sector entities often undertake a much wider range of risk-bearing activities than private sector entities, additional guidance is needed to identify insurance contracts in a public sector context.

AusB16.2

Governments often arrange to provide support as a result of events that affect individuals and communities. Some of these arrangements involve transactions that are best accounted for as insurance contracts, while many of these arrangements relate to a government’s role in providing services such as: social benefits, universal health care and disaster relief. In making the distinction between these types of arrangements, the indicators outlined in paragraphs AusB16.4 to AusB16.25 are considered collectively so that a balanced judgement can be made.

AusB16.3

Individual indicators would not necessarily be regarded as definitive in determining whether public sector arrangements would be accounted for as insurance contracts.

### Similarity of risks covered and benefits provided

- AusB16.4 Under an insurance contract, significant insurance risk is transferred from an insured to an insurer. Private sector insurers accept a wide range of risks. These include risks relating to, for example: property loss, loss of income, professional and trade indemnity, public and legal liability, medical costs, mortality and disability. In the event that an insured event occurs, to the extent required under an insurance contract, the insurer would typically provide a benefit commensurate with the loss.
- AusB16.5 Many of the risks covered by private sector insurers are also the subject of social benefits provided by governments. Accordingly, judgement needs to be applied to determine the relevance of this indicator.
- AusB16.6 It is an indicator that a public sector entity's arrangements would be accounted for as insurance contracts when they involve accepting risks and providing benefits that are the same as, or similar to, those offered by private sector insurers. In some cases, public sector entities operate alongside private sector insurers to accept risks and provide benefits that are the same, for example, in respect of employer liability for workers' compensation risks.
- AusB16.7 In some cases, public sector entities are monopolies in their jurisdictions, and there are no relevant counterpart arrangements of private sector entities to consider. In these cases, consideration is given to whether a public sector entity's arrangements involve accepting risks and providing benefits that are the same as, or are similar to, those offered by private sector insurers in other, similar, jurisdictions. In relation to other jurisdictions, only information that is 'readily available' need be considered. That is, public sector entities need not conduct an exhaustive search for counterpart arrangements.
- AusB16.8 In some cases there will be a clear similarity between the risks being accepted and the benefits being provided by a public sector entity and private sector insurers, and this is an indicator that a public sector entity's arrangements would be accounted for as insurance contracts.
- AusB16.9 Conversely, the greater the level of dissimilarity between the risks accepted and benefits provided by a public sector entity and those offered by any relevant counterpart private sector insurer, the more likely it would be that the public sector entity's arrangements would not be accounted for as insurance contracts.

### Identifiable coverage period

- AusB16.10 An insurance contract has an identifiable coverage period – either the period during which insured events occur (losses-occurring coverage) or the period during which claims become known (claims-made coverage). The coverage period might be explicitly stated in the contract or otherwise be determinable from the terms of the contract.
- AusB16.11 An indicator that a public sector entity's arrangements would be accounted for as insurance contracts is the existence of an identifiable coverage period.
- AusB16.12 Conversely, open-ended arrangements to provide benefits based on eligibility criteria would not be accounted for as insurance contracts.

### Enforceable nature of arrangement

- AusB16.13 Under AASB Standards, a contract is an agreement between two or more parties that creates enforceable rights and obligations. An insurance contract is a contract under which one party (the 'insurer') accepts significant insurance risk from another party (the 'insured') by agreeing to compensate the insured if a specified future event adversely affects the insured.<sup>1</sup>
- AusB16.14 When a public sector entity or its controlling government does not have the practical ability under existing or substantively enacted legislation to deny or change promised benefits, it is an indicator that an arrangement would be accounted for as an insurance contract. That is, the policyholder has enforceable rights under the arrangement and the public sector entity has enforceable obligations for promised amounts or for amounts based on agreed parameters.

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<sup>1</sup> AASB 17 Appendix A/PBE IFRS 17 paragraph 13.1

AusB16.15 Conversely, when a public sector entity or its controlling government has the practical ability under existing or substantively enacted legislation to retrospectively deny or change promised benefits or compensation, it indicates that an arrangement is not enforceable. For example, if an entity can retrospectively change the amount of benefits or compensation being paid to a beneficiary in relation to a past event under existing legislation, this is an indicator that the arrangement would not be accounted for as an insurance contract.

AusB16.16 An arrangement that involves a public sector entity issuing documentation to another party, similar to an insurance contract issued by a private sector insurer, would be indicative of an agreement that creates enforceable rights and obligations. However, a substantive reliance on legislation or other regulation as a part of an arrangement would not necessarily be an indicator that the arrangement is unsuitable to be accounted for as an insurance contract. In common with the private sector, arrangements need to be interpreted within a regulatory framework and, when applying AASB 17, an entity is required to consider its substantive rights and obligations, whether they arise from a contract, law or regulation under paragraph 2.

### *Source and extent of funding*

AusB16.17 Under an insurance contract, a policyholder usually pays premiums to an insurer. In most cases, the premiums are the primary source of funding the payment of any claims and the costs of operating the insurance business. Insurers usually also generate investment income and might sometimes receive supplementary contributions from governments, for example, such as those aimed at encouraging the use of private health insurance.

AusB16.18 When a public sector entity receives ‘premiums’ under an arrangement in exchange for accepting risks from those who stand to benefit, it is an indicator that an arrangement would be accounted for as an insurance contract. The more direct the relationship between the participant who stands to benefit from an arrangement and the participant providing the funding the more indicative this would be of a policyholder-insurer relationship and a transaction that would be accounted for as an insurance contract.

AusB16.19 Conversely, when a public sector entity receives all of its funding from sources other than ‘premiums’ from policyholders (that is, sources such as recurring funding from general taxation), it is an indicator that arrangements would not be accounted for as insurance contracts.

AusB16.20 The lower is the proportion of a public sector entity’s funding to meet benefits that is received in exchange for accepting risks from those who stand to benefit, the less likely is it that those arrangements would be accounted for as insurance contracts. For example, a co-payment that is intended to help ration services and is not intended to fully fund services is unlikely to indicate that arrangements would be accounted for as insurance contracts.

AusB16.21 Under most general insurance contracts issued by private sector insurers, in the event that a policyholder cancels its coverage prior to the end of the coverage period, the policyholder would ordinarily receive a pro rata premium refund, possibly adjusted for administrative costs. Although not all contracts issued by private sector insurers allow for refunds, the practice is indicative of insurance contracts. Accordingly, a public sector entity arrangement that allows for a refund of premium when the policyholder terminates the arrangement early is an indicator that an arrangement would be accounted for as an insurance contract.

### *Management practices and assessing financial performance*

AusB16.22 An indicator that an arrangement would be accounted for as insurance contracts would be that the public sector entity has objectives, policies and processes for managing risks associated with those arrangements and has its financial performance assessed against those objectives and how successfully it applies those policies and processes. In that context, the entity would be expected to conduct the following activities (either itself or via outsourcing):

- (a) underwriting and risk assessment;

- (b) managing the entity’s ‘capital’ based on the measurement of risks and uncertainties relating to coverage and incurred claims and their potential future impacts; and
- (c) fair and prudent claims management.

The presence of all three of these factors is an indicator that those arrangements would be accounted for as insurance contracts. Conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

**Assets held to pay benefits**

AusB16.23 Consistent with the guidance above on ‘Management practices and assessing financial performance’, the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits can be regarded as evidence that a public sector entity is operating and being managed as an insurer. The existence of a separate fund, or earmarked assets is also consistent with the guidance above on ‘Source and extent of funding’ because it would generally involve investing funds raised via premiums or levies received in exchange for accepting risks from those who stand to benefit.

AusB16.24 While the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits is a feature of some public sector arrangements that are not in the nature of insurance, the feature is still regarded as an indicator, in conjunction with other indicators, that those arrangements would be accounted for as insurance contracts. The alternative would be when a public sector entity receives its funding from sources such as general taxation, which is an indicator that arrangements would not be accounted for as insurance contracts.

AusB16.25 To be relevant, the separate fund, or earmarked assets need not be managed by the public sector entity itself. It is the existence of a separate fund, or earmarked assets, that is indicative, not the performance of investing activities.

- 9. Paragraph AusB64.1 is added to Appendix B *Application guidance*. Paragraph B64 is not amended but is included for reference.

**Measurement (paragraphs 29-71)**

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...

**Cash flows within the contract boundary (paragraph 34)**

...

**B64** Paragraph 34 refers to an entity’s practical ability to set a price at a future date (a renewal date) that fully reflects the risks in the contract from that date. An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same characteristics as the existing contract issued on that date, or if it can amend the benefits to be consistent with the price it will charge. Similarly, an entity has that practical ability to set a price when it can reprice an existing contract so that the price reflects overall changes in the risks in a portfolio of insurance contracts, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder. When assessing whether the entity has the practical ability to set a price that fully reflects the risks in the contract or portfolio, it shall consider all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining service. In determining the estimates of future cash flows at the end of a reporting period, an entity shall reassess the boundary of an insurance contract to include the effect of changes in circumstances on the entity’s substantive rights and obligations.

AusB64.1 Public sector entities often operate within a broad government policy framework that takes into account general economic circumstances and community needs and not only the circumstances specific to the entity and its policyholders. For example, there may be cases when the entity’s management, including relevant government Minister(s), deliberately phases in price increases or decreases (or benefit adjustments) over a long period to help individuals or businesses manage through an economic cycle. Although the phasing in process might notionally take into account risks relating to a number of coverage periods, this is not the motivating factor. The broader policy objectives are the motivating factor. Therefore, in the context of AASB 17 paragraph 34(b)(ii), the public

sector entity would not be regarded as taking into account the risks that relate to periods after the reassessment date.

10. Paragraph AusC1.1 is added in Appendix C *Effective date and transition*. Paragraph C1 is not amended but is included for reference.

## **Effective date**

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C1 An entity shall apply AASB 17 for annual reporting periods beginning on or after 1 January 2023. If an entity applies AASB 17 earlier, it shall disclose that fact. Early application is permitted for entities that apply AASB 9 *Financial Instruments* on or before the date of initial application of AASB 17.

AusC1.1 Notwithstanding paragraph C1, this Standard applies to public sector entities for annual reporting periods beginning on or after 1 July 2025. Early application is permitted for public sector entities. If an entity applies AASB 17 earlier, it shall disclose that fact.

...

## **Commencement of the legislative instrument**

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11. For legal purposes, this legislative instrument commences on ...[30 June 2025].



## Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, [Draft] AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector* and [Draft] PBE IFRS 17 *Insurance Contracts in the Public Sector*. Once the Boards have finalised any public sector modifications to AASB 17 and PBE IFRS 17, the AASB intends to amend its Basis for Conclusions to AASB 17 and the NZASB intends to amend its Basis for Conclusions to PBE IFRS 17 to explain their considerations in reaching their final conclusions with respect to public sector entities applying the Standards.

## Introduction

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BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s and the New Zealand Accounting Standards Board’s considerations in reaching the conclusions in this Exposure Draft. It sets out the reasons why the Boards developed the Exposure Draft, the approach taken to developing the Exposure Draft and the bases for the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

## Reasons for proposing these amendments

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BC2 AASB 17 *Insurance Contracts* and PBE IFRS 17 *Insurance Contracts* have a mandatory application date of annual reporting periods beginning on or after 1 January 2023.

BC3 IFRS 17 *Insurance Contracts*, which is incorporated into AASB 17/PBE IFRS 17, has been developed largely for the for-profit private sector, and to a limited extent also for a (not-for-profit) mutual entity context [AASB 17/PBE IFRS 17.B16]. IFRS 17 has not been designed to cater for the public sector context. Accordingly, the AASB and the NZASB are undertaking a joint project to include modifications in AASB 17/PBE IFRS 17 to suit the public sector context in Australia and New Zealand.

BC4 Other jurisdictions, such as the UK and Canada, are also considering the application of IFRS 17 in the public sector. At the time of preparing this Basis for Conclusions, those jurisdictions had not yet sought to make any public-sector-specific proposals.

BC5 At the time of preparing this Basis for Conclusions the IPSASB was not considering the development of an insurance Standard based on IFRS 17.

BC6 In addition, there are possibly existing inconsistencies in Australia in the application of Standards as some Australian public sector entities with similar arrangements are currently applying AASB 1023 *General Insurance Contracts* and others are applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. This project might help achieve a greater level of consistency.

BC7 The AASB and the NZASB each commenced a project in 2017 to consider expanding the scope of AASB 17/PBE IFRS 17 to include insurance contracts and arrangements that have similar characteristics to insurance contracts in the public sector and address any issues specific to the public sector. Each Board has previously issued a public consultation document:

- (a) AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities*; and
- (b) NZASB Exposure Draft ED 2018-7 *PBE IFRS 17 Insurance Contracts*.

Each Board has considered respondents’ comments to their respective consultation documents. Paragraphs BC262 and BC263 outline a brief project history relating to this earlier stage of the project.

## Joint project

BC8 Currently, AASB 17 does not apply to not-for-profit public sector entities [under paragraph 6A of AASB 1057 *Application of Australian Accounting Standards* (July 2015, as amended by AASB 17)].

BC9 PBE IFRS 17 currently applies to not-for-profit public benefit entities [PBE IFRS 17.2.1]; however, it is not regarded as applying to arrangements of public sector public benefit entities.

BC10 In 2020, the AASB and the NZASB decided to work jointly to progress the project with the following background and objectives.

- BC11 Both Boards maintain different tiers of reporting, which among other things, use the ‘public accountability’ distinction developed by the IASB. Entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses are identified as having public accountability. Both Boards generally regard entities engaged in insurance activities as having public accountability and needing to prepare Tier 1 general purpose financial statements.
- BC12 Some of the public sector entities in Australia that conduct insurance activities have self-identified as for-profit entities – most have self-identified as not-for-profit entities. In principle, Tier 1 for-profit public sector entities apply AASB Standards incorporating IFRS Standards without modification. The *AASB Not-for-Profit Entity Standard-Setting Framework* notes the Financial Reporting Council’s broad strategic direction that the AASB applies the principle of transaction neutrality (modified as necessary) in setting standards for not-for-profit and public sector entities. This Framework notes (emphasis added):
- 22 IFRS Standards (including Interpretations) are appropriate as a base for the following reasons: ...
- (d) **IFRS Standards can be modified appropriately for NFP-specific issues**, as demonstrated by the International Public Sector Accounting Standards Board (IPSASB) using IFRS Standards as a base for their corresponding Standards, **departing only to the extent appropriate for public sector issues**.
- BC13 The following background applies for the NZASB.
- (a) The *New Zealand Accounting Standards Framework* notes (emphasis added):
28. The accounting standards applying to the PBE tiers are as follows: ...
- PBE Tier 1: Tier 1 PBE Accounting Requirements – These are the requirements in the accounting standards (referred to as PBE Standards) and applicable authoritative notices.  
  
They comprise International Public Sector Accounting Standards (IPSAS), **modified as appropriate for New Zealand circumstances** (for either public sector or NFP entities), together with additional standards as necessary and applicable authoritative notices.
- (b) Additional standards for PBEs include IFRS Standards for which there is no equivalent IPSAS (for example, PBE IFRS 4) and domestic standards.
- (c) In February 2018, the NZASB considered the application of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) and decided to develop PBE IFRS 17. The trigger in the PBE Policy Approach for developing PBE IFRS 17 is the change to an IFRS Standard (IFRS 4 is superseded by IFRS 17) that has been used as the basis for a PBE Standard.
- (d) A further motivation for developing PBE IFRS 17 was to capture schemes that are eligible<sup>1</sup> to apply the insurance approach as permitted under IPSAS 42 *Social Benefits* [PBE IFRS 17.BC7]. (The ‘insurance approach’ would involve applying IFRS 17 [IPSAS 42.AG19].)

## Consistency in financial reporting – within and between jurisdictions

- BC14 The AASB Discussion Paper (2017) proposals identified as an objective “to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information” [page 6]. While the NZASB has fewer public sector stakeholders with arrangements that might be accounted for as insurance contracts, consistency remains a key issue.
- BC15 Although there is no binding agreement in place regarding public sector entities, to the extent feasible, the Boards consider it would be desirable to have the same standards applying in Australia and New Zealand. This is because, for example, there can be useful benchmarking of financial position and performance of public sector entities between the two jurisdictions. Accordingly, the Boards are taking a ‘best endeavours’ approach to trying to achieve a consistent outcome in the two jurisdictions.
- BC16 Both Boards are making the same proposals in this Exposure Draft, except the proposed approach on risk adjustments.
- BC17 In developing the proposals, the Boards considered the responses received from stakeholders to earlier consultative documents and also conducted a series of interviews with key stakeholders in 2020 and early

<sup>1</sup> IPSAS 42 does not require an entity that meets the criteria to apply the ‘insurance approach’ – only that the entity is eligible to apply that approach.

2021 to gain insights into operations of those entities (and their users and auditors) most likely to be impacted by the project.

- BC18 The Boards have also consulted the Public Sector Focus Group, a sub-group of the Transition Resource Group for AASB 17 *Insurance Contracts*, which includes members from both jurisdictions.

## **Sub-grouping of contracts**

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### **Requirements under AASB 1023/PBE IFRS 4**

- BC19 The Boards observed that, under AASB 1023/PBE IFRS 4, the liability for remaining coverage is measured as the amount of premium received and/or receivable for the contract period that remains unearned. An insurer is required to apply a Liability Adequacy Test to the carrying amount of the liability for remaining coverage (represented by ‘unearned premium’) when there is an indication that the liability may be inadequate [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]. The Liability Adequacy Test is applied at a portfolio of contracts level. The Boards noted that, in the case of some public sector entities, there is only one portfolio of contracts and, for those entities, the Liability Adequacy Test is effectively conducted at the whole-of-entity level.

- BC20 The Liability Adequacy Test involves comparing:

- (a) the amount of the liability for remaining coverage recognised on the statement of financial position; with
- (b) current estimates of the present value of the expected future cash flows relating to future claims arising from existing insurance contracts, plus a risk margin that reflects the inherent uncertainty in the central estimate.

There is a deficiency if (a) is less than (b), in which case an additional ‘unexpired risk liability’ is recognised for the deficiency,<sup>2</sup> which is also recognised immediately as a loss.<sup>3</sup>

### **Requirements in AASB 17/PBE IFRS 17: Sub-grouping of onerous versus non-onerous contracts**

- BC21 AASB 17/PBE IFRS 17 has a much greater emphasis (than AASB 1023/PBE IFRS 4) on identifying onerous contracts and their identification has fundamental impacts on a wide range of accounting outcomes. In particular, at initial recognition, insurance contracts within each portfolio of contracts must be sub-grouped as:

- (a) contracts that are onerous at initial recognition, if any;
- (b) contracts that have no significant possibility of becoming onerous subsequently, if any; and
- (c) other (non-onerous) contracts [AASB 17/PBE IFRS 17.16].<sup>4</sup>

- BC22 The Boards noted the following:

- (a) In the private for-profit sector, the presumption is that insurers issue insurance contracts that are intended to be profitable. In practice, the profit component should act as a ‘buffer’ to any liability inadequacy and private for-profit sector insurers only occasionally need to test for liability inadequacy and few entities need to recognise an unexpired risk liability under AASB 1023/PBE IFRS 4.
- (b) In contrast, for most public sector entities applying AASB 1023/PBE IFRS 4, the liability for remaining coverage based on unearned premium is routinely inadequate because they price to break even after taking into account projected investment returns.<sup>5</sup> That is, the amounts collected in levies/premiums are typically inadequate to meet expected claims. Accordingly, many public sector entities routinely recognise unexpired risk liabilities under AASB 1023/PBE IFRS 4.

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2 Because a deficiency is not represented by ‘unearned premium’ in the context of AASB 1023/PBE IFRS 4, the deficiency is separately recognised as an ‘unexpired risk liability’.

3 An entity with deferred acquisition costs and intangible assets related to insurance contracts would write those off before recognising any remaining deficiency [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]; however, public sector entities do not ordinarily have material deferred acquisition costs or intangible assets.

4 In practical terms, there are two sub-groups: (a) onerous; and (b) non-onerous. Early indications are that most insurers consider ‘contracts that have no significant possibility of becoming onerous subsequently’ would be a rarity.

5 The expected investment returns are ordinarily higher than the discount rates (for time value) applied to measure insurance liabilities.

The Boards highlighted this as a key distinguishing factor among public sector entities compared with private sector for-profit entities.

- BC23 The Boards acknowledged that there are no public-sector-specific modifications to AASB 1023/PBE IFRS 4 based on this key distinguishing factor and that the routine recognition of unexpired risk liabilities, which are typically offset by investment income/gains, is an accepted practice. However, the Boards noted that the AASB 17/PBE IFRS 17 requirement to sub-group contracts based on whether they are onerous versus non-onerous raises further potential accounting complications. In particular, the Boards observed that:
- (a) accounting for a whole portfolio that is onerous is likely to be relatively simple compared with having to identify some (possibly) non-onerous contracts from within a largely onerous portfolio of contracts and account for them separately;
  - (b) the level of interest among public sector entities and their users in knowing about profitable sub-groups of contracts that might exist within a wider loss-making portfolio, would be lower than the level of interest among private sector insurers and their users in knowing about loss-making sub-groups of contracts that might exist within a wider profitable portfolio; and
  - (c) any interest among users of public sector entities' financial statements in knowing about cross-subsidisation among different classes of policyholders would probably be best met through disclosures (rather than disaggregation that affects recognition and measurement).

### **Analysis on sub-grouping by onerous versus non-onerous contracts**

- BC24 The Boards noted that:
- (a) there is no impact on the long-run overall results from taking different approaches to onerous contract units of account and annual cohorts of contracts versus a portfolio unit of account; and
  - (b) the main impact of AASB 17/PBE IFRS 17 (relative to AASB 1023/PBE IFRS 4) would be to recognise losses upfront that would otherwise have been recognised over the coverage period. The Boards thought that, since most of the coverage periods are typically one year, the timing of loss recognition would typically not be very different as between AASB 17/PBE IFRS 17 and AASB 1023/PBE IFRS 4.
- BC25 The Boards observed that the IASB decided on the requirements in AASB 17/PBE IFRS 17.16 to divide each portfolio of contracts into sub-groups because it regards information about onerous contracts to be useful information about an entity's decisions on pricing contracts and about future cash flows, and wants this information to be reported on a timely basis. The IASB does not want this information to be obscured by offsetting onerous contracts in one group with profitable contracts in another group [IFRS 17.BC119].<sup>6</sup> The Boards acknowledged that the upfront recognition of losses may be particularly useful in a private sector for-profit context.
- BC26 The Boards observed that the impact of AASB 17/PBE IFRS 17 would depend on the nature of the arrangements and how they have been priced and they considered the following examples by way of illustration.
- (a) Worker's compensation insurance contracts are typically priced for the expected actual risks by employer and/or industry. At initial recognition, unless a deliberate decision has been taken to under-price for risk on some contracts and over-price others, ordinarily there would not be onerous and non-onerous sub-groups. Typically, in a public sector context (of break-even pricing before taking into account investment earnings), the portfolio would be expected to comprise only one group of onerous contracts.
  - (b) Transport accident insurance contracts are typically priced for the expected actual risks over the whole portfolio. However, the public sector entity might have relatively granular information available about policyholders by risk profile. For example, it may be known that drivers living in particular geographic regions are likely, on average, to give rise to fewer claims and are largely profitable. In such a case there may be onerous and non-onerous groups of contracts based on geographic regions.
- BC27 The Boards noted that AASB 17/PBE IFRS 17.20 provides relief from sub-grouping as onerous versus non-onerous contracts when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics. Accordingly, in the transport accident case noted above, if the pricing constraints on the entity are the cause of overpricing for low-claim geographic regions, they need not be separately accounted for (as a non-onerous contract group). However, the Boards remained concerned that

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<sup>6</sup> The IASB chose groups of contracts as a way of striking a compromise between accounting on an individual contract basis (that would be particularly burdensome) and accounting at the portfolio level of aggregation [IFRS 17.BC123 & BC124].

this relief may be difficult to apply in some cases due to possible ambiguity about where price/levy/benefit decision-making power may reside – with the entity itself, or with the government [for example, the relevant Minister(s)].

- BC28 The Boards considered feedback received from stakeholders on sub-grouping of contracts in response to earlier consultation documents.
- BC29 NZASB ED 2018-7 proposed no changes to PBE IFRS 17 in respect of onerous contracts; however, it specifically sought feedback from stakeholders on the requirements in PBE IFRS 17.16. The responses to NZASB ED 2018-7 generally argued for public-sector-specific modifications based on a view that the requirements in PBE IFRS 17.16 are not relevant to the circumstances of public sector insurers in New Zealand. The responses included the following:
- (a) pricing decisions and the resulting onerous contracts will often be a consequence of broader policy decisions of government;
  - (b) the level of aggregation should be the same as the level used for setting levies;
  - (c) while for-profit insurers use granular information to improve profitability and avoid adverse selection by policyholders – this is not relevant to public sector entities, which typically deliberately cross-subsidise across communities;
  - (d) public sector entities do not choose their customers or seek to market their services to particular customers, and risks are usually community rated – accordingly, grouping by onerous/non-onerous arrangements is not relevant.
- BC30 The AASB Discussion Paper (2017) did not specifically request input on this topic and there were no comments from stakeholders on onerous contract groups. However, the topic was raised in stakeholder outreach conducted in 2020-21 and the following matters were raised.
- (a) In any given year, all contracts in a portfolio are likely to be onerous at initial recognition because the entity relies on investment returns to break even. That is, amounts raised from the levies/premiums charged are inadequate relative to expected claims and there will be a negative insurance service result (negative underwriting result). Accordingly, unless there is sound evidence of a non-onerous group of contracts there would be no disaggregation of the portfolio under AASB 17/PBE IFRS 17.
  - (b) Given that some entities do not price differentially based on policyholder-specific risks, they do not monitor (and may not possess) the information necessary to differentiate between onerous versus non-onerous contracts at initial recognition. For example, some entities are not permitted to hold information on gender or age; however, if available, gender and/or age-related information would enable the entity to identify onerous versus non-onerous contracts.
  - (c) Ordinarily, all of a public sector entity’s onerous contracts and non-onerous contracts would be the result of regulatory impediments that are covered by the ‘relief’ in AASB 17/PBE IFRS 17.20; however, there may be exceptions.
  - (d) The entity takes a long-term view to avoid volatility in premiums/levies – periodically, there may be profitable or onerous contracts that depend on whether, for example, there are deficits to be ‘rectified’ or surpluses to be ‘used up’.
- BC31 The Boards considered a number of possible approaches to addressing the sub-grouping of contracts in a public sector context, including the following.
- (a) All public sector entities should be exempted from AASB 17/PBE IFRS 17.16, on the basis that:
    - (i) timely information on profitability is not relevant to most public sector entities; and
    - (ii) whether public sector entities have portfolios of onerous contracts and sub-groups of onerous contracts;are not relevant. However, it was acknowledged that information on sub-groups of onerous contracts might be useful in helping to inform users about cross-subsidies between different classes of policyholders.
  - (b) Only not-for-profit public sector entities (which is the majority of the relevant entities) should be exempted from AASB 17/PBE IFRS 17.16 for the reasons noted in (a) above.
  - (c) All public sector entities should be exempted from AASB 17/PBE IFRS 17.16; however, require disclosure about the nature of the pricing process, including constraints under which an entity operates to cross-subsidise different policyholder cohorts, that can lead to some groups of contracts being onerous. This might provide additional relevant information about the impact of price constraints on each entity. However, it was acknowledged that the additional disclosure could be a

burden and may already be readily available from other sources (although the burden might be mitigated by permitting disclosure by cross-reference).

- (d) AASB 17/PBE IFRS 17.16 should apply to public sector entities and guidance should be provided for the public sector context on the manner in which AASB 17/PBE IFRS 17.20 would provide relief from the need to sub-group contracts.

### **Sub-grouping onerous versus non-onerous contracts – conclusions**

BC32 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16. That is, public sector entities would not be required to sub-group contracts based on whether, at initial recognition, they are:

- (a) onerous;
- (b) have no significant possibility of becoming onerous subsequently, or
- (c) are neither (a) nor (b).

BC33 The practical impact of this proposed exemption is that public sector entities would have a basic unit of account that is a portfolio (also see the discussion below on annual sub-grouping). Accordingly, their liabilities for remaining coverage and liabilities for incurred claims would be measured for each portfolio as a whole (and, for those entities with only one portfolio, effectively at the whole-of-entity level).

BC34 The Boards consider this exemption is justified for the following reasons.

- (a) The motivation behind the AASB 17/PBE IFRS 17 requirements for information about onerous contracts is useful information about an entity's decisions on pricing contracts, which is not as relevant in the public sector context (relative to the private sector). This is particularly the case for not-for-profit entities. However, even public sector entities that are identified as for-profit entities are typically not able to underwrite risks in the manner available to private sector insurers and, therefore, disaggregating onerous versus non-onerous contracts would not provide useful information for assessing a public sector entity's financial position or performance.
- (b) Public sector entities' information systems are often geared to identifying, at a broad level, high-risk groups of policyholders for strategic and government policy decision-making (for example, to conduct safety campaigns), but not necessarily for identifying separate groups of contracts that give rise to accounting profits or losses. The managements of public sector entities (whether for-profit or not-for-profit) typically do not seek to financially remediate groups of onerous contracts or seek to attract more profitable customers in the same manner as private sector insurers. And, unlike private sector insurers, public sector entities do not ordinarily choose the customers to which they market their products. Accordingly, the costs for public sector entities of disaggregating onerous versus non-onerous groups of contracts would exceed any likely benefits.
- (c) If public sector entities are subject to AASB 17/PBE IFRS 17.16, it would be necessary to explain how the relief in AASB 17/PBE IFRS 17.20 could be applied in a public sector context. That would mean explaining whether the constraints identified in AASB 17/PBE IFRS 17.20 would be constraints imposed only on the entity itself or on the entity and its controlling government [Minister(s)]. In the context of AASB 17/PBE IFRS 17, there is the potential for ambiguity in considering whether:
  - (i) a public sector entity's practical ability to fully price for risks or benefits includes the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits in their capacity as managers of the public sector entity; versus
  - (ii) overall pricing constraints relevant to AASB 17/PBE IFRS 17.20 in respect of government policy more broadly.

BC35 The Boards also considered that the differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers might also justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16.<sup>7</sup>

BC36 The Boards concluded that they would propose requiring additional disclosures about the nature of the pricing process; including information about the manner in which pricing/benefits are determined, the timeframes for which they are typically determined, and any other relevant constraints under which an entity operates that result in, for example, cross-subsidising different classes of policyholders. The Boards noted that this information may already be publicly available from other sources and that the proposed requirement could be

<sup>7</sup> In that context, the Boards noted: paragraph 30(g) of the [AASB Not-for-Profit Entity Standard-Setting Framework](#); and, to some extent, paragraph 62 of the [New Zealand Accounting Standards Framework](#).

met by cross-reference to relevant authoritative sources available to users of the financial statements on the same terms as the financial statements and at the same time.

- BC37 The Boards acknowledged that, in general, Accounting Standards do not require disclosures around pricing decisions and whether they involve cross-subsidisation among customers. However, the Boards consider this additional disclosure is justified due to the likely significance of the manner in which pricing/benefits are determined on the performance and financial position of public sector entities that bear insurance risk.

### **Sub-grouping of contracts issued no more than a year apart**

- BC38 The Boards observed that portfolios of contracts might include contracts entered into over successive years, and that AASB 17/PBE IFRS 17 requires entities to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart [AASB 17/PBE IFRS 17.22]. The effect of this requirement is to reveal cases of onerous contracts issued in a particular year without them being obscured by profitable contracts issued in other years. This is mainly an issue when there are contracts with multi-year coverage periods.
- BC39 The Boards noted that, given the monopoly position of many public sector entities, they may phase in increases and decreases to levies/premiums and the extent to which arrangements might be onerous or non-onerous for any given annual cohort of contracts is likely to be less relevant than for a private sector for-profit insurer.
- BC40 The Boards noted that some of the responses to NZASB ED 2018-7 argued for a public sector modification based on the view that the requirement in PBE IFRS 17.22 is not relevant to the circumstances of some public sector insurers that take a long view on pricing. That is, for example, grouping by annual cohort is irrelevant when the insured risk is for highly uncertain and infrequent events where the entity is a monopoly provider (and cannot withdraw from the market).

### **Analysis of sub-grouping of contracts issued no more than a year apart**

- BC41 The Boards noted that the IASB decided to require sub-grouping of contracts issued no more than a year apart because it considers annual grouping by the underwriting year to be important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis [IFRS 17.BC136].
- BC42 In the context of the Australian and New Zealand public sectors, the Boards observed the following.
- (a) Many public sector entities would only issue contracts with one year of coverage and the difference between the portfolio perspective versus sub-grouping by annual cohort would not be particularly relevant. However, some public sector entities issue contracts that provide multi-year coverage – for example, in respect of domestic building risk coverage arrangements, and there may exist onerous versus non-onerous annual cohorts of contracts.
  - (b) When relevant, the requirement in AASB 17/PBE IFRS 17.22 to identify separate groups of contracts by their year of issue is expected to result in insurers identifying their reporting period as the relevant period. Australian and New Zealand public sector entities have 1 July to 30 June financial years and, if they were to comply with AASB 17/PBE IFRS 17.22, would be expected to regard all contracts issued between 1 July and 30 June as being within one group of contracts.
- BC43 The Boards noted that the AASB 17/PBE IFRS 17.22 requirement to determine groups of contracts based on the underwriting year as the unit of account for the liability for remaining coverage could have flow-on consequences for the information that needs to be produced to manage the liability for incurred claims (unless insurers operate two parallel systems). This might be the case for the following reasons.
- (a) Claims are usually monitored in the context of the related levies/premiums ‘earned’, and premium ‘earning’ under AASB 17/PBE IFRS 17 would be based on the underwriting year used for the liability for remaining coverage under AASB 17/PBE IFRS 17.22.
  - (b) Many public sector entities tend to manage claims on an ‘accident year’ basis because claims management plays such a prominent role for public sector entities, rather than profitability and underwriting performance.<sup>8</sup> Under an accident year basis, all claims arising from incidents/accidents within a particular annual period are tracked over time and compared year-on-year with levies/premiums earned in that year for the related contracts, regardless of when those contracts were issued/underwritten.

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<sup>8</sup> The liability for incurred claims is also the focus of management attention for most public sector entities because their liabilities for incurred claims are usually much larger than their liabilities for remaining coverage.

- (c) For some public sector entities, the underwriting year and the accident year are the same due to most (or all) contracts being issued with coverage that coincides with the annual reporting period. However, for other public sector entities they are different.

BC44 The Boards also noted that some insurance risks relate to providing coverage for highly uncertain infrequent events. While the coverage period for contracts for these risks are often only one year, the insured events might be expected to occur many years apart. Accordingly, in years when there are no relevant events, the contracts are highly profitable; while in years when a relevant event occurs, the contracts result in large losses. The Boards observed that:

- (a) from the perspective of a private sector insurer that can choose to engage in these contracts or withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 might help track this profit or loss volatility; while
- (b) from the perspective of a public sector entity that is a monopoly and cannot choose to withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 seems much less relevant. For these entities, tracking sub-groups of contracts by the year in which the infrequent events occur (accident year) might be more relevant.

### **Sub-grouping of contracts issued no more than a year apart – conclusions**

BC45 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22. The Boards consider this exemption is justified for the following reasons:

- (a) The IASB's reasoning behind the requirements (annual groupings by issue date are important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis) is generally less crucial (or is unimportant) to public sector entities.
- (b) The main focus of interest among public sector entities is on claims experience rather than profitability or underwriting performance. Some of those entities would track and manage claims on an accident year basis (not an underwriting year). Others use an underwriting year basis. Some entities track claims on both bases. Managements are likely to continue their existing tracking focus (which they have found to be effective) even if the external reporting requirements changed to groups based on the date when contracts are issued. The costs for some entities of operating a parallel tracking system (based on the underwriting year) to facilitate external reporting would not justify any benefits that might arise from applying AASB 17/NZ IFRS 17.22.
- (c) The requirement in AASB 17/PBE IFRS 17.57 to compare the liability for remaining coverage<sup>9</sup> with the fulfilment cash flows that relate to remaining coverage when facts and circumstances indicate a group of insurance contracts is onerous could be applied at the portfolio level.<sup>10</sup> Given that, for most public sector entities, the liability for remaining coverage is routinely inadequate because they price to break even after taking into account projected investment returns, exempting public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22 would rarely (if ever) result in delayed recognition of onerous contracts.

### **Initial recognition when contracts are onerous**

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BC46 In general, the following applies under AASB 1023/PBE IFRS 4.

- (a) An insurance liability is recognised when premium is received or receivable, because the measurement model simply defers unearned premiums received or receivable on the balance sheet. Premiums might be received before coverage begins, on the day coverage begins or after coverage begins.
- (b) An unexpired risk liability (onerous contract loss) is recognised based on whether unearned premiums are adequate to meet expected future claims and other relevant costs. Accordingly, loss recognition is dependent on when unearned premiums are recognised on the balance sheet.

BC47 In contrast, AASB 17/PBE IFRS 17.25 requires a group of insurance contracts an entity issues to be recognised from the earliest of the following:

- (a) the beginning of the coverage period of the group of contracts;

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<sup>9</sup> Calculated using the premium allocation approach, which is expected to be the main approach used by public sector entities applying AASB 17/PBE IFRS 17.

<sup>10</sup> This is the level at which the Liability Adequacy Test is currently applied under AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1).]



- (b) the date when the first payment from a policyholder in the group becomes due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

BC48 The Boards observed that, for the onerous contract trigger in AASB 17/PBE IFRS 17.25(c) to be the earliest date, the insurer would have already accepted the insured's risk before coverage commences and before premiums are due and there are facts and circumstances indicating a group of insurance contracts is onerous.<sup>11</sup> Accordingly, there would need to be up-front loss recognition for any onerous contracts that have been entered into as at the balance date, even though the coverage period may only commence in the subsequent financial year. This reflects the emphasis in AASB 17/PBE IFRS 17 on the early recognition of onerous contract losses.

BC49 The Boards observed that the differing circumstances of public sector entities compared with their private sector counterparts would potentially mean that applying AASB 17/PBE IFRS 17.25(c) would have unhelpful accounting consequences.

- (a) Private sector for-profit insurers would typically only by exception knowingly issue onerous contracts [see the perspective in IFRS 17.BC135]. However, most public sector entities routinely issue onerous contracts (because levies/premiums charged are inadequate to cover expected claims).
- (b) Private sector insurers will typically have contracts commencing throughout their financial year and, therefore, only a relatively small portion of contracts that commence in the following year would typically be enforceable on the entity at any given reporting date. However, some public sector entities have a large portion of their contracts covering periods that coincide with their financial year. Accordingly, for these entities, all or most of next year's contracts could be enforceable on the entity at each reporting date.

The Boards noted that, for an entity that has enforceable arrangements in the weeks before year end for the following 1 July to 30 June coverage period, applying AASB 17/PBE IFRS 17.25(c) would mean all of the onerous contract losses associated with next year's arrangements would need to be included in the current year's results. While this may not have a major impact year-on-year, the Boards thought it would be a counter-intuitive outcome.

## Conclusions

BC50 Based on the above deliberations, the Boards concluded that they would propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c). The Boards consider this exemption is justified for the following reasons.

- (a) The consequences of applying AASB 17/PBE IFRS 17.25(c) to some public sector insurers would be potentially burdensome from a practical viewpoint, since their systems are not currently set up to capture this information, and would lead to information that is not useful for users of the financial statements. This is because, for some public sector entities, on an ongoing basis, the results for the current period would include the onerous contract losses of all or most of the following year's contracts.
- (b) AASB 17/PBE IFRS 17.25(c) was conceived in the context of private sector for-profit insurers for which, in theory, onerous contracts would be the exception and for which enforceable contracts as at the reporting date that relate to the following year of coverage would be a relatively small proportion of total contracts.

## Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA)

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BC51 AASB 17/PBE IFRS 17 includes two approaches to measuring liabilities for remaining coverage:

- (a) a general measurement model that involves discounting fulfilment cash flows and, when relevant, recognising a 'contractual service margin' (deferred profit/loss); and
- (b) the premium allocation approach, which is a 'simplified approach' and typically much less burdensome to apply than the general measurement model.

BC52 The Boards noted that identifying contract boundaries and coverage periods under AASB 17/PBE IFRS 17 are crucial for two main reasons:

- (a) identifying the cash flows used to measure liabilities for remaining coverage for in-force arrangements; and

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<sup>11</sup> Based on IFRS 17.BC140 to BC144.

- (b) determining whether liabilities for remaining coverage for in-force arrangements are eligible to be measured by applying the premium allocation approach.
- BC53 The Boards also noted that eligibility for the premium allocation approach is available on a ‘group of contracts’ basis<sup>12</sup> – that is, an entity might apply the general measurement model to some groups of contracts and the premium allocation approach to other (eligible) groups of contracts. However, they further noted that creating an accounting system capable of implementing the general measurement model, of itself, could involve significant costs, even if it only needs to be applied to some of an entity’s arrangements.
- BC54 The Boards observed that, for most public sector entities currently applying AASB 1023/PBE IFRS 4, the liability for incurred claims<sup>13</sup> is typically much larger than the liability for remaining coverage.<sup>14</sup> Nonetheless, the liability for remaining coverage would be expected to be a material amount for most public sector entities with arrangements that would be scoped into AASB 17/PBE IFRS 17. Accordingly, eligibility to apply the premium allocation approach is a key issue for public sector stakeholders.
- BC55 The Boards noted the two bases on which arrangements might be eligible for the premium allocation approach under AASB 17/PBE IFRS 17.53 – at the inception of a group:
- (a) the entity reasonably expects the premium allocation approach would produce a measurement of the liability for remaining coverage that would not differ materially from the one that would be produced applying the general measurement model: or
- (b) the coverage period of each contract in the group is one year or less (determined at that date applying AASB 17/PBE IFRS 17.34).
- The Boards observed that the same criteria apply in respect of reinsurance contracts held under AASB 17/PBE IFRS 17.69. They also observed that, when there are contracts with coverage periods longer than a year, criterion (a) would involve creating a system to periodically test for material differences that, of itself, could involve significant costs.
- BC56 The Boards considered that, given the difficulty that can be associated with meeting the criterion in AASB 17/PBE IFRS 17.53(a), the manner in which the criterion in AASB 17/PBE IFRS 17.53(b) might apply in a public sector context could be crucial.

## Coverage periods of public sector arrangements

- BC57 The Boards noted that, of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17:
- (a) most have ‘stated’ coverage periods of one year; however
- (b) a minority of arrangements have coverage periods longer than a year, including:
- (i) for example, arrangements issued in respect of construction and home building risks; and
- (ii) some reinsurance contracts held.
- BC58 Arrangements between public sector entities and their policyholders ordinarily include an identified period that is presumed to be the coverage period for the purposes of applying AASB 1023/PBE IFRS 4. For example, the stated period of cover for arrangements relating to transport accidents or workers’ compensation would usually be one year and the liabilities and revenues are recognised on this basis.
- BC59 The Boards acknowledged that AASB 17/PBE IFRS 17 does not make this same presumption. Under AASB 17/PBE IFRS 17, the ‘coverage period’ might be different from the stated period in a contract or arrangement because it is determined, in large part, based on identifying the cash flows that are within the ‘contract boundary’. In that context, the Boards noted that cash flows are regarded as being within the boundary of an insurance contract to the extent that the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with insurance contract services [AASB 17/PBE IFRS 17.34].
- BC60 The Boards further noted that, an entity’s substantive obligation to provide insurance contract services ends when:
- (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks [AASB 17/PBE IFRS 17.34(a)]; or
- (b) both of the following criteria are satisfied:

12 Although the Boards propose that, effectively, the basic unit of account for public sector entities would be portfolios.

13 Generally referred to as the ‘outstanding claims liability’ under AASB 1023/PBE IFRS 4.

14 Akin to the ‘unearned premium liability’ referred to in AASB 1023/PBE IFRS 4.

- (i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
  - (ii) the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date [AASB 17/PBE IFRS 17.34(b)].
- BC61 The Boards observed the following.
- (a) Criterion (a) relating to individual policyholders, would usually only be applicable for large risks that are individually underwritten. This might, for example, be relevant for large construction risk arrangements entered into by some public sector entities.
  - (b) The vast majority of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17 would be priced at a level higher than individual contracts and the criteria in AASB 17/PBE IFRS 17.34(b) would be relevant.
- BC62 The Boards acknowledged that these criteria mean a coverage period could be either longer or shorter than the contractually-stated term, and noted the following examples.
- (a) A contract with a stated term of one year and a \$100 premium is accompanied by an option for a second year of coverage for another \$100 premium. The initial contract would be regarded as a contract for two years of coverage because the insurer does not have the practical ability to fully reprice the risk/benefits for the second year.
  - (b) A contract with a stated term of ten years involves ten annual premiums that are reset each year to reflect current expected risks/benefits. Although the insurer is obliged to keep accepting premiums and providing coverage for ten years, each year (up to a possible ten years) would be regarded as a separate coverage period because the insurer has the practical ability to reprice risk/benefits each year.
- BC63 The Boards observed that the criteria in AASB 17/PBE IFRS 17.34 are based on the existence of the insurer's practical ability to fully price for risks/benefits, not the manner in which the insurer might choose to use that ability. Accordingly, the fact that an entity might have the 'practical ability' to fully price for risks/benefits but choose not to use that ability, is not relevant to determining the cash flows within the boundary of an insurance arrangement.
- BC64 In relation to the contract boundary criteria, the Boards noted there may be issues specific to the public sector that were not necessarily considered in the development of IFRS 17, which they might need to specifically address in AASB 17/PBE IFRS 17. In particular, those issues include:
- (a) whether a public sector entity (itself) would be regarded as having the practical ability to set prices and benefits, or whether that power lies more broadly with government, including for example, the relevant Minister(s); and
  - (b) assessing the practical ability to set prices and benefits for a monopoly provider that cannot cease insuring risks by withdrawing from the market.

## **Coverage periods and 'practical ability'**

- BC65 The Boards observed that the levy/premium and benefit decision-making power may reside with the public sector entity itself, or more commonly, resides with the government [for example, the relevant Minister(s) or regulatory pricing supervisor].
- BC66 The Boards noted that a typical public sector model involves:
- (a) benefits largely being determined by reference to regulation or legislation, which would be the product of consultation and review; and
  - (b) levies/premiums being set under a process where the public sector entity makes recommendations to a government regulatory pricing supervisor or Minister for approval. The recommendations may be approved with or without alterations.
- BC67 In these circumstances, literally, the public sector entity (itself) does not have the practical ability to set prices/levies and benefits. A strict interpretation of AASB 17/PBE IFRS 17.34 might mean that the public sector entity's arrangements are open-ended and coverage is virtually perpetual. The Boards noted a flow on consequence of this would be that, under AASB 17/PBE IFRS 17, a public sector entity may need to account for arrangements as if they were issuing very long-term multi-year contracts with the need to estimate cash flows over long forecast periods.

- BC68 The Boards considered the main alternative perspective to be that the entity and its controlling government<sup>15</sup> [including any relevant Minister(s) or regulatory pricing supervisor] would be regarded collectively as having the practical ability to fully price for risks/benefits. The Boards noted a flow on consequence of this perspective is that, under AASB 17/PBE IFRS 17, a public sector entity's arrangements would be regarded as having contract boundaries based on the timing (often annual) of pricing/benefit reviews by government, rather than being open-ended.
- BC69 The Boards also considered whether the practical ability of a government or public sector entity should be affected by constraints imposed by the political and economic environment. However, they noted that:
- (a) all entities face political and/or economic constraints of some kind; including, for example, competitive pressures facing private sector insurers; and
  - (b) the 'practical ability' benchmark needs to be applied in the context of AASB 17/PBE IFRS 17.B64, which says (in part): "An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same characteristics as the existing contract issued on that date ...".
- BC70 Accordingly, provided the constraints (political or commercial) apply to new (current) arrangements as well as existing arrangements, they are not regarded as constraints that affect an insurer's practical ability to fully price for risks/benefits in relation to the existing arrangements. The Boards considered that, instead, the focus should be on the constraints operating under existing and substantively enacted legislation.

### **Coverage periods and 'practical ability' – conclusions**

- BC71 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's practical ability to fully price for risks/benefits also includes the ability of its controlling government [including any relevant Minister(s) and/or regulatory pricing supervisor] under existing and/or substantively enacted legislation to decide on pricing and benefits. The Boards consider this guidance to be supportable for the following reasons.
- (a) The approach seems reasonable given that the government 'owns and controls' the public sector entity and users of the financial statements would know, when relevant, that the ultimate decision-making power lies with the government.
  - (b) Without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how long-run pricing affects the entity's 'practical ability'; and inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

### **Coverage periods – impact of monopoly and standing ready over the long-run**

- BC72 The Boards observed that:
- (a) the IASB presumably developed IFRS 17 largely with competitive markets in mind [IFRS 17.BC167 & BC168(a)]; and
  - (b) most of the public sector entities that are the subject of the joint AASB/NZASB project are monopolies or near monopolies,<sup>16</sup> and are not able to withdraw from the market(s) they serve without a change of legislation.
- BC73 The Boards also observed that, for a public sector entity, a monopoly position can mean:
- (a) the power to charge above-market levies/premiums; but
  - (b) the responsibility to keep providing insurance services to a community of policyholders in perpetuity, or at least until there is legislative change and/or structural changes to the markets served.
- BC74 The Boards considered whether the responsibility to keep providing insurance services to a community of policyholders might have consequences for the 'contract boundary'; and the 'coverage period' of a public sector entity's arrangements and noted the following possible views.

<sup>15</sup> Under existing (or substantively enacted) legislation.

<sup>16</sup> The reference to 'near monopolies' relates mainly to schemes such as the workers' compensation schemes that operate in most Australian states, from which 'approved' large employers can be excluded on meeting certain conditions.

- (a) The responsibility to keep providing insurance services to a community of policyholders means the contract boundary (and coverage period) extends over multiple years, even though the contractually-stated coverage period might be, for example, one year.
- (b) An alternative view is that this year's policyholders may or may not continue to be policyholders next year and, accordingly, the responsibility to keep providing insurance services to a community of policyholders over the long term is not relevant to determining coverage periods.

### **Coverage periods and 'monopolies' and standing ready over the long-run – conclusions**

BC75 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance to the effect that an entity's monopoly status (and the possible inference that there is a legislative obligation to stand-ready to insure future policyholders), of itself, does not affect an entity's practical ability to fully price for risks/benefits and, therefore, would not affect the coverage period of an insurance contract. The Boards consider this guidance to be supportable for the following reasons.

- (a) The monopoly or near monopoly status of public sector entities, coupled with their inability to withdraw from the markets they serve without a change of legislation, is a set of circumstances unique to the public sector. The Boards consider that providing some direction to the affected public sector entities could have a cost-beneficial impact on the application of AASB 17/PBE IFRS 17.34(b)(ii). Accordingly, to the extent guidance is provided that these circumstances do not, of themselves affect an entity's practical ability to fully price for risks/benefits is a 'modification' of IFRS 17, it would be justified under the Boards' frameworks for setting standards for public sector entities.
- (b) If the monopoly status of a public sector entity was to be regarded as leading to multi-year coverage periods, the entity would need to estimate the number of years of coverage. It seems highly likely that the entity's estimates would prove to be different from the actual number of periods over which participants continue their coverage. If the difference between the originally-determined coverage periods and the actual coverage period is significant, this would result in 'a modification of an insurance contract' under AASB 17/PBE IFRS 17.72 and 73. The existing contract would be derecognised and a new (modified) contract would be recognised. This process has the potential to involve complex and costly tracking of information and it seems unlikely this is a scenario that was contemplated in developing IFRS 17.
- (c) The guidance could be regarded as reasonable under the principles in AASB 17/PBE IFRS 17 given that typically there is turnover among policyholders over successive years, even though it may be limited. For example, in respect of compulsory third party (personal injury) insurance, at the margin, some motor vehicles registered and insured in the current year may be deregistered and uninsured in the following year.
- (d) Without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how monopoly status affects the entity's 'practical ability'; and inconsistent determinations about 'practical ability' might be made by different entities in similar circumstances.

### **Coverage periods – impact of monopoly and long-run pricing**

BC76 The Boards observed that the pricing of levies/premiums for many public sector entities is based on achieving a break even result over the long-term. Accordingly, in some cases, the actual amounts charged in any given period might be regarded as being the result, in part, of taking into account the risks that relate to periods after the current contract period. In these cases, the criterion in AASB 17/PBE IFRS 17.34(b)(ii) would not be met and the arrangements would be regarded as, for example, involving a multi-year coverage period, even though the contractually-stated coverage period might be one year.

BC77 The Boards noted that the long-run focus of pricing for many public sector entities might be based solely on past experience and not be influenced by projections of risk relating to future periods. This is likely to be the case for entities providing coverage for risks that evolve only slowly over time in their nature and level of severity. For example, typically this might be expected to apply for workers' compensation and transport accident risks. The long-run focus of pricing for other public sector entities might be based, at least in part, on projections of risk relating to future periods. For example, this might be the case for entities providing coverage for risks that are scheduled to change, and possibly when an entity insures for losses arising from infrequent severe events such as earthquakes.

- BC78 The Boards noted the following possible scenarios:
- (a) A legislative change has been made to significantly increase benefits relating to certain types of injuries that occur after July 20X1. Based on government policy, the entity is gradually increasing levies/premiums over the 20X2 to 20X7 financial years in order to establish reserves to help fund the higher benefits. In this case, the current-year pricing is taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as extending from 20X2 until 20X7 and possibly beyond.
  - (b) An entity insures against losses from what is projected to be a one-in-20-year event and charges levies/premiums for one-year contracts each year over a 20-year period that are designed to meet the expected benefits that will need to be paid. In a competitive (private sector) market context, the entity would not be regarded as taking into account the risks that relate to periods after the current contract period because the entity would be viewed as considering the risk of loss for each one-year period. Policyholders could obtain the same coverage from a different insurer in a subsequent year. Accordingly, in the private sector context, the contract boundary (and coverage period) would be determined as being one year. In a monopoly public sector context, the current-year pricing could be regarded as taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as being 20 years.
- BC79 The Boards observed that applying AASB 17/PBE IFRS 17 unamended might have a range of related implications. This could include public sector entities having to estimate the average time that a policyholder is expected to keep participating in the scheme to determine a coverage period for the purposes of AASB 17/PBE IFRS 17. This could have flow-on consequences for uncertainty around the estimated length of coverage periods and the volatility of cash flows.

### **Coverage periods – impact of monopoly and long-run pricing – conclusions**

- BC80 The Boards concluded that, for the avoidance of doubt, it would be appropriate to propose guidance that a public sector entity would not fail to meet the criterion that pricing up to the date when the risks are reassessed does not take into account risks for periods after the reassessment date simply because it has a deliberate policy of setting prices and benefits based on a medium to long term view.
- BC81 The Boards considered the guidance is justified on the basis that public sector entities are more likely than their private sector counterparts to have overriding public policy objectives imposed upon them that would necessitate medium to long-term pricing and benefits approaches. The Boards were also concerned that, without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how medium to long-term pricing and benefits would affect their ability to meet the criterion in AASB 17/PBE IFRS 17.34(b)(ii).
- BC82 The Boards also noted that, in principle, such pricing policies are unlikely to mean that the entity has lost its practical ability to price its arrangements based on risks and benefits for the relevant (current) periods of coverage. They simply mean the entity [together with its controlling government, Minister(s) and/or regulatory pricing supervisor] has chosen to take a longer-term perspective.

### **Disclosure and long-run pricing**

- BC83 The Boards considered that, given the impact on public sector entities of medium to long-term pricing and benefits approaches on the application of the requirements of AASB 17/PBE IFRS 17.34, where those approaches exist, they should be the subject of disclosure. This is because the disclosure could provide useful context for users of the financial statements.
- BC84 The Boards observed that the pricing and benefit approaches of public sector entities might be the subject of transparent public processes and, therefore, adequate disclosures might already be made outside the financial statements.

#### *Disclosure and long-run pricing – conclusions*

- BC85 For the reasons noted immediately above, the Boards concluded they would propose that, when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period, it should be required to disclose information about the manner in which pricing/benefits are determined and the timeframes for which they are typically determined. The Boards concluded that the proposed disclosure could be made either directly in the notes to the financial statements or by reference to an authoritative source, provided that source is available to users of the financial statements on the same terms as the financial statements and at the same time.

## Risk adjustments

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### Background

- BC86 The Boards noted that:
- (a) under AASB 17/PBE IFRS 17, a risk adjustment is: “the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts”; while
  - (b) under AASB 1023/PBE IFRS 4, a risk margin relates to the inherent uncertainty in the central estimate of the present value of the expected future payments.
- BC87 The Boards noted that the notion of a risk adjustment in AASB 17/PBE IFRS 17 is the compensation the entity would require to make it indifferent between fulfilling a liability of fixed amount and a liability of uncertain amount that has a central estimate equivalent to the fixed liability [AASB 17/PBE IFRS 17.B87]. It is designed to convey information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk associated with the amount and timing of cash flows.
- BC88 The Boards noted that AASB 1023/PBE IFRS 4 has no equivalent to the AASB 17/PBE IFRS 17 notion of compensation – instead, the risks are regarded as being inherent in the cash flows. Conceivably, it might be argued that, under AASB 17/PBE IFRS 17, a public sector entity could have a risk adjustment of ‘zero’ if the entity does not seek compensation for bearing non-financial risk, while AASB 1023/PBE IFRS 4, assumes an entity includes a risk margin based on the inherent uncertainty around the cash flows.
- BC89 The Boards noted that:
- (a) there is a presumption that for-profit private sector entities would need to be compensated for bearing risk and, as risk is released, that revenue would be recognised; and
  - (b) public sector entities may have a different perspective and not need to be compensated for bearing risk on the basis that:
    - (i) they are often monopolies and there may be the opportunity to increase premiums/levies to meet future claims; and
    - (ii) they have explicit or implicit government guarantees of financial support.

### Industry benchmarks and current practices

- BC90 The Boards noted that neither Standard requires a particular technique to be used to measure risk adjustments; however, currently entities typically use a confidence level (probability of adequacy) approach. The Boards also noted that:
- (a) under AASB 1023/PBE IFRS 4, many entities benchmark to a 75% confidence level (indicating the liability for incurred claims would be adequate to meet actual claims three years in four); and
  - (b) under AASB 17/PBE IFRS 17, when an approach other than the confidence level technique is used, an entity must disclose the technique used and the confidence level corresponding to the results of that technique [AASB 17/PBE IFRS 17.119].
- BC91 The Boards observed that the 75% confidence level benchmark originally arose from a minimum prudential reporting benchmark and has become a widely used reference point in Australia and New Zealand and more broadly in other jurisdictions. Additionally, although other methods (such as cost of capital techniques) may be used to measure risk adjustments, they are often only permitted by regulators subject to achieving a minimum confidence level.
- BC92 The Boards observed that most of the public sector entities applying AASB 1023/PBE IFRS 4 recognise risk margins at a 75% confidence level, or some level close to that benchmark. The Boards also observed that some of the Australian public sector entities applying AASB 137 also recognise risk margins at a 75% confidence level, or some level close to that benchmark. In outreach conducted in 2021-21, some stakeholders indicated that information about uncertainties in the cash flows are important to them, even in measuring provisions (under AASB 137).

### Previous public sector proposals and stakeholder feedback

- BC93 The Boards noted that the AASB Discussion Paper (2017) and NZASB ED 2018-7 did not propose any modifications in respect of the risk adjustment requirements in AASB 17/PBE IFRS 17. However, they noted that the AASB Discussion Paper Basis for Conclusions [AASB DP.BC8 to BC13] raised the possibility of a

risk adjustment of zero based on a case of a public sector entity with a government guarantee and/or a monopoly position in which it can recoup current and past losses from its controlling government or via future contracts. However, the AASB Discussion Paper concluded that, while the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil because:

- (a) the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment are a characteristic of the claims liability; and
- (b) in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period and an entity's monopoly position is not relevant [AASB DP.BC10].

BC94 The Boards noted that, in response to the AASB Discussion Paper (2017) proposals:

- (a) some respondents considered that there would be risk adjustments (above zero) and also noted various considerations, including:
  - (i) disclosures around the techniques used to determine risk adjustments should be required to help ensure transparency;
  - (ii) if the AASB expects risk adjustments to be different from those in the private sector, the implication is that they would be lower (compared with the private sector) and guidance would be needed to help entities make those calculations; and
  - (iii) whether it is appropriate to imply that risk adjustments in the public and private sectors should be aligned;
- (b) other respondents considered that there would be circumstances in which a risk adjustment could be zero, such as:
  - (i) when there is absolute certainty around the government backing of the best estimate liability; and
  - (ii) the liability cash flows are so long term that the volatility is mitigated by long-term investment returns.

BC95 The Boards noted that some respondents to NZASB ED 2018-7 considered that risk adjustments would not be relevant to many public sector entities and, if they were to be required:

- (a) explicit guidance on determining risk adjustments in the public sector would be needed; and/or
- (b) the Standard should specify that risk adjustments are zero for public sector entities.

BC96 The Boards noted the comments of respondents to NZASB ED 2018-7, which included the following:

- (a) risk adjustments are predicated on the liability being an estimated amount a third party would likely want to be paid to assume the risk of settling claims, which is akin to an exit price; however, the liabilities will be settled by the entity itself;
- (b) if the entity seeks to fund a liability that includes a risk adjustment, in order to report a break-even result, the entity would need to set levies and other forms of income at amounts that (on average) would be higher than necessary; and
- (c) if the entity is funded to meet a best estimate liability, including a risk adjustment in the liability would automatically result in reported losses, which may never eventuate.

BC97 The Boards also noted the following feedback received from stakeholder outreach conducted in 2020-21.

- (a) AASB 1023/PBE IFRS 4 is regarded as requiring a risk margin to be included in measuring liabilities for outstanding claims, while AASB 137/PBE IPSAS 19 is generally regarded as not requiring a risk margin to be included in measuring provisions, but can be interpreted as permitting a risk/prudential margin to be included.
- (b) A key reason for some stakeholders choosing to apply AASB 137/PBE IPSAS 19 (rather than AASB 1023/PBE IFRS 4) is that they do not regard risk margins as appropriate to their circumstances.
- (c) Some stakeholders had assumed that their risk adjustments under AASB 17/PBE IFRS 17 would be the same as their risk margins under AASB 1023/PBE IFRS 4, while others had yet to consider whether they would have a risk adjustment under AASB 17/PBE IFRS 17 and, if they did, whether it would be more or less than any risk margin they currently apply.

## **Alternative approaches considered by the Boards**

BC98 The Boards considered the following possible approaches regarding the risk adjustments requirement:



- (a) Approach 1: require public sector entities to apply AASB 17/PBE IFRS 17 with no modifications or guidance;
- (b) Approach 2: require public sector entities to have a zero risk adjustment; and
- (c) Approach 3: require a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities.

### **Approach 1: Apply AASB 17/PBE IFRS 17 with no modifications or guidance**

BC99 The Boards considered the possible advantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.

- (a) It could be considered consistent with the principle of only making modifications to the IFRS Standards if there is a strong case based on substantive differences in circumstances of public sector entities (compared with the entities for which IFRS Standards are developed).
- (b) It would allow for different risk adjustments to be recognised to suit the nature of each entity's claims liabilities, which would be helpful since different public sector entities hold claim liabilities with different characteristics. For example, very long-tail, relatively predictable claims (such as regular income support payments), would result in a relatively small risk adjustment. In contrast, claims subject to future legal judgements might result in a relatively large risk adjustment.
- (c) Different public sector entities hold different views on whether they should include a risk adjustment in measuring their claim liabilities based on their circumstances. Each entity would be able to determine its position consistent with its own objectives, management philosophy, and level of risk aversion.
- (d) A for-profit public sector entity could recognise a risk adjustment on the basis that it expects to profit from bearing risk, while a not-for-profit entity might not recognise a risk adjustment because it does not seek to profit from bearing risk.

BC100 The Boards considered the possible disadvantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.

- (a) IFRS 17 was designed to be applied by private sector entities. The public sector context is often different; in particular, due to entities holding a monopoly position and being driven by public policy objectives.
- (b) Different public sector entities may determine different outcomes even though they have similar operations. Accordingly, their reported financial position and financial performance would not be comparable.
- (c) Public sector entities might expend a disproportionate amount of time and resources determining the compensation they might notionally require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils its arrangements. There may be little or no additional information value achieved for users of the financial statements through this process.

### **Approach 2: Require public sector entities to have a zero risk adjustment**

BC101 The Boards noted that opinions differ about whether, in concept, an entity can have a risk adjustment of zero and still claim to have contracts that transfer insurance risk. For the purposes of discussion, the Boards assumed that, in particular circumstances, a zero risk adjustment is compatible with the transfer of insurance risk and noted the example of a mutual risk-pooling arrangement that involves accepting risk from each policyholder and sharing the risk with other policyholders. Although a public sector entity might be regarded as simply an administrator of such a pooling arrangement, it could nevertheless also be seen as bearing risk for the current in-force arrangements because the risk is typically pooled over a number of coverage periods.

BC102 The Boards considered the possible advantages of requiring public sector entities to have a zero risk adjustment.

- (a) All public sector entities would have a consistent approach (based on best estimate claim liabilities).
- (b) Best estimates (with no risk adjustment) are typically relevant to user decision making because they ordinarily provide a basis for determining how much levies or other charges need to be generated to sustain the entity in the long term.
- (c) Most of the relevant public sector entities are monopolies and/or have the power to adjust future levies and charges to meet any shortfalls in funding the existing claim liabilities. Accordingly, risk adjustments are not relevant because these entities have no reason to be risk averse.

- (d) Zero risk adjustments (and, therefore, zero changes from period to period in risk adjustments) would avoid misleading impacts on the income statement, since risk adjustments tend to create short term losses and longer-term gains as actual claims revert to the best estimate over the long term.
  - (e) Zero risk adjustments would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments and to make disclosures about risk adjustments.
- BC103 The Boards considered the possible disadvantages of requiring public sector entities to have a zero risk adjustment.
- (a) Many public sector entities hold strong views on the need to show their users that claim liabilities carry a level of uncertainty as to timing and amount, and consistency does not necessarily lead to comparability. All entities are risk averse to varying degrees.
  - (b) There would be no changes in risk adjustments to provide useful information about changes in the levels of uncertainty among cash flows over time.
  - (c) There are often obstacles to exercising monopoly and other powers. For example, it might not currently be feasible to increase levies in either the short to medium term to meet shortfalls in a timely manner. The risks that exist within in-force arrangements should not be regarded as being able to be offset by possible future transactions.
  - (d) It is normal commercial practice to determine risk adjustments and many public sector entities, particularly those with independent boards of management, would wish to have a risk adjustment for financial reporting purposes to match their risk management activities (and management reporting).

**Approach 3: Require a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities**

- BC104 The Boards considered the possible advantages of requiring a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities.
- (a) All public sector entities would have a consistent approach (based on a common confidence level).
  - (b) A common confidence level would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments. In particular, this requirement would be generally consistent with prevailing current practice (which is long-standing) and be readily understood by all relevant stakeholders.
  - (c) Relative to having a zero risk adjustment, the common confidence level approach would show, from period to period, the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty about the amount and timing of cash flows over time.
- BC105 The Boards considered the possible disadvantages of requiring a particular confidence level for liabilities for incurred claims for determining risk adjustments for all public sector entities.
- (a) It would be inconsistent with principle-based standard setting to set an arbitrary benchmark such as a 75% confidence level.<sup>17</sup>
  - (b) The approach prevents entities from determining risk adjustments appropriate to their particular circumstances. Requiring a percentage confidence level also presumes that this is the best technique for determining risk adjustments in all circumstances; however, an entity might consider that another technique (e.g. a ‘cost of capital’ technique) is more appropriate.
  - (c) Consistency does not necessarily lead to comparability.
  - (d) If there is a general shift in expectations about the uncertainty surrounding the amount and timing of cash flows, the required confidence level might need to be updated by the Boards.

*Disclosures*

- BC106 The Boards considered that each of the three approaches outlined above could be supplemented with disclosures such as the following.

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<sup>17</sup> The Boards noted that some Australian public sector entities are required (via regulation imposed in that jurisdiction) to benchmark to APRA prudential requirements, which include a minimum risk margin.

- (a) If Approach 1 is adopted (no modifications), the entity could also be required to disclose a risk adjustment for benchmark confidence level (such as 75%) to provide a point of reference for comparison.
- (b) If Approach 2 is adopted (zero risk adjustment), the entity could also be required to disclose what the risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.
- (c) If Approach 3 is adopted and each public sector entity recognises a risk adjustment for a standardised confidence level (such as 75%), the entity could also be required to disclose what its risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.

BC107 The Boards also considered whether, if Approach 3 were proposed as a rebuttable presumption, disclosure should be proposed of the basis for any rebuttal. However, they observed that this would go beyond counterpart disclosures already required in AASB 17/PBE IFRS 17. For example, they noted that AASB 17/PBE IFRS 17.119 requires that an entity using a technique other than the confidence level technique for determining the risk adjustment need only disclose the technique used and the confidence level corresponding to the results of that technique.

## Analysis of approaches by the Boards

BC108 The Boards analysed the basis for the IASB's decisions on requiring a risk adjustment and reflected on how each of the benefits the IASB identified might still be met in a public sector context under each of the approaches (no modifications, mandated zero risk adjustment, or mandated 75% confidence level).

BC109 The Boards noted that requiring a risk adjustment is intended to provide a clear insight into the insurance contracts and distinguishes them from risk-free liabilities [IFRS 17.BC211(a)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.

BC110 The Boards noted that requiring a risk adjustment results in a profit recognition pattern that reflects both the profit recognised by bearing risk and the profit recognised by providing services [IFRS 17.BC211(b)]. The Boards considered this reasoning would be less relevant in respect of public sector entities that are not seeking to profit from bearing risk (albeit IFRS 17 applies to not-for-profit mutual entities). However, on balance, the Boards thought that this reasoning could also be applied to revenue recognition and be relevant to a public sector entity, and would probably best support the view that the risk adjustment requirements of AASB 17/PBE IFRS 17 should be applied unmodified.

BC111 The Boards noted that requiring a risk adjustment can be necessary to faithfully represent circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums [IFRS 17.BC211(c)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.

BC112 The Boards noted that requiring a risk adjustment should result in changes in estimates of risk being reported promptly and in an understandable way [IFRS 17.BC211(d)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment would be inappropriate.

BC113 The Boards also analysed the following criticisms of risk adjustments considered by the IASB in developing IFRS 17 and reflected on whether they might be more relevant in the public sector and, therefore, justify a different outcome from the requirements in AASB 17/PBE IFRS 17.

- (a) Currently, there is no single well-defined measurement approach to risk adjustments that would necessarily provide consistency and comparability of results [IFRS 17.BC210(a)]. This criticism is no more relevant, in a general sense, in the public sector than it is for private sector insurers.
- (b) Some measurement techniques for risk adjustments are difficult to explain to users of financial statements [IFRS 17.BC210(b)]. This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector users might be relatively less familiar with actuarial techniques. The NZASB in particular thought that this criticism might imply that mandating a widely-understood basis of measurement (such as a confidence level approach) could be useful in a public sector context.
- (c) It is impossible to assess retrospectively whether a particular adjustment was reasonable, including whether (for example) a decision to set a confidence level at a particular percentile was appropriate [IFRS 17.BC210(c)]. This criticism is no more relevant in the public sector than it is for private sector insurers.
- (d) Developing systems to determine risk adjustments will involve costs that are not justified by the benefits [IFRS 17.BC210(d)]. This criticism may be more relevant in the public sector than it is for

private sector insurers because the public sector entities may not otherwise have to determine risk adjustments for management or prudential reporting purposes and typically do not price arrangements to be compensated for risk. The NZASB in particular thought that this criticism might imply that it would be inappropriate to simply leave public sector entities to apply the risk adjustment requirements of AASB 17/PBE IFRS 17 unaided.

- (e) Including a risk adjustment in identifying any loss on initial recognition is inconsistent with IFRS 15 (on revenue) [IFRS 17.BC210(e)]. This criticism is no more relevant (and possibly less relevant given the infrequent application of AASB 15 *Revenue from Contracts with Customers*) in the public sector than it is for private sector insurers.
- (f) If including a risk adjustment results in a loss, that loss will reverse in later periods as the entity is released from that risk, which may confuse some users of financial statements [IFRS 17.BC210(f)]. This criticism may be more relevant in the public sector than it is for private sector insurers because many public sector entities would be aiming to break even over the long term, rather than earn profits or incur losses. In contrast, private sector entities would typically aim to profit from bearing risk. However, the Boards also acknowledged that any tendency of risk adjustments to create short term losses and longer-term gains would generally be a ‘once-off’ impact and would not usually affect ongoing reported financial performance unless the volumes of transactions are volatile year-on-year.
- (g) A risk adjustment could be used to introduce bias into the measurement of insurance contracts [IFRS 17.BC210(g)]. This criticism is no more relevant in the public sector than it is for private sector insurers.

### **AASB conclusions**

BC114 The AASB observed that:

- (a) most public sector entities do not seek to profit from bearing insurance risk;
- (b) under AASB 17, public sector entities might determine a zero risk adjustment on the basis that they are monopolies and can adjust future prices to make up for higher-than-expected past claims;
- (c) under AASB 17, public sector entities might determine a risk adjustment based on a particular level of adequacy based on their facts and circumstances; and
- (d) providing a benchmark confidence level, even as a rebuttable presumption, is not consistent with principle-based standard setting.

BC115 Accordingly, the AASB concluded that it would support Approach 1 and propose not making public-sector-specific modifications to the requirement to include a risk adjustment in measuring liabilities for incurred claims.

### **NZASB conclusions**

BC116 A primary concern for the NZASB is that entities, their advisors and auditors might expend considerable effort to identify and measure a relevant ‘compensation-based’ risk adjustment for little benefit to users.

BC117 The NZASB observed that existing practice under AASB 1023/PBE IFRS 4 has developed over many years and most public sector entities applying these standards benchmark to a 75% confidence level. The benchmark seems to have become widely accepted (including outside Australia and New Zealand) because it is:

- (a) relatively easy (and low cost) to measure;<sup>18</sup>
- (b) relatively easy to understand; and
- (c) financial statement users and entity managements have found it informative.

BC118 The NZASB considered that the 75% benchmark has been an effective and low-cost way for public sector entities to measure risk margins under AASB 1023/PBE IFRS 4. Nevertheless, the NZASB also acknowledged that there may be circumstances in which a benchmark other than a 75% confidence level is more relevant and that entities should be able to rebut the 75% benchmark.

BC119 Accordingly, the NZASB concluded that it supports Approach 3 and to propose a public-sector-specific modification of a rebuttable presumption that risk adjustments are measured at an amount that achieves a 75% confidence level in respect of liabilities for incurred claims. The NZASB also concluded that, in the event that

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<sup>18</sup> The Boards observed that, of itself, very little additional actuarial effort is likely to be needed to determine a risk adjustment – most of the relevant work is performed to determine the best estimate.

an entity rebuts the presumption, the existing PBE IFRS 17 already requires disclosure of the actual confidence level applied and that no further disclosures need be proposed.

- BC120 While acknowledging that providing a benchmark confidence level is not consistent with principle-based standard setting, the NZASB considers that the proposed modification is justified because:
- (a) the cost-saving benefits of using the benchmark will exceed any loss of information value; and
  - (b) the rebuttable presumption would still allow for flexibility in circumstances in which a 75% confidence level may not be appropriate.

### **Conclusions on further disclosures about risk adjustments in a public sector context**

- BC121 The Boards noted that there are comprehensive disclosure requirements in AASB 17/NZ IFRS 17 about risk adjustments, particularly in the requirements for reconciliations of insurance liabilities.
- BC122 Both Boards concluded that it would be inappropriate to require more disclosure of public sector entities than is required of other entities applying AASB 17/NZ IFRS 17 about risk adjustments in general.

## **Identifying public sector arrangements scoped into the Standard**

- BC123 The general approach of the Boards to establishing proposals for identifying which arrangements in the public sector would be accounted for as insurance contracts is based on:
- (a) considering the definitions and guidance on ‘insurance contracts’, ‘insurance contract services’ and ‘insurance risk’ in AASB 17/PBE IFRS 17; and
  - (b) identifying a range of indicators that are to be considered collectively, along with related guidance.
- BC124 The Boards regard a collective consideration of the indicators set out in paragraphs Aus/NZB16.1 to Aus/NZB16.25 as meaning that:
- (a) the existence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would apply; and
  - (b) the absence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would not apply.
- BC125 In developing the indicators, the Boards noted that the main alternative requirements applicable to liabilities of public sector entities are set out in AASB 137/PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Accordingly, the Boards were mindful of the key differences between the requirements of AASB 17/PBE IFRS 17 and AASB 137/PBE IPSAS 19, which include different discount rate requirements for present valuing cash flows and the specific requirement in AASB 17/PBE IFRS 17 for a risk adjustment.
- BC126 Paragraphs BC127 to BC211 outline the Boards’ deliberations in identifying indicators for determining when AASB 17/PBE IFRS 17 would be applied. This includes deliberations on indicators that were considered and rejected.

### **Similarity of risks covered and benefits provided**

- BC127 The AASB Discussion Paper (2017) proposals identified, as a suggested criterion for determining whether activities relate to insurance, that the transactions or arrangements entered into have similar characteristics and relate to a similar level of insurance risk as those entered into by for-profit private sector entities that are accounted for as insurance contracts [AASB DP.E14(c)]. This is not a factor explicitly identified in NZASB ED 2018-7, although it can be argued that it was proposed implicitly via other proposed indicators.
- BC128 The Boards observed that some public sector arrangements have direct counterparts with private sector insurance contracts, including for example, workers’ compensation contracts. In the context of a transaction neutral approach to accounting standard setting, the Boards regard this as a useful indicator that some types of arrangements in the public sector would be accounted for by applying AASB 17/PBE IFRS 17.
- BC129 The Boards noted that an arrangement in the public sector might provide a combination of types of coverage and benefits that are not matched by a private sector insurance contract, but that components of the arrangement might be directly comparable to a private sector insurance contract. For example, in Australia, compulsory third party motor insurance arrangements provided by a public sector entity includes coverage for serious or catastrophic injuries; whereas, the counterpart private sector insurance contracts typically do not. That serious or catastrophic injury coverage is often provided under a separate public sector arrangement.

- BC130 Accordingly, the Boards acknowledge the limitations in some circumstances of using the similarity of risks covered and benefits provided as an indicator of whether AASB 17/PBE IFRS 17 would apply because directly comparable forms of coverage may not be identifiable. However, the Boards note that considering the similarity of risks covered and benefits provided would involve a broader analysis than simply assessing whether directly comparable forms of coverage exist.
- BC131 The field testing conducted in 2021-22 on the indicators revealed mixed views. Some stakeholders considered ‘similarity of risks covered and benefits provided’ to be one of the most significant indicators. Other stakeholders considered that it is not a useful indicator either because:
- (a) there are examples of similar risks and benefits being addressed via insurance and (non-insurance) compensation schemes; or
  - (b) there are some arrangements that are clearly insurance contracts, but are currently exclusively issued in Australia by public sector entities.
- BC132 The field testing also revealed that the perspectives of some stakeholders about what constitutes a ‘similar risk’ can vary depending on whether the participants/policyholders are third parties or other public sector entities within the same government (see the discussion on ‘captive’ insurer at paragraphs BC216 to BC224). The Boards noted that the similarity of risks relates to the risks (or the amount and timing of cash flows) transferred and would not depend on the identity of the participants/policyholders. From the perspective of the public sector entity in its stand-alone general purpose financial statements, related-party participants/policyholders are nevertheless third parties.

## Conclusions

- BC133 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the similarity of risks covered and benefits provided due to the fact that the transfer of insurance risk is central to the definition of ‘insurance contract’.
- BC134 The Boards considered how widely entities would be expected to search for counterpart insurance contracts and concluded it would be reasonable for entities to consider counterpart contracts both within and outside Australia and New Zealand, using information that is ‘readily available’. That is, public sector entities would not need to conduct an exhaustive global search for counterpart contracts.

## Identifiable coverage period

- BC135 A key feature of an insurance contract in the context of AASB 17/PBE IFRS 17 is the existence of an identifiable coverage period, which is defined as ‘the period during which the entity provides insurance contract services’. The coverage period provides the basis for determining the cash flows to include in measuring insurance contracts.
- (a) Most insurance contracts provide protection for events that occur during the coverage period – for example, coverage for claims that might arise from an incident over a one-year contract period. The claims may not come to light until after the coverage period has ended. These are sometimes referred to as ‘claims incurred’ contracts because the time when the event occurs is crucial to identifying valid claims.
  - (b) Some insurance contracts provide protection for claims that arise during the coverage period, regardless of when the incidents that gave rise to the claims have occurred. These are sometimes referred to as ‘claims made’ contracts because the time when the claim emerges is crucial to identifying valid claims.
- BC136 The Boards observed that, instead of having an identifiable coverage period, social benefit type schemes tend to be open-ended and depend on participants continuing to meet eligibility criteria, which might include, for example, being unemployed, being a student, or being above a certain age. In that context, IPSAS 42.5 defines ‘social benefit’ as:
- cash transfers provided to:
- (a) specific individuals and/or households who meet eligibility criteria;
  - (b) mitigate the effect of social risks; and
  - (c) address the needs of society as a whole.
- The social benefit eligibility criteria relate to someone’s inherent status, rather than relating to an uncertain future event that occurs within a particular coverage period.
- BC137 The field testing revealed that some stakeholders consider having an identifiable coverage period is an essential feature for arrangements to be accounted for as an insurance contracts on the basis that:

- (a) without a coverage period, an entity would be unable to determine the relevant fulfilment cash flows to include in measuring insurance liabilities; and
- (b) having an identifiable coverage period contrasts with open-ended compensation schemes that provide benefits based on meeting eligibility criteria (and would not be accounted for as insurance contracts).

BC138 With the benefit of feedback from field testing the indicators, the Boards noted that there is a distinction between a period being identified for the purposes of raising levies to fund a compensation scheme and the notion that an amount is collected to cover events that occur over a particular ‘coverage period’.

## Conclusion

BC139 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of an identifiable coverage period.

## Enforceable nature of arrangement

BC140 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach (and apply IFRS 17) is that the arrangements between the entity and its participants are enforceable in a similar manner to an insurer being required to act in accordance with an insurance contract [IPSAS 42.AG25(a)]. Both the AASB Discussion Paper (2017) [AASB DP.E13(b)] and NZASB ED 2018-7 [ED 2018-7.AG1.6] proposed a similar indicator. The AASB Discussion Paper proposal identified as a key criterion that a scheme participant’s beneficial rights cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended.

BC141 The Boards observed that, in a for-profit private sector setting, an insurer is required to act in accordance with the terms of the contract with a policyholder in terms of the types of risks covered and what constitutes insured events and, therefore, could be the subject of a valid claim. The actual amounts of compensation paid in respect of claims are determined by reference to the terms of the contract. Typically, those terms would be based on:

- (a) the extent of loss; and
- (b) the extent to which the policyholder or another party is responsible for the events that led to the loss (that is, which party is at fault), including failure to take reasonable steps to avoid the loss.

However, in some cases, there is an identified insured amount (for example, an agreed value for motor vehicle write-off) and sometimes the amount is a function of a number of factors and possibly negotiation.

BC142 Nevertheless, the extent of a claim in a for-profit private sector setting would need to be determined in the context of the insurance contract terms – there would ordinarily not be an opportunity for an insurer to arbitrarily change those terms under an existing contract.

BC143 This is in contrast with an arrangement under which participants in a scheme are promised a benefit, but the public sector entity retains the capacity to change the benefits payable to scheme participants. This is potentially a distinguishing feature of some public sector schemes (relative to the enforceable nature of contracts in the for-profit private sector). However, the significance of this capacity may be mitigated by the extent to which benefits could be changed for existing scheme participants under arrangements in place at the reporting date.

BC144 The Boards considered three examples to help illustrate the relevance of this capacity. Assume a public sector scheme has a liability for providing income support for permanently disabled motor accident victims based on paying 50% of Average Weekly Earnings (AWE).

- (a) Example A: The entity has the power to change the rate of benefits to future scheme participants to less than 50% of AWE. However, the entity has an enforceable commitment to paying 50% of AWE to existing scheme participants, for example, by way of settlements.
- (b) Example B1: The entity (or the government that controls the entity) has the power to change the rate of benefits to existing scheme participants to less than 50% of AWE but only after obtaining a change to existing legislation.
- (c) Example B2: The entity (or the government that controls the entity) has the unilateral power to change the rate of benefits to existing scheme participants to less than 50% of AWE, for example, based on projected budget priorities.

BC145 The Boards noted that:

- (a) the terms in Example A are like those under most insurance contracts sold in the for-profit private sector;

- (b) the terms in Example B1 are unlike those under most insurance contracts sold in the for-profit private sector; however, the fact that a legislative change would be needed to change the benefits is significant; and
  - (c) the terms in Example B2 are unlike insurance contracts sold in the for-profit private sector because these insurers would not be able to arbitrarily change benefits.
- BC146 The Boards identified that the enforceable nature of an arrangement is consistent with the basis for the accounting in AASB 17/PBE IFRS 17. Accordingly, the Boards considered that the extent to which the existing benefits under an arrangement are enforceable on the relevant public sector entity is an indicator for determining when that arrangement is accounted for as an insurance contract. [Correspondingly, the Boards also considered that cases when an entity would be able to arbitrarily change benefits seems indicative of a conventional social benefit arrangement.]
- BC147 The Boards observed that, relative to private sector insurers, governments are in a unique position to be able to legislate, which is relevant to Example B1 above. Having established an arrangement that provides benefits to scheme participants in a scheme, in theory, the government subsequently has the power to take those benefits away or at least adjust the amount of benefits.
- BC148 The Boards also observed that AASB 17/PBE IFRS 17 relies on the notion of an insurer having a ‘practical ability’ for the purposes of, for example:
- (a) determining the boundary of an insurance contract (practical ability to set a new price or new benefits [AASB 17.34(a)/PBE IFRS 17.34(a)]); and
  - (b) relief from recognising a separate onerous contract group (when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits [AASB 17.20/PBE IFRS 17.20]).
- BC149 The Boards identified that the notion of ‘practical ability’ could be used to help distinguish those cases when a public sector arrangement should be regarded as enforceable from cases when an arrangement is not enforceable. That is, an indicator that it is relevant to account for public sector arrangements as insurance contracts would be that the entity (or its controlling government) does not have the practical ability to change a benefit retrospectively.
- BC150 The Boards noted that some insurance contracts include a range of options in their original terms about subsequently amending coverage and AASB 17/PBE IFRS 17 requires an insurer to determine the probabilities of those options being exercised in measuring insurance liabilities. When expectations are different from actual events, the insurer recognises ‘experience adjustments’ and remeasures insurance liabilities based on updated expectations. However, these contract options are at the discretion of the insured and are different from changes to existing contract terms made by an issuer.

### **Contract versus statute**

- BC151 The Boards noted that the AASB Discussion Paper (2017) proposals included the following [page 5].
- The AASB’s view is that although AASB 17 applies only to contracts, the *Framework for the Preparation and Presentation of Financial Statements* (Conceptual Framework) does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way.
- The respondents to the Discussion Paper either explicitly or implicitly accepted the view that AASB 17 could apply when there is an insurance arrangement based on statute (and not contracts).
- BC152 The Boards also noted PBE IFRS 17.BC5 explains that, when developing NZASB ED 2018-7, the NZASB observed some public sector PBEs were applying the requirements of PBE IFRS 4 for ‘insurance-like’ activities that arose from statute rather than contract.
- BC153 The Boards observed that the stakeholder outreach conducted in 2020-21 and the field testing of the indicators conducted in 2021-22 identified three broad types of response from stakeholders.
- (a) The manner in which the scheme or arrangement has been established (contract versus statute) is a matter of form rather than substance. These stakeholders have observed that:
    - (i) virtually identical forms of coverage are provided under either statutory or private sector (contractual) arrangements (such as comprehensive third-party motor coverage) –



accordingly, the insurance Standards would apply by analogy to statutory arrangements under the accounting policy hierarchy;<sup>19</sup>

- (ii) the purpose of having a statutory (rather than contractual) arrangement is generally to mandate that people obtain coverage from the one entity (usually a public sector entity); and
  - (iii) individuals and entities are required by statute to pay for some types of insurance coverage from private sector insurers (such as workers' compensation coverage) and the arrangements are effectively a combination of contractual and statutory terms.
- (b) Literally, the insurance Standards are considered to apply only to 'contracts', and entities' activities in respect of relationships based only on statute are (strictly interpreted) not within the scope of the insurance Standards. These stakeholders have observed that: AASB 15 and AASB 16 *Leases* provide clear definitions and descriptions of 'contracts' that can be used as a 'bright line'.
- (c) For some types of risks (such as workers' compensation coverage), the existence of documentation that includes substantive information about risks and benefits (well beyond the detail in any relevant enabling legislation or regulations), is an indication of an insurance contract.

BC154 The Boards noted that, under AASB 17/PBE IFRS 17, the description of the rights and obligations that would be accounted for under insurance contracts is broad (and go beyond the contract). AASB 17.2/PBE IFRS 17.2 says (emphasis added):

- 2 An entity shall consider its substantive rights and obligations, whether they arise from a **contract, law or regulation**, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations<sup>[20]</sup>. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's **customary business practices**. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). **Implied terms in a contract include those imposed by law or regulation**. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

BC155 Stakeholders have requested the Boards to clarify whether an arrangement where a public sector entity is required by statute or other regulation alone, without a separate documentation evidencing agreements directly with participants, could indicate a 'contract' exists for the purposes of AASB 17/PBE IFRS 17. The Boards observed, for arrangements that would be accounted for as insurance contracts, it would generally be expected that some form of documentation, in addition to statutory requirements, would exist to evidence rights and obligations of participants and the relevant public sector entity. However, the Boards considered that there may be circumstances in which there is only limited documentation in addition to statutory requirements, and that limited documentation, within the statutory environment, could still be regarded as comprising a 'contract'.

## Conclusions

BC156 Based on the above deliberations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the absence of a practical ability to retrospectively change coverage or benefits. The Boards also concluded that they would propose the 'practical ability' is linked to existing or substantively enacted legislative powers. [The Boards noted that, otherwise, in a public sector context, an assessment of 'practical ability' would probably need to take into account a range of factors, including whether the entity (or its controlling government) has sufficient political capital to make a change that reduces a benefit, which would not be workable].

BC157 The Boards also concluded that the existence or otherwise of 'contracts' versus legislative requirements is not, of itself, likely to be a useful indicator of arrangements that would be accounted for as insurance contracts. Instead, the Boards consider the enforceable nature of the arrangements (the absence of a practical ability to retrospectively change coverage or benefits) is the most relevant focus, not the form of the documentation of the arrangements.

19 AASB 108/PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* [paragraphs 10 and 11/paragraph 14].

20 The second sentence of AASB 17.2/PBE IFRS 17.2 is the same as the definition for 'contract' used more generally in IFRS Standards (including: AASB 15 *Revenue from Contracts with Customers*).

## Source and extent of funding

### Fully funded

BC158 One of the criteria in IPSAS 42 for being eligible to apply the insurance approach is that a scheme is intended to be ‘fully funded’ from contributions and levies. NZASB ED 2018-7 proposed using the ‘fully-funded’ criterion for determining whether PBE IFRS 17 would apply [ED 2018-7.AG1.1 to AG1.4].

BC159 IPSAS 42.AG20 explains ‘fully funded’ as follows.

AG20 A social benefit scheme is intended to be fully funded from contributions when:

- (a) The legislation or other arrangement governing the social benefit scheme provides for the scheme to be funded by contributions or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme, together with investment returns arising from the contributions or levies; and
- (b) One or both of the following indicators (individually or in combination) is satisfied:
  - (i) Contribution rates or levy rates are reviewed (and, where appropriate, adjusted in line with the scheme’s funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the revenue from contributions or levies will be sufficient to fully fund the social benefit scheme; and/or
  - (ii) Social benefit levels are reviewed (and, where appropriate, adjusted in line with the scheme’s funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the levels of social benefits provided will not exceed the level of funding available from contributions or levies.

BC160 Some respondents to NZASB ED 2018-7 commented that the meaning of ‘fully funded’ is not necessarily clear for entities that aim to be self-funded over the long term, but that in any given year might be:

- (a) overpricing to make up for past deficits;
- (b) underpricing to use up past surpluses; or
- (c) underpricing to suit current economic conditions.

### Substantially self-funded

BC161 The AASB was also mindful of the IPSASB’s work on social benefits in preparing its Discussion Paper (2017) proposals, but considered that ‘fully funded’ would be too much of a ‘bright line’ [AASB DP.BC28(b)(ii)].

BC162 Instead, one of the non-mandatory criteria proposed in the AASB Discussion Paper for determining whether AASB 17 should apply in the public sector was that the arrangement be ‘substantially self-funded’ [AASB DP.E14(a)]. Under the proposal, there were two aspects to ‘self-funding’:

- (a) the source of funding should be those who stand to benefit from the arrangement or those who exacerbate the risks to potential beneficiaries; and
- (b) the revenue being sufficient and/or the benefit levels being managed such that the scheme is self-sustaining.

BC163 There was a limited response to the proposal of a ‘substantially self-funded’ criterion. Those who did respond generally supported using the criterion.

### Beneficiary pays

BC164 The Boards observed that all of the public sector entities in Australia and New Zealand that are currently applying the insurance standards, or have contemplated applying the insurance standards, receive contributions from scheme participants either directly or indirectly via ‘premiums’ or ‘levies’. In general, most

or all of the funding for these entities is sourced from scheme participants, who stand to benefit from the coverage.

- BC165 The Boards also observed that some of the public sector entities in Australia that are currently not applying the insurance standards also source most or all of their funding from those who stand to benefit from the coverage.
- BC166 The Boards noted that, if this indicator were applied, it would at least have the benefit of immediately ruling out the application of the insurance standards to a range of ‘social benefits’ such as aged pensions or universal healthcare activities and disability support. The Boards also noted a possible complication is that schemes such as Medicare in Australia, at least notionally, have dedicated funding through the Medicare levy on taxpayers. However, the Boards considered the Medicare levy to probably be sufficiently ‘tax-like’ to be regarded as not being a beneficiary pays model as intended under this indicator. Accordingly, the Boards considered whether it might also be helpful to explain that the significance of the indicator would be on a spectrum relating to the extent to which premiums or levies represented a ‘beneficiary-pays’ model.
- BC167 The Boards observed that a payment/contribution to the insurer from a policyholder is not a part of the ‘insurance contract’ definition in AASB 17/PBE IFRS 17. However, they noted that some type of funding from a scheme participant is probably a reasonable indicator of the relevance of applying AASB 17/PBE IFRS 17 in the sense that it helps to establish an enforceable contract-like relationship between the entity providing the coverage and the scheme participants.
- BC168 The Boards observed that the practice of refunding pro rata amounts of payments/contributions in the event that a scheme participant cancels its coverage prior to the end of the coverage period would be further evidence of an enforceable contract-like relationship between the entity providing the coverage and a scheme participant. The Boards noted that this is a widespread practice in the private sector general insurance industry.

### **Capitalising/recapitalising**

- BC169 The Boards noted that some public sector entities might need funding from consolidated revenue from time-to-time to help capitalise or recapitalise a public sector arrangement. These might be regarded as ‘equity’ injections in some cases, rather than a source of routine funding. Accordingly, the Boards observed that periodic injections of funding from general taxation to capitalise or recapitalise a public sector arrangement would not be in conflict with a self-funding or beneficiary-pays model of funding, for the purpose of determining whether an arrangement should be accounted for under AASB 17/PBE IFRS 17.

### **Administrative convenience**

- BC170 The Boards noted that some public sector arrangements involve sourcing funds by way of levies on transactions between participants and private sector entities (which may be insurers). The Boards noted that, while there may not be a direct cash transaction between the public sector entity and participants in terms of the collection of funds, this is often due to the need for administrative convenience, which would not affect an assessment of the extent to which funds are sourced from participants.

### **Conclusions**

- BC171 Based on the above considerations, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the extent to which a scheme participant is responsible for paying a contribution. This is on that basis that it provides evidence of a contract-like relationship between a scheme participant and the public sector entity. The Boards concluded that references to ‘fully-funded’ and ‘substantially self-funded’ are probably not useful because they are difficult to interpret, but that relevant contributions would be expected to be more than, for example, a relatively small co-payment.
- BC172 Consistent with this perspective, the Boards also concluded that the extent to which a contribution from a scheme participant is an indicator of public sector arrangements to be accounted for as insurance contracts is dependent on:
- (a) the strength of the association between the contribution and the risks covered – for example, a motor vehicle owner (scheme participant) contributes in return for being covered for risks associated with road use; and
  - (b) the extent to which the contribution is substantive relative to the risks being transferred.
- BC173 The Boards also noted the level of contributions from scheme participants that might be sought in any given period could be affected by the extent to which the public sector entity is currently fully funded. That is, contributions might be higher or lower in any given period to either make up for earlier funding shortfalls or

use up existing surpluses.<sup>21</sup> Accordingly, a medium-term view (rather than a year-by-year view) might need to be taken when assessing whether contributions are substantive relative to the risks being transferred in any given period.

## Management practices and assessing financial performance

### Assessing financial performance (in general)

- BC174 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach is that the entity assesses its financial performance and financial position of a scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme [IPSAS 42.AG25(d)].
- BC175 The Boards noted that NZASB ED 2018-7 included a proposed indicator similar to this indicative criterion in IPSAS 42 [ED 2018-7.AG1.6(d)]. The Boards also noted that the AASB Discussion Paper (2017) included a proposed indicator similar to this indicative criterion in IPSAS 42, but that the Discussion Paper proposal placed an emphasis on the assessment of claims performance [AASB DP.E14(b)].
- BC176 The Boards observed that there was little feedback on this proposal in response to NZASB ED 2018-7 and a mixed response to the AASB Discussion Paper proposal, with most respondents saying the criterion was not helpful in distinguishing insurance activities from other types of activities. In general, respondents considered there are accountability and performance mechanisms across the spectrum of social benefit and insurance arrangements in most jurisdictions.

### Management focus of the entity (more specifically)

- BC177 The Boards noted that, in stakeholder outreach conducted in 2020-21, there was more interest in discussing the ways in which they managed their particular activities, rather than the more general matter of assessing financial performance.
- (a) Most of the stakeholders from entities that are currently applying AASB 1023/PBE IFRS 4 expressed the view that they have been established to manage an area of risk and effectively provided with ‘seed capital’ and a licence to charge levies/premiums in order to operate with relative financial independence. They are generally expected to be self-funding with a view to not making further calls on government funding and consider themselves to be operating an insurance-like business on a long-term sustainable basis. Within the constraints imposed upon them, they price risk based on commercial principles and manage claims fairly and prudently.
  - (b) Most of the Australian stakeholders from entities that are currently applying AASB 137 expressed the view that they are operating a compensation scheme based on terms that have largely been dictated to them (for example, through their enabling legislation) and do not have the scope to manage the risks in the manner of a private sector insurer.
  - (c) A small number of Australian stakeholders indicated that they consider the way their entities are currently managed would be better reflected in a change to their existing accounting – some from AASB 1023 to AASB 137 and some from AASB 137 to AASB 1023/AASB 17.
- BC178 The Boards considered that, the manner in which an entity is managed is, in principle, an important indicator of which Standards should be applied on the basis that faithfully reflecting the ‘business model’ in financial statements is something that Standards ordinarily aim to achieve. However, this type of indicator is likely to be subject to wide interpretation unless it is associated with specific insurance liability management practices. In that context, the Boards considered those insurance liability management practices could include the following.
- (a) *Underwriting and pricing specific types of risks*: although few (if any) public sector entities are completely unconstrained in their ability to differentially price their services, many of them are able to price risk based on a scheme participant’s characteristics (for example, industry of employment, claims experience or type of vehicle).
  - (b) *Use of reinsurance contracts to manage capital*: this is not to say that the existence of a reinsurance contract, of itself, is indicative. However, in association with other factors, such as a policy of protecting its own capital base (rather than relying on the taxpayer) for its continuing operation, the existence of a reinsurance contract can indicate that the entity is expected to manage its liabilities prudently in a manner consistent with a private sector insurer.

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21 Public sector entities often occupy a monopoly position and are able to raise or lower contributions to either make up for earlier funding shortfalls or use up existing surpluses.

- (c) *Fair and prudent management of claims and remediation of significant claims risks*: although fair and prudent claims management would typically be a feature of a broad range of compensation schemes, it is a particularly significant feature of managing insurance risk, especially when coupled with possible remediation activities. Remediation will necessarily be different in a monopoly context compared with a typical commercial context. In a commercial context, remediation will often include resetting underwriting terms to exclude certain types of (high-risk) customers; whereas, monopoly public sector entities are not generally able to filter their scheme participant base. Accordingly, for public sector entities, remediation would usually take other forms, such as interventions with risk management education programs or safety campaigns. The Boards acknowledged that, while public sector entities do not have the same imperatives commercial insurers might have on managing claims in a manner that permits them to keep trading, they are required to act fairly and would typically be required to act prudently. Accordingly, while the need to act fairly and prudently might be important in identifying arrangements that would be accounted for as insurance contracts, its presence could also be indicative of a broader range of compensation arrangements.

## Conclusions

- BC179 The Boards concluded that general practices of assessing scheme financial performance and financial position on a regular basis, reporting internally on financial performance and, where necessary, taking action to address any scheme under-performance is not a potentially useful indicator of public sector arrangements to be accounted for as insurance contracts. The Boards consider the inference that social benefit schemes versus insurance schemes are less likely to monitor performance in this way is probably not supportable.
- BC180 Instead, the Boards concluded that they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts that the entity has objectives, policies and processes for managing risks associated with those arrangements and for its financial performance to be assessed based on how the entity meets those objectives and how successfully it applies those policies and processes. The Boards concluded that, in this context, the public sector entity would be expected to conduct the following activities (either itself or via outsourcing):
- (a) underwriting and risk assessment;
  - (b) the measurement of risks and uncertainties and their impacts; and
  - (c) fair and prudent claims management and, when relevant, engage in remediation work.
- BC181 The Boards concluded that the presence of all three of these factors would be an indicator of public sector arrangements to be accounted for as insurance contracts; and, conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

## Assets held to pay benefits

- BC182 IPSAS 42 identifies the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits as being an indicator of insurance contracts [IPSAS 42.AG26(b)]. Similarly, the AASB Discussion Paper (2017) proposals identified that assets and liabilities arising from the arrangements being held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries as indicating an insurance arrangement [AASB DP.E14(d)]. However, the AASB Discussion Paper proposals also noted that the absence of separately allocated assets is not necessarily an indicator the arrangement is not insurance.
- BC183 The Boards noted that there is a link between the indicator on ‘Source and extent of funding’ (discussed above) and ‘Assets held to pay benefits’ because funds that are sourced from scheme participants are more likely to be set aside in a scheme fund than would be the case for funds sourced from general taxation.
- BC184 The Boards also noted that there is a link with the indicator on ‘Management practices and assessing financial performance’ (discussed above) because public sector entities that manage their own assets intended to meet claims would be more likely to have management practices that more generally mirror those of private sector insurers. The Boards observed that this perspective is supported by feedback received in recent stakeholder outreach, with many public sector entities having been established to be self-sustaining and having responsibility for overseeing an area of risk while achieving a breakeven result from all of their activities, including investment performance. This is a characteristic of private sector for-profit insurers, some of which routinely operate on a long-term sustainable basis by generating underwriting losses that are more than offset by investment returns.
- BC185 The Boards acknowledged that the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits is a feature that can also apply to arrangements which are not

in the nature of insurance. For example, a compensation scheme might be established for the victims of a recent disaster and be funded from general taxation, public appeals, or levies on certain suppliers or consumers that are pooled and invested and subsequently applied to help fund recovery efforts. Nonetheless, the Boards considered that this feature is a potentially important indicator because its absence might be indicative of arrangements that should not be accounted for as insurance contracts.

- BC186 The Boards noted that some public sector entities have assets set aside for benefits, but are not actively involved in the management of the underlying investments, which is handled centrally, for example, by a government agency established for this purpose. The public sector entity's role might be limited to advising that agency about its liquidity needs. The Boards consider the existence of assets set aside to meet benefits to be the crucial factor, and do not regard the extent of a public sector entity's active involvement in the management of its underlying investments as affecting the validity of this indicator.

## Conclusions

- BC187 Based on the above considerations, the Boards concluded they would propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of assets being held in a separate fund, or an entity having access to earmarked assets, that are restricted to being used to provide benefits to scheme participants.

## Profit seeking

### Australian entities

- BC188 Most of the Australian public sector entities currently applying AASB 4 and AASB 1023 classify themselves as not-for-profit entities, with some classifying themselves as for-profit entities.
- BC189 The AASB Discussion Paper (2017) proposed that the amendments to AASB 17 for public sector entities should apply to both for-profit and not-for-profit public sector entities and the respondents who directly commented on this issue agreed with the AASB's proposal.
- BC190 In the stakeholder outreach conducted in 2020–21, there was virtually no support for excluding a public sector entity from applying AASB 17 on the basis that it is a not-for-profit entity. For the few stakeholders who supported automatically including a public sector entity within the scope of AASB 17 on the basis that it is a for-profit entity, their support hinged on a view that a for-profit entity is more likely to be seeking to profit from the service of bearing risk. These stakeholders viewed this as consistent with AASB 17 requiring a risk adjustment in measuring insurance liabilities and recognising revenue from bearing risk in a pattern based on the release from risk.
- BC191 The AASB observed that the differing classifications (for-profit versus not-for-profit) across Australian jurisdictions seem to be driven largely by the funding structure and, for example, whether the entity has been tasked with paying dividends to government in recognition of the cost of government capital deployed to the entity. The AASB also observed that there are a number of entities deemed by their governments to be for-profit entities that seemingly have highly similar operations to entities that have been deemed not-for-profit.

### New Zealand entities

- BC192 Currently, the New Zealand public sector entities applying PBE IFRS 4 all classify themselves as not seeking to profit from their activities.<sup>22</sup>
- BC193 NZASB ED 2018-7 did not include any proposals relating to the profit-seeking motive.

## Conclusions

- BC194 The Boards noted that the IASB did not regard the not-for-profit nature of mutual insurance entities to be a factor that would cause IFRS 17 to be inapplicable. The IFRS 17 Basis for Conclusions makes it clear that, in the IASB's view, IFRS 17 can be applied consistently to for-profit entities and mutual entities [IFRS 17.BC264 to BC269]. For-profit insurance entities and mutual insurance entities often compete for customers in the same markets.

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<sup>22</sup> Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders (paragraph 6 of XRB A1 *Application of the Accounting Standards Framework*). PBEs comprise not-for-profit entities and public sector entities.

BC195 Based on the above deliberations, the Boards concluded they would propose that the not-for-profit nature of an entity should not be a barrier to public sector arrangements being accounted for as insurance contracts, and this has not been proposed as an indicator. However, the Boards also noted that the classification (as for-profit versus not-for-profit) would be a part of the context in which the proposed indicators are considered and, therefore, could impact on the outcome of a collective assessment of those indicators.

## Scoping out ‘social benefits’ or specific entities

BC196 The Boards noted that IPSAS 42.5 includes a definition of ‘social risks’, which mentions events or circumstances that are intended to give rise to distinct benefits from the causes of other forms of aid, such as benefits provided as the result of a disaster [IPSAS 42.AG10]. The IPSAS 42 definition is:

Social risks are events or circumstances that:

- (a) relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
- (b) may adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

BC197 The Boards observed that ‘social risks’ identified in the definition are indicative, rather than implying that the same risks might not also be the subject of insurance contracts. They further noted that most, if not all, the classes of ‘social risks’ mentioned in the definition could be the subject of insurance contracts sold by for-profit private sector entities, such as: annuities (age-related); health insurance (health-related); and income protection (related to health, poverty and/or employment status). Accordingly, the Boards concluded that it would not be productive to propose scoping out ‘social benefits’ using the definition in IPSAS 42.

BC198 The Boards also considered whether it might be feasible to identify particular entities or activities that would not fall within the scope of AASB 17/PBE IFRS 17. For example, whether entities such as those closely associated with the hospital/health system, as a way of automatically excluding them and removing the need for an analysis of indicators to determine whether they need to apply AASB 17/PBE IFRS 17. In that context, the Boards noted that AASB 17/PBE IFRS 17 sets a precedent by specifically scoping out particular types of transactions conducted by particular types of entities that would otherwise probably need to be accounted for as insurance contracts. These transactions include, for example, warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer [AASB 17/PBE IFRS 17.7(a)].

## Conclusions

BC199 The Boards concluded that, while it would provide certainty for some entities, they are generally opposed to specifically identifying public sector schemes that are not within the scope of AASB 17/PBE IFRS 17 because it is typically not the role of the Boards to identify specific entities that should, or should not, apply particular Standards.

BC200 The Boards also concluded that while there may be some merit in proposing that specifically identified types of activities are not within the scope of AASB 17/PBE IFRS 17:

- (a) this could be problematic due to the potential interface between, for example, the public health system and the medical nature of many claims that might be the subject of arrangements that would be accounted for as insurance contracts; and
- (b) the relevant types of excluded activities should be able to be identified based on applying other proposed indicators.

## Fault-based nature of an arrangement

BC201 In respect of many classes of risk, for-profit private sector insurers attribute fault in determining whether claims are valid or the amount of those claims. For example, a policyholder that is negligent may receive a lower claim benefit than a policyholder who is not at fault, which is designed to avoid moral hazard issues. Accordingly, it could be argued that fault-based arrangements are more likely to result in insurance activities.

BC202 The Boards noted that public sector schemes vary across jurisdictions. For example, some of the Australian Compulsory Third Party motor insurance arrangements for non-serious injury are fault-based, while all the Compulsory Third Party motor insurance arrangements that include serious injury are no-fault schemes. Currently, Australian stakeholders’ application of either AASB 4 and AASB 1023 versus AASB 137 has not reflected the fault status of the arrangements. That is, some public sector entities operating no-fault arrangements are applying AASB 4 and AASB 1023, while others are applying AASB 137. However, the Boards are not aware of any public sector entities operating fault-based arrangements that are applying AASB 137.

BC203 The Boards also observed that, while no-fault arrangements are more prevalent in the public sector, many classes of risk covered by for-profit private sector insurers do not involve attributing fault in determining whether claims are valid or the amount of those claims. For example, insurance contracts for risks such as health/disease and longevity are typically no-fault contracts.

## Conclusion

BC204 Based on the above deliberations, the Boards concluded that the no-fault versus fault-based nature of public sector arrangements would not be helpful in indicating whether the arrangements are to be accounted for as insurance contracts and this distinction has not been proposed as an indicator.

## Judgement to be applied

BC205 The Boards are aware that assessing indicators to determining whether a public sector entity's arrangements should be accounted for using AASB 17/PBE IFRS 17 requires the application of judgement.

BC206 Once a judgement has been made about whether a public sector entity's arrangements would be accounted for as insurance contracts, a redeliberation of this judgement would only be expected if there is substantive change to the entity's circumstances and/or the nature of its arrangements. In the absence of such substantive change, the Boards observed that any change to an earlier judgement would need to meet the threshold for a change in accounting policy set out in AASB 108/PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

## Relative significance of the indicators

BC207 The Boards considered whether some indicators should be:

- (a) separately identified as being pre-requisites for applying AASB 17/PBE IFRS 17 (that is, their absence means AASB 17/PBE IFRS 17 would not apply); or
- (b) separately identified as being determinative in applying AASB 17/PBE IFRS 17 (that is, their presence means AASB 17/PBE IFRS 17 would apply); or
- (b) otherwise ranked in some manner based on their significance in determining arrangements that should be accounted for by applying AASB 17/PBE IFRS 17.

BC208 The field testing conducted in 2021-22 on the proposed indicators revealed a range of views. Some stakeholders noted a preference for ranking the indicators in some manner, although there was no consensus among those stakeholders for a particular ranking of the indicators. However, many of those seeking some form of ranking typically identified the most significant indicators as being:

- (a) an identifiable coverage period – on the basis that it contrasts with an open-ended compensation scheme that provides benefits based on meeting eligibility criteria; and
- (b) the enforceable nature of the arrangement – on the basis that it means there is a binding arrangement between the public sector entity and a participant similar to that found in an insurance contract issued by a private sector insurer.

BC209 In contrast, the field testing also revealed that many of those seeking some form of ranking typically identified the least significant indicators as being:

- (a) management practices and assessing financial performance – on the basis that there are many sound management and reporting practices that are routinely practiced both by insurers and by those responsible for compensation schemes; and
- (b) the existence of a separate fund or earmarked assets held to pay benefits – on the basis that funds are often set aside within compensation schemes.

## Conclusion

BC210 The Boards concluded that they would not propose assigning a relative significance to each of the indicators on the basis that this is generally inconsistent with principle-based standard setting and with the notion of making a collective assessment and applying judgement based on the relevant circumstances. Instead, the Boards responded to the field test feedback by trying to better explain the relevant aspects of the indicators considered by some to be the least significant.

BC211 The Boards also decided to include a specific question in the Exposure Draft on whether the indicators should be ranked in some manner and, if so, how they should be ranked and the reasons for that ranking.



## Application date of the Standard

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- BC212 The existing mandatory application date of AASB 17/PBE IFRS 17 is periods beginning on or after 1 January 2023. For public sector entities that typically have a July to June financial year, that would mean first applying AASB 17/PBE IFRS 17 for the period 1 July 2023 to 30 June 2024, with comparative information for the period 1 July 2022 to 30 June 2023.
- BC213 The Boards noted that they typically provide at least a one-year gap between the time a new or revised Standard is issued and the beginning of the comparative reporting period to which it applies. This is designed to allow stakeholders to adequately prepare for any changes to processes for preparing and auditing financial statements.
- BC214 Accordingly, the Boards concluded they would propose that public sector entities falling within the scope of AASB 17/PBE IFRS 17 be required to apply it for annual reporting periods beginning on or after 1 July 2025.<sup>23</sup> Consistent with existing practice, the Boards also concluded on proposing that entities would be permitted to apply AASB 17/PBE IFRS 17 earlier and, if an entity does apply the Standard early, it must disclose this fact.
- BC215 Under the proposals, public sector entities that typically have a July to June financial years would first be required to apply AASB 17/PBE IFRS 17 for the period 1 July 2025 to 30 June 2026, with comparative information for the period 1 July 2024 to 30 June 2025.

## Other modifications considered but not proposed

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### Captive insurers

- BC216 The Boards noted that large consolidated group entities sometimes establish a ‘captive insurer’ subsidiary to coordinate risk management for all (or most) entities within the group.<sup>24</sup> The subsidiary typically charges premiums to other entities in the group and pays them valid claims in respect of insured events, and ordinarily (re)insures some or all of the risks with one or more third-party (re)insurer(s). Australian or New Zealand-based captive insurers would need to be registered as insurers and, therefore, required to prepare general purpose financial statements and meet relevant regulatory and prudential requirements.
- BC217 The Boards noted that governments also create captive insurers and the key motivations are typically to:
- (a) centralise the administration of insurable risks across a complex group of entities and coordinate risk management policies and processes;
  - (b) charge premiums to other government agencies and, thereby, create incentives for them to manage risks; and
  - (c) in some cases, coordinate in a cost-beneficial manner the acquisition of insurance/reinsurance coverage from an external insurer/reinsurer.
- BC218 The Boards observed that, at the whole-of-government level:
- (a) transactions between the captive insurer and other government agencies are eliminated;
  - (b) any (re)insurance contracts between the captive and third-party insurers are treated as insurance contracts in which the government is a policyholder; and
  - (c) any remaining liabilities to third parties (for example, to government employees for workplace injuries) would be accounted for by applying AASB 137/PBE IPSAS 19.
- BC219 The Boards considered whether they should:
- (a) in the context of the requirements imposed on private sector Australian-based and New Zealand-based captive insurers, explicitly require public sector captive insurers to prepare general purpose financial statements, including applying AASB 17/PBE IFRS 17; or
  - (b) given the eliminations at the whole-of-government level, explicitly scope public sector captive insurers out of applying AASB 17/PBE IFRS 17.
- BC220 The Boards noted the following in respect of the AASB Discussion Paper (2017).

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23 The NZASB is proposing that PBE IFRS 17 be applied to annual periods beginning on or after 1 January 2025; however, the impact is the same as the AASB proposal of annual periods beginning on or after 1 July 2025 due to the financial year used by the relevant New Zealand public sector entities.

24 For a consolidated group that is not an insurer, the captive insurer would typically organise the group’s insurance coverage. For a consolidated group that is an insurer, the captive insurer would typically organise the group’s reinsurance coverage.

- (a) It was proposed that public sector captive insurers should be permitted an optional exemption to not apply AASB 17 on the basis that:
  - (i) some captive public sector entities do not currently apply insurance accounting to their insurance transactions; and
  - (ii) the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation. (In the consolidated entity, since insurance risk has not been transferred to a party outside the group, any claim liabilities would probably be accounted for as provisions).
- (b) It was also proposed that, in the event there is a public sector entity that accepts insurance risk from both related and unrelated parties, the optional exemption from applying AASB 17 would apply only to transactions with related parties.
- (c) Respondents expressed mixed views, including:
  - (i) support for captive insurers being scoped out of AASB 17;
  - (ii) support for the optional exemption;
  - (iii) strong disagreement with the proposals based on a view they would create complexity for some entities within a group reporting structure that are required to use two different measurement bases; and
  - (iv) when there are no users dependent upon the financial statements of a captive insurer, it would be at the discretion of the relevant government to exempt the entity from preparing general purpose financial statements.

BC221 The Boards noted that NZASB ED 2018-7 did not raise the issue of captive insurers and nor did any of the respondents to the ED.

BC222 The Boards also noted that more recent stakeholder consultation revealed a variety of reasons for different practices among Australian governments in terms of whether separate general purpose financial statements are presented for captive insurers.

- (a) Various accountability mechanisms and reporting requirements apply across the public sector and captive insurers either report separately (or not) based on those general requirements. For example, an entity may be regarded as being primarily engaged in providing claims management services to other areas of government rather than bearing insurance risk, which may lead a jurisdiction to conclude that:
  - (i) separate general purpose financial statements are not needed; or
  - (ii) if separate general purpose financial statements are needed, they would be prepared on the basis that the entity is a service provider for managing the claims process, rather than bearing insurance risk, and would not apply insurance contract accounting.
- (b) Historical responsibilities for bearing risks have been allocated to the entity, which were accompanied by particular (usually legislated) accountability mechanisms and reporting requirements.
- (c) A deliberate policy has been adopted to impose accountability mechanisms and reporting requirements on a captive insurer, consistent with (for example) having an independent board of directors. Entities with independent boards of directors/management might be particularly keen to demonstrate accountability and prepare separate financial statements. Some stakeholders consider the fact that their customers are related entities makes it all the more important that they prepare separate general purpose financial statements.

## Conclusion

BC223 The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues, that could affect the application of accounting standards more generally, rather than being issues of particular relevance to the insurance project. The Boards observed that governments which regard their captive insurer(s) as needing to prepare general purpose financial statements would have to determine whether they have:

- (a) insurance contracts and need to apply insurance contract accounting; or
- (b) are only service providers, akin to insurance brokers that are intermediaries between policyholders and insurers, that would apply, for example, AASB 15/PBE IPSAS 9 *Revenue from Exchange Transactions*.

The Boards also observed that governments which regard their captive insurer(s) as not needing to prepare general purpose financial statements, might seek to have them prepare a type of segment information, for example, for management purposes.

BC224 Accordingly, the Boards concluded that wider issues regarding the identification of reporting entities are at stake and are not specifically relevant in this project as a way of exempting public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements. They noted that, if a jurisdiction determines that an entity should prepare general purpose financial statements, provided the entity's activities fall within the scope of AASB 17/PBE IFRS 17, that Standard should be applied.

## Discounting and inflating

BC225 Based on public sector arrangements that seem likely to fall within the scope of AASB 17/PBE IFRS 17 and the Boards' proposals on contract boundaries and coverage periods (paragraphs Aus/NZ34.1 to 34.3 and B64.1), the Boards noted that:

- (a) most coverage periods are one year or less; and
- (b) levies/premiums are typically received either shortly before coverage commences or early in the coverage period.

BC226 Accordingly, the Boards observed that the discounting requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56):

- (a) would not be expected to be relevant in measuring levies/premiums and in measuring most liabilities for remaining coverage;
- (b) might be relevant in the unlikely event that the general model would need to be applied to measure liabilities for remaining coverage for arrangements that provide multi-year coverage.

BC227 However, the Boards observed that public sector arrangements which seem likely to fall within the scope of AASB 17/PBE IFRS 17 often involve claims that are settled over long periods – sometimes many decades – and that discounting and inflating is usually an important aspect of measuring liabilities for incurred claims.

BC228 The Boards noted that, under AASB 1023/PBE IFRS 4, expected future cash flows are:

- (a) discounted for the time value of money at a risk-free rate based on current observable, objective rates that relate to the nature, structure and term of the future obligations;
- (b) may need to be inflated because the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement; and
- (c) not expected to be either discounted or inflated when they are settled within a year.

BC229 The Boards noted that, under AASB 17/PBE IFRS 17, essentially the same notions of discounting and inflating cash flows apply, but that the discount rate relates to a current time value of money and the liquidity characteristics of the insurance contracts. That is, all other things being equal, the discount rates under AASB 17/PBE IFRS 17 would be expected to be higher than under AASB 1023/PBE IFRS 4 due to the adjustment for illiquidity.

BC230 The Boards noted the various sources of guidance and requirements (outside the Standards) for determining discount rates and inflation rates, including:

- (a) Australian and New Zealand actuarial guidance on valuation of general insurance claims;
- (b) Australian Prudential Regulation Authority prudential requirements on insurance liability valuation;
- (c) the risk-free discount rates and consumer price index (CPI) assumptions published by the New Zealand Treasury that must be used for the purpose of preparing the financial statements of government reporting entities submitting valuations to Treasury for measuring insurance claims liabilities under PBE IFRS 4.

BC231 The Boards noted that, in respect of discount rates, all the various sources of guidance have a common starting point of sovereign bond yields for durations that match the relevant claims liabilities, with extrapolation when needed.

## Illiquidity premium

BC232 The Boards observed that, in concept, the size of an illiquidity premium would be positively correlated with:

- (a) the length of time over which claims (cash flows) are expected to be paid; and
- (b) the predictability of the cash flows.

Accordingly, the longer the time to expected settlement and the more predictable are the cash flows, the larger is the illiquidity premium.

BC233 The Boards noted that, in general, private sector insurers have yet to settle on their approach to determining an illiquidity premium under AASB 17/PBE IFRS 17 and that there are, as yet, no readily-available and widely-accepted benchmarks that can be applied. However, the Boards expect that an industry practice will emerge that public sector entities could apply.

BC234 The Boards considered whether there might be a need for public sector specific guidance on determining an illiquidity premium, but concluded that the issues for public sector entities are no different from those that need to be addressed by other entities applying AASB 17/PBE IFRS 17.

### **Investment rates of return and discount rate volatility**

BC235 The Boards noted that:

- (a) most public sector entities set premiums/levies with a view to breaking even, after taking into account any relevant projected investment earnings; and
- (b) the rate of projected investment returns assumed is typically above the time value of money rate applied to measure liabilities for incurred claims.

Accordingly, public sector entities ordinarily recognise unexpired risk liabilities (onerous contract losses) due to the 'gap' between the rates.

BC236 The Boards also noted that, for many public sector entities, the liability for incurred claims is by far the largest liability and small changes in discount rates can create liability changes from period to period that create the largest expense or revenue item in the income statement. In recent years, yields on government bonds that are typically used to determine risk-free rates have been at historical lows, and small changes in rates have been having a larger than usual impact.

BC237 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there is a widespread awareness that:

- (a) the gap between discount rates leads to up-front loss recognition;
- (b) changes in discount rates lead to volatility; and
- (c) some stakeholders find the up-front loss recognition and volatility potentially misleading.

BC238 The Boards noted some stakeholders consider that long-run investment rates of return should be applied to discount cash flows in measuring liabilities for incurred claims, which may generally remove the up-front loss recognition and mitigate the volatility in liabilities for incurred claims.

BC239 The Boards considered whether there might be a need for public sector-specific guidance or modifications in respect of the discount rate requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56) on the basis that:

- (a) for-profit private sector insurers typically have a profit 'buffer' that (in most cases) avoids the need to recognise an up-front loss relating to the impact of the gap between risk-free and investment rates; and
- (b) the gap between the risk-free and investment rates can be larger for public sector entities relative to their regulated private sector counterparts. This is because regulated private sector insurers typically hold investments with an overall lower risk/return profile than their public sector counterparts, which do not face the same regulatory disincentives to investing in higher risk/return asset classes.

### **Rates in other Standards**

BC240 The Boards noted that some Australian public sector entities have arrangements that give rise to claims settled over long periods and these arrangements are currently accounted for as provisions by applying AASB 137. They noted that discount rates required for measuring provisions reflect current market assessments of the time value of money and the risks specific to the liability.

BC241 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there are differing views on the rates required by AASB 137/PBE IPSAS 19.

- (a) Some stakeholders interpret the AASB 137/PBE IPSAS 19 requirements as being the same or similar to the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17.
- (b) Some stakeholders regard the AASB 137/PBE IPSAS 19 requirements as being different from the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17. They see a key

potential difference being the focus of AASB 1023/PBE IFRS 4 (and AASB 17/PBE IFRS 17) on an entity perspective because an insurer is expected to fulfil its insurance liabilities. In contrast, they see the focus of AASB 137/PBE IPSAS 19 as being on settlement, which could be with a third party and be measured at more or less than ‘face value’.

## Presentation

- BC242 The Boards observed that:
- (a) under AASB 1023/PBE IFRS 4, both the initial and subsequent impacts of discounting and inflating fulfilment cash flows are presented within the ‘underwriting result’; however.
  - (b) under AASB 17/PBE IFRS 17:
    - (i) only the initial impacts of discounting fulfilment cash flows are presented within the ‘insurance service result’;
    - (ii) the impacts of subsequent discount rate changes are presented in ‘insurance finance income and expenses’, including the impact on insurance liabilities of the unwinding of the discount as time passes and the impact of discount rate changes; and
    - (iii) some of the subsequent impacts of inflation rate changes are presented in ‘insurance service result’ and others in ‘insurance finance income and expenses’ under AASB 17/PBE IFRS 17.B128.
- BC243 The Boards noted that at least some of the volatility currently presented as a part of the underwriting result would be separately presented under AASB 17/PBE IFRS 17 as finance income or expense, which may help facilitate explaining the impacts of changing discount rates to users of the financial statements.
- BC244 The Boards also noted that the distinction between the subsequent impacts of inflation rate changes that are presented in ‘insurance service result’ versus ‘insurance finance income and expenses’ has yet to be clarified in practice, but the issues are the same for both private and public sector entities. Accordingly, the Boards expect that an industry practice will emerge that public sector entities could apply.

## Conclusions

- BC245 The Boards considered whether there might be a need for public sector-specific modifications to the discount rate requirements of AASB 17/PBE IFRS 17 to address concerns about up-front loss recognition and volatility.
- BC246 The Boards concluded that they would not propose any modifications on discounting fulfilment cash flows for the following reasons.
- (a) The same discounting issues which arise for public sector entities also arise for private sector entities, while acknowledging those issues can have a more significant impact for public sector entities.
  - (b) The issues of volatility of liabilities due to discount rate changes from period to period are also a feature of the discount rate requirements in other Standards (such as AASB 119/PBE IPSAS 39 *Employee Benefits*), and that any efforts to address these issues would need to involve a broad-based project that goes beyond a project on insurance arrangements in the public sector.
  - (c) Any project on discount rates might involve a broader consideration of measurement issues more generally.
- BC247 Specifically in relation to the possible application of long-run investment returns as the basis for discount rates, the Boards noted that, conventionally, assets and liabilities are measured independently. That is, for example, the measurement of a liability is based on the liability’s inherent characteristics, not on the characteristics of any assets that might be available to settle the liability. Accordingly, the Boards concluded that any consideration of overturning long-standing conventions of this nature would need to involve a review of principles that go beyond a project on insurance arrangements in the public sector.

## Measurement of investments backing insurance liabilities

- BC248 When it is feasible under Accounting Standards to measure an investment that backs insurance liabilities at fair value through profit or loss, AASB 1023/PBE IFRS 4 requires an entity to apply fair value through profit or loss accounting. This includes applying accounting policy choices/designations within accounting standards to use fair value through profit or loss accounting for: financial instruments; investment property; and, in relation to separate financial statements, investments in subsidiaries, joint ventures and associates.

- BC249 The Boards acknowledged that the AASB 1023/PBE IFRS 4 requirements were based on a view that fair value accounting for investments would provide the greatest level of balance sheet and income statement consistency with the measurement of insurance liabilities, which is largely a current value basis.
- BC250 The Boards noted that, in respect of public sector entities, AASB 17/PBE IFRS 17 should not mandate fair value through profit or loss accounting for investments backing insurance liabilities. The Boards took this approach because, unlike AASB 1023/PBE IFRS 4, IFRS 17 is a global Standard, and asset measurement and reporting practices (other than fair value through profit or loss) may emerge within the insurance industry globally, which Australian and New Zealand insurers should be able to follow.
- BC251 The Boards noted that, in stakeholder consultation conducted for this project in 2020-21, the following themes emerged.
- (a) Most public sector entities do not determine their own accounting policies, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury office of their jurisdiction.
  - (b) The established practice is to apply fair value through profit or loss accounting to assets when feasible and this shows no sign of changing.
  - (c) Many public sector entity investments are managed separately by a specialist public sector funds management entity. Those funds management entities ordinarily hold assets for trading and apply fair value through profit or loss accounting. Most funds management entities typically only supply fair value information to their unitholders.

## Conclusions

- BC252 The Boards considered that:
- (a) in practical terms, there are strong existing incentives for public sector entities to apply fair value through profit or loss accounting;
  - (b) in broad terms, the general application of fair value through profit or loss accounting to investments backing insurance liabilities is probably the most useful approach to meet the needs of public sector users of the financial statements; and
  - (c) all the relevant public sector entities are likely to voluntarily continue applying fair value through profit or loss accounting.
- BC253 The Boards concluded that there is no need to carry forward into AASB 17/PBE IFRS 17 the modifications on investment measurement from AASB 1023/PBE IFRS 4 for public sector entities.

## Risk mitigation program and other similar costs

- BC254 The Boards noted that most entities that conduct insurance business undertake risk mitigation activities, which are not directly related to particular insurance arrangements. They could include, for example:
- (a) risk assessments of a customer’s premises that are to be insured; and/or
  - (b) education programs among policyholders regarding safe work practices.
- BC255 The Boards observed that, for private sector for-profit insurers, these activities would be expected to typically be closely associated with underwriting or claims management and to be attributable to particular contracts or groups of contracts.
- BC256 The Boards also observed that the same types of activities are conducted by public sector entities; however, they would often have a broader community focus, including for example:
- (a) road safety campaigns;
  - (b) research into medical practices in public hospitals; and/or
  - (c) research into rehabilitation techniques to improve return to work experience.
- BC257 The Boards noted that, compared with AASB 1023/PBE IFRS 4, AASB 17/PBE IFRS 17 has more specific requirements around the types of costs that are to be accounted for as a part of insurance contract liabilities and more specific presentation requirements around the income statement line items that make up the ‘insurance service result’. In particular, they noted that costs which might currently be accounted for as a part of the ‘underwriting result’ under AASB 1023/PBE IFRS 4 may not be sufficiently attributable to the fulfilment of particular groups of contracts to be accounted for within the ‘insurance service result’ under AASB 17/PBE IFRS 17.

- BC258 This led the Boards to consider whether there is a need for public-sector-specific modifications in respect of costs associated with risk mitigation activities that might not be attributable to particular groups of contracts. This is particularly since these costs may be more significant in a public sector context (compared with private sector for-profit entities).
- BC259 The Boards noted the following feedback received from stakeholder outreach conducted in 2020-21.
- (a) Some public sector entities that provide risk coverage for policyholders also have a separate (sometimes legislated) objective of educating communities about safety or investing in infrastructure that promotes safe outcomes.
  - (b) Public sector entities are typically separately accountable for costs associated with risk mitigation and they are usually readily identifiable.

**Conclusions**

- BC260 Based on the above considerations, the Boards concluded that there is no need to propose any public sector modifications in respect of risk mitigation program and other similar costs.
- BC261 The Boards considered that:
- (a) public sector entities would have little difficulty identifying risk mitigation program costs and classifying them in accordance with AASB 17/PBE IFRS 17; and
  - (b) presenting these costs separately from the insurance service result would be useful in a public sector context since they usually relate to a separate and identifiable organisational objective.

**Summary of project history 2017 to 2020**

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**AASB**

BC262 The table below outlines a brief history of the AASB’s project between 2017–2020.

| <i>Time</i> | <i>Milestone</i>  | <i>Remarks</i>  |
|-------------|---|---|
| July 2017   | AASB makes <a href="#">AASB 17 Insurance Contracts</a> , which incorporates IFRS 17 <i>Insurance Contracts</i> (May 2017) applicable to annual reporting periods beginning on or after 2021 | The AASB’s Basis for Conclusions notes:<br>AusBC27 ... the AASB was aware of key concerns from the NFP public sector in particular that need further consideration before a decision is made about whether those entities should be subject to AASB 17 without amendment. Chiefly among those concerns was AASB 17 applicability to statutory obligations such as Medicare, the National Disability Insurance Scheme or worker’s compensation insurance.<br><br>AusBC28 The AASB acknowledged those concerns and decided to temporarily exclude NFP public sector entities from the scope of AASB 17 pending the outcome of its separate project to address these issues. Until such time as the NFP public sector issues are addressed, those affected entities continue to be subject to AASB 4, AASB 1023 and AASB 1038 (and, potentially, Interpretation 1047). |
| Nov 2017    | <a href="#">Discussion Paper Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities</a>   | For comment by 28 February 2018<br>The DP notes in the introduction:<br><br>The AASB’s view is that although AASB 17 applies only to contracts, the <i>Framework for the Preparation and Presentation of Financial Statements</i> (Conceptual Framework) does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way.  |

| <i>Time</i> | <i>Milestone</i>   | <i>Remarks</i>   |
|-------------|--|--|
|             |  | The DP specifically sought feedback on: <ul style="list-style-type: none"> <li>• applying AASB 17 to ‘insurance-like’ arrangements in the public sector</li> <li>• applying the requirements for a risk adjustment (to insurance liabilities)</li> <li>• determining the contract boundary</li> <li>• captive insurance arrangements</li> </ul>  |
| Sep 2018    | AASB considers a summary of constituent feedback on the Discussion Paper                                   | The <a href="#">minutes</a> record the AASB decided to: <ol style="list-style-type: none"> <li>conduct further field testing of the ‘insurance-like’ criteria</li> <li>based on the field testing, consider whether clarifications of the ‘insurance-like’ criteria are required, particularly the ‘funding’ criteria</li> <li>consider the assumptions used in determining discount rates for public sector entities</li> <li>consider the assumptions used in determining risk margins for public sector entities.</li> </ol> Six formal responses to the DP were received (including from HoTARAC and ACAG).  |
| Jun 2019    | <a href="#">Exposure Draft of proposed amendments to AASB 17</a>   | AASB ED 292 incorporated amendments to IFRS 17 proposed by the IASB.<br>For comment to AASB by 30 August 2019 and to the IASB by 25 September 2019   |
| Jul 2020    | AASB makes <a href="#">AASB 2020-5 Amendments to Australian Accounting Standards – Insurance Contracts</a> | AASB 2020-5 amends AASB 17 to be in line with an amended IFRS 17 issued by the IASB in June 2020.<br>Key amendments to AASB 17 and IFRS 17 are: <ul style="list-style-type: none"> <li>• a revised mandatory application date of annual reporting periods beginning on or after 1 January 2023</li> <li>• requiring separate presentation of insurance assets and liabilities by ‘portfolio’ rather than ‘group of contracts’</li> <li>• permitting the recognition of a separate acquisition costs asset in particular circumstances</li> <li>• recognising reinsurance contract held gains relating to onerous underlying contract losses in particular circumstances</li> <li>• entities preparing interim financial statements can choose to apply the ‘year-to-date’ measurement principle in AASB 134 / IAS 34 <i>Interim Financial Reporting</i></li> </ul> |

## NZASB

BC263 The table below outlines a brief history of the NZASB’s project between 2017–2020.

| <i>Time</i> | <i>Milestone</i>   | <i>Remarks</i>                                  |
|-------------|--|---|
| Aug 2017    | NZASB issues <a href="#">NZ IFRS 17 Insurance Contracts</a> , which incorporates IFRS 17 <i>Insurance Contracts</i> (May 2017) applicable to annual reporting periods beginning on or after 2021 | NZ IFRS 17 applies only to for-profit entities. |
| Feb 2018    | NZASB agrees to develop a PBE Standard based on IFRS 17  |   |



| <i>Time</i> | <i>Milestone</i>  | <i>Remarks</i>   |
|-------------|---|--|
| Dec 2018    | <a href="#">NZASB ED 2018-7 PBE IFRS 17 Insurance Contracts</a>                     | <p>For comment by 17 May 2019</p> <p>NZASB ED 2018-7 proposed amending the scope of PBE IFRS 17 to capture schemes that are eligible to apply the insurance approach under IPSAS 42 <i>Social Benefits</i> (i.e. intended to be fully funded from contributions and levies; and there is evidence the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the arrangement on a regular basis).</p> <p>NZASB ED 2018-7 sought feedback on</p> <ul style="list-style-type: none"> <li>• appropriateness of a risk adjustment for certain PBEs</li> <li>• whether the ‘contract boundary’ is clear for entities funded through levies</li> <li>• whether ‘portfolios’ and ‘onerous contract groups’ are appropriate for PBEs</li> <li>• relevant discount rates for PBEs.</li> </ul> |
| June 2019   | NZASB considers constituent feedback on NZASB ED 2018-7                             | <p>Six formal responses to the ED were received.</p> <p>The Board:</p> <p>(a) NOTED the feedback received on NZASB ED 2018-7 PBE IFRS 17 <i>Insurance Contracts</i>; and</p> <p>(b) AGREED to:</p> <p>(i) add a public sector-specific PBE insurance project to its workplan to consider the public sector-specific issues raised by respondents; and</p> <p>(ii) proceed to issue PBE IFRS 17 <i>Insurance Contracts</i> with a proposed scope modification to limit its application to Tier 1 and Tier 2 not-for-profit PBEs.</p>  |
| Aug 2019    | <a href="#">NZASB ED 2019-3 Proposed amendments to PBE IFRS 17</a>                  | <p>NZASB ED 2019-3 proposed to incorporate into PBE IFRS 17 the amendments to IFRS 17 proposed by the IASB in June 2019.</p> <p>Comments were due to the NZASB by 19 November 2019.</p>  |
| Aug 2020    | NZASB issues <a href="#">Amendments to NZ IFRS 17 and Amendments to PBE IFRS 17</a> | <p>Key amendments to NZ IFRS 17, PBE IFRS 17 and IFRS 17 are:</p> <ul style="list-style-type: none"> <li>• a revised mandatory application date of annual reporting periods beginning on or after 1 January 2023</li> <li>• requiring separate presentation of insurance assets and liabilities by ‘portfolio’ rather than ‘group of contracts’</li> <li>• permitting the recognition of a separate acquisition costs asset in particular circumstances</li> <li>• recognising reinsurance contract held gains relating to onerous underlying contract losses in particular circumstances</li> <li>• entities preparing interim financial statements can choose to apply the ‘year-to-date’ measurement principle in AASB 134/IAS 34 <i>Interim Financial Reporting</i></li> </ul>   |

## **Implications for AASB 4, AASB 1023 and AASB 1038**

BC264 The AASB noted that adopting IFRS 17 would supersede the following Standards and, therefore, change current accounting requirements for insurance contracts:

- (a) AASB 4 *Insurance Contracts*;
- (b) AASB 1023 *General Insurance Contracts*; and
- (c) AASB 1038 *Life Insurance Contracts*.

BC265 The AASB acknowledged that doing so would improve financial reporting in some respects but not in other respects.

- BC266 Regarding the key aspects, the AASB noted that:
- (a) the main improvements include:
    - (i) greater clarity around the accounting for acquisition costs, particularly for general insurance; and
    - (ii) greater alignment with other industries of the basis for revenue recognition for insurance contracts with coverage periods greater than one year; and
  - (b) the main areas of concern include:
    - (i) use of historical (inception-date) discount rates in accounting for the contractual service margin (CSM) under the ‘general model’;
    - (ii) use of ‘coverage period’ (rather than pattern of service provision) as the basis for recognising the CSM in profit over the contract life; and
    - (iii) the level of aggregation of contracts for accounting purposes.
- BC267 In weighing up these issues, the AASB also acknowledged the precedent it established when it decided not to adopt IAS 26 *Accounting and Reporting by Retirement Benefit Plans* in favour of retaining the Australian accounting requirements specified in AAS 25 *Financial Reporting by Superannuation Plans*. This decision was subsequently reconfirmed when the AASB issued AASB 1056 *Superannuation Entities* to supersede AAS 25.
- BC268 In considering the facts and circumstances surrounding the AASB’s decisions not to adopt IAS 26 (and thereby have an exception to its IFRS adoption policy), the AASB concluded that the legislative environment as well as tailored financial reporting requirements for superannuation entities (which were not adequately addressed in IAS 26) justified the need for a specific Australian pronouncement (see paragraphs BC7–BC11 of AASB 1056). In contrast, overall, the AASB concluded that IFRS 17 represents a comprehensive, internationally consistent, set of financial reporting requirements for Australian insurers, despite the issues noted in paragraph BC266(b).
- BC269 On balance, the AASB considered that the benefits arising from international harmonisation in relation to the accounting for insurance contracts, and the greater alignment of the basis for revenue recognition with other industries noted in paragraph BC266(a)(ii), outweighed the drawbacks noted in paragraph BC266(b). Accordingly, the AASB decided to supersede AASB 4, AASB 1023 and AASB 1038 (and Interpretation 1047 – see paragraphs BC271–BC274) with the issue of AASB 17 for private sector entities. When AASB 17 is applied or operative for public sector entities, it supersedes AASB 4, AASB 1023 and AASB 1038 (and Interpretation 1047) for public sector entities.
- BC270 The AASB noted that a consequence of its decision to supersede AASB 1023 and AASB 1038 is that Australian specific disclosures (e.g. paragraphs 17.8 and 17.10(c) of AASB 1038 relating to regulatory capital disclosures and conformance with the *Life Insurance Act 1995*) are no longer required. The AASB is closely monitoring the response of the Australian Prudential Regulation Authority to the introduction of AASB 17. At this stage there are no plans for the AASB to include similar supplementary disclosures in AASB 17.

## ***Implications for Interpretation 1047 Professional Indemnity Claims Liabilities in Medical Defence Organisations***

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- BC271 Interpretation 1047 was originally issued in June 2002 to address divergent views as to whether a Medical Defence Organisation (MDO) should recognise a liability for future claims arising from the medical indemnity insurance it offered, given the MDO had discretion as to whether to pay claims made by members. The Interpretation required that a MDO recognise its obligations in a manner consistent with the principles in AASB 1023.
- BC272 After 1 July 2003, the *Medical Indemnity Act 2002* came into effect and regulatory arrangements allowed only authorised general insurers to offer medical indemnity insurance. In August 2016 the AASB noted feedback from staff outreach to industry stakeholders indicating that all medical indemnity insurance had, as of then, been transferred to authorised general insurers (or subsidiaries thereof).
- BC273 Also at its August 2016 meeting, the AASB noted that some business written by MDOs prior to 1 July 2003 could still be in existence, and therefore might still require the guidance of Interpretation 1047. However, on balance, based on the feedback from staff outreach to industry stakeholders, the AASB concluded that any such remaining business would be immaterial to the financial statements of the affected insurers.
- BC274 Accordingly, the AASB decided to supersede Interpretation 1047 upon the adoption of IFRS 17 for private sector entities given it was no longer materially relevant, could result in a perceived ‘difference’ from IFRS Standards if retained and no longer reflected predominant current practice.

## **Fatal-Flaw Review Draft Standard AASB 2022-X Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities**

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- BC275 For-profit public sector entities are currently required to apply AASB 17 for annual periods beginning on or after 1 January 2023. However, the AASB decided to defer the AASB 17 mandatory effective date for public sector entities. Therefore, the AASB issued a Fatal-Flaw Review version of an Amending Standard *AASB 2022-X Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities* to propose amendments to relevant Australian pronouncements so that for-profit public sector entities would be permitted to continue applying AASB 4 and AASB 1023 until a Standard making public-sector-specific modifications to AASB 17 is effective or applied.
- BC276 In addition, when developing this Exposure Draft, the Board observed that AASB 1038 and Interpretation 1047 are not relevant to public sector entities. Since private sector entities will be applying AASB 17 for annual periods beginning on or after 1 January 2023, AASB 1038 and Interpretation 1047 would become redundant on this date.
- BC277 Therefore, the Fatal-Flaw Review version of the Amending Standard noted in paragraph BC275 also proposes that AASB 1038 be repealed and Interpretation 1047 be superseded for annual reporting periods beginning on or after 1 January 2023.

## **Implications for AASB 1056 Superannuation Entities**

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- BC278 The AASB issued Exposure Draft ED 223 *Superannuation Entities* (December 2011) proposing new accounting requirements for superannuation entities as part of the AASB's comprehensive review of AAS 25. ED 223 proposed that superannuation entities must measure any liabilities arising from insurance arrangements provided to members in accordance with the approach in AASB 119 *Employee Benefits* for defined benefit plans.
- BC279 The AASB issued AASB 1056 in June 2014 instead requiring that superannuation entities apply the defined benefit member liability measurement requirements of AASB 1056, as opposed to AASB 119, in response to feedback received on ED 223.
- BC280 When issuing AASB 17 the AASB was aware that a superannuation entity acting in the capacity of an insurer would apply the insurance requirements of AASB 1056 and not those of AASB 17 because AASB 1056 effectively overrides AASB 17 for a superannuation entity acting in the capacity of an insurer. The AASB noted this would mean superannuation entities could not claim compliance with IFRS Standards. However, the AASB noted that superannuation entities could not claim IFRS compliance anyway because AASB 1056 does not incorporate the corresponding IASB Standard. Accordingly, the AASB decided that no amendments were necessary to the insurance requirements of AASB 1056 as IFRS compliance is not an objective in this limited circumstance. For the avoidance of doubt, the AASB also decided to prevent superannuation entities from applying AASB 17 through an amendment to AASB 1057 *Application of Australian Accounting Standards*. Consequently, the AASB deleted a cross-reference to IAS 26 from paragraph 7(b) of AASB 17 instead of replacing it with a cross-reference to AASB 1056.
- BC281 The AASB also considered groups where the consolidated financial statements of a superannuation entity include an insurance subsidiary that applies AASB 17. On this matter the AASB noted that no significant issues were brought to its attention during the development of either AASB 1056 or AASB 17, nor since.
- BC282 Accordingly, the AASB decided to issue AASB 17 without any consequential amendments to the insurance requirements of AASB 1056.